



Portsmouth Water Limited **ANNUAL REPORT & ACCOUNTS 2013**



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HIGHLIGHTS

Mission Statement

“We aim to supply drinking water of the highest quality, providing high levels of customer service and excellent value for money”

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

- 5th highest performing Company in the Ofwat qualitative assessment
- RoSPA Gold Medal for health and safety
- Successful implementation of new billing system
- Exceeded water efficiency target set by Ofwat

Operating profits down by 2.8% due to lower income from work to divert mains for residential and commercial developers although this was partially offset by savings in water abstraction and electricity costs.

Charges to customers are the lowest in England and Wales with an average bill of £94, an increase of only 1.1% since 2010.

Our commitment to providing the highest levels of customer service is illustrated by:

- The Ofwat Qualitative Service Incentive Mechanism customer survey result, which ranks us 5th highest performing Company in the industry in terms of service received by customers
- Only 10.5 written complaints per 10,000 connected properties, compared with an industry average of 61

Turnover £m

£36.28m

2010	37.34
2011	35.52
2012	36.67
2013	36.28

Operating profit £m

£6.33m

2010	8.86
2011	6.11
2012	6.51
2013	6.33

Operating profit before depreciation £m

£15.25m

2010	16.76
2011	14.37
2012	15.09
2013	15.25

Operating cashflow £m

£15.67m

2010	17.15
2011	17.56
2012	15.72
2013	15.67

Capital expenditure £m

£15.36m

2010	14.61
2011	9.55
2012	8.13
2013	15.36

BOARD OF DIRECTORS

Executive



Neville Smith

B.A., F.C.M.A.³

Managing Director

Joined and appointed to the Board in February 1998. Appointed Managing Director in December 2011.



Nicholas John Sheeran

B.Sc. (Hons), A.C.M.A.

Finance and Regulation Director

Joined and appointed to the Board in December 2011. Previously with Invensys plc and Caradon plc.



Roderic Colquhoun Porteous

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

Engineering Director

Joined in 1999. Previously with South East Water. Appointed to the Board in May 2012.

Non-Executive



Terence Michael Lazenby MBE

FR.Eng.¹²³

**Independent Non-Executive Chairman
Chairman of the Nomination Committee**

Joined in June 2002 and appointed Chairman in January 2003. Previously Chairman of the Engineering Construction Industry Training Board, Non-Executive director of MTL Instruments Group plc and Expro International plc, before which he held a number of senior executive positions with British Petroleum. Trustee of ITV Pension Fund.



Michael Peter Kirk

MBA, C.Eng., M.I.Chem., M.Sc., B.Sc. (Hons)¹²³

**Senior Independent Non-Executive Director
Chairman of the Audit Committee**

Joined in November 2012. Chairman of KBC Environmental Ltd and Senior Independent Director of KBC Advanced Technologies plc. Chairman of Thackray Medical Museum, Trustee and Chairman of Performance Audit and Risk Committee, The Conservation Volunteers. Previously partner at Cazenove and Co. and Managing Director of Weber Shandwick.



Heather Virginia Benjamin

B.A., C.M.I.P.D., I.A.C.C.M., C.I.P.S.¹²³

**Independent Non-Executive Director
Chair of the Remuneration Committee**

Joined in November 2012. Previously held senior positions with Centrica plc. Current Non-Executive Board member of Academy of St. Martins in the Fields Orchestra and Volunteering England and Advisory Board for 4C Consultancy.

¹ Member of the Audit Committee

² Member of the Remuneration Committee

³ Member of the Nomination Committee

CHAIRMAN'S STATEMENT

Despite the South East of England being in drought at the beginning of the year the Company's supply situation was sufficient to ensure that it did not have to impose restrictions on its customers. Indeed it has not done so since 1976 and, as a result of the current groundwater levels, it is unlikely to do so this year.

In October 2012 the Company successfully implemented a new billing and customer relationship management system. This represented a major challenge for the business as significant resource had to be channelled to the programme. Despite these challenges the Company was ranked 5th out of 21 companies for the whole of 2012/13 in a survey of customers conducted by Ofwat to assess how well the Company handled all types of contact. In addition the Company still expects to have had the lowest level of complaints in the industry.

The health and safety of employees has the highest priority for the business and the effort and commitment of everyone at the Company was rewarded by the award of a Gold Medal from RoSPA. This award is in recognition of achieving seven Gold Awards and an industry sector award in the last eight years.

During the year the Company carried out a full, independent review of leakage and has identified that it is higher than previously thought and that the Company had in fact missed its leakage target. The Company immediately put in place a programme to reduce leakage which began in November 2012. The programme is on schedule but the Company will miss its target for leakage for 2012/13 by approximately 13%. This programme will continue in 2013/14 and further reductions in leakage will be achieved. The higher leakage figure has had no impact on customer's bills and the additional cost of this programme will be met by the shareholders and not by our customers and will amount to £0.4m. of operating cost and £0.5m. of capital expenditure. Despite the expenditure the Company will remain comfortably within its covenants for interest cover and gearing.

Against this the Company has again exceeded its target for water efficiency by claiming overall savings of 0.35 mega litres per day (Ml/d) against an annual target of 0.29 Ml/d.

In May 2013 the Company published its latest Water Resource Management Plan 2014 (WRMP) for consultation. The WRMP examines the factors which will impact upon the demand for water from its customers such as population change and climate change and determines whether the Company will have sufficient water resources over the next 25 years to meet this demand.

In the WRMP the Company is projecting a water resource surplus in the period to 2040. As a result, the Company does not need to invest in new resources to meet the needs of its own customers during this period. However, the Company has been approached by two neighbouring water companies to provide bulk supplies of water to meet the needs of their customers, which has been included in the Plan.

The Company is currently working on preparing its Business Plan for the next review period (2015 - 2020). We expect that this will be submitted to Ofwat in December 2013. We are determined to put the views of our customers and stakeholders at the heart of our Plan. As part of this we established an independent Customer Challenge Group (CCG) in 2011 comprised of both customers and other stakeholders. The CCG meets on a regular basis and their remit is to review our Plan

proposals and provide feedback and challenge from the customers' perspective. The CCG is led by an independent Chairman.

In December 2011 Ofwat published its paper "Water Industry Act 1991, Section 13 proposals to modify the conditions of appointment of all water only and water and sewerage companies". The Company responded to this consultation in February 2012 and, in common with all the other water companies in the industry, rejected its proposals. Following this rejection, further negotiations between Ofwat and the Industry took place and agreement was reached in January 2013. The agreed changes allow for a separation of retail and wholesale price controls and the wholesale price control will continue to be indexed to RPI.

Following the publication of the draft Water Bill in July 2012, the Government announced in the Queen's speech in May 2013 that it would introduce a full bill this year. The proposals will allow greater choice of water supplier for business customers, make it easier for Water Companies to trade water and put resilience at the heart of decisions made in the water sector.

For its part the Company has participated in the discussions on the issues involved in market reform and is considering how it will respond to the changes in the Bill. The Company is supportive of wider water trading, which can be used to improve water resources regionally. With a projected surplus of resources and low cost of supply the Company is in a good position to play its part in this. We also recognise that the introduction of retail competition for a greater number of business customers may well yield overall benefits, however we believe that wider market reform should only be pursued where the net benefit can be clearly demonstrated.

Turning to the financial results for the year, they reflect the 2009 Price Determination, made by Ofwat which included a real reduction in charges for customers in the year of 1.7%. Turnover for the year reduced by 1% to £36.3m. The fall in turnover is largely due to income from work to divert mains for residential and commercial developers, which was £1.1m lower than the previous year. Activity on work to divert mains for residential and commercial developers was low during the year as less work was requested. A major mains diversion project in Portsmouth, which was expected to commence in 2012/13 is now anticipated to commence in 2013/14.

Operating costs, excluding depreciation and the FRS17 pension charge, increased by £0.4m in the year mainly due to higher employment costs of £1.3m. £1.0m of this increase related to payments made to employees from the Employee Benefit Trust. An additional £0.3m was incurred as a result of expenditure connected with the leakage recovery programme. These additional costs were offset to some extent by savings in water abstraction charges and electricity costs. As a result of the above operating profit was reduced slightly to £6.3m (2012 - £6.5m).

Profit before tax increased to £3.1m (2012 - £2.7m).

Capital Expenditure in the year to March 2013 was £15.4m (2012 - £8.1m) and included £5.2m (2012 - £3.9m) on mains renewals. This spend was higher than usual due to a major scheme to reduce the risk of water quality and security issues at the River Itchen and Farlington Treatment Works which were completed during the year. Expenditure on the scheme amounted to £4.9m. Next year's capital expenditure

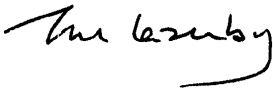
CHAIRMAN'S STATEMENT

will be lower following the completion of this scheme.

During the year the Company renewed 18.9km of mains (2012 – 23.2km) at a cost of £5.2m. The higher cost compared to the previous year was a result of a reduction in mains laying in the verge and open fields and a lower percentage (20.6%) of mains renewed in the year using “no dig” techniques compared with 24% in 2011/12. “No dig” techniques are less expensive than the conventional methods of renewals, but cannot be used in all circumstances.

In October 2012 two of the Company's Non-Executive Directors, Ray Tennant and Robert Sullivan retired after ten years with the Board. The Board would like to thank them for their valuable contribution to the Company over the last ten years. The Board welcomes two new Non-Executive Directors who formally joined the Company in November 2012. Mike Kirk is a former partner at Cazenove and Heather Benjamin has previously been Chief Procurement Officer at Centrica plc.

The high level of performance demonstrated in this report is due to the dedication and commitment of the employees and the Board would like to thank them for their efforts. They have risen to the challenges arising from the last price determination and I am confident that the Company will continue to deliver good value for both customers and shareholders.



T. M. Lazenby MBE
Chairman

OPERATING AND FINANCIAL REVIEW

Our Business

Portsmouth Water provides water to 307,000 homes and businesses in an area covering 868 square kilometres from the River Meon in Hampshire to the River Arun in West Sussex. The Company serves the cities and towns of Portsmouth, Chichester, Fareham, Gosport, Havant and Bognor Regis. On average, each day it supplies approximately 172 million litres of water through a network of over 3,200 kilometres of underground mains. The water supplied is derived from the chalk of the South Downs and is abstracted from wells, boreholes, springs and the River Itchen. The table below shows the major sources used by the Company during the year. The springs at Havant and Bedhampton, which provide 26% of the total supply, are thought to be the largest group of springs used for public supplies in Europe.

Source	Actual 2012/13 Abstraction (Million Litres)	% of Supply 2012/13	% of Supply 2011/12
Springs at Havant & Bedhampton	16,838	26	28
River Itchen	5,769	9	12
Boreholes, Wells & Adits	41,136	65	60
Totals	63,743	100	100

A map showing the Company's area of supply and the location of its sources and treatment works is shown on page 19.

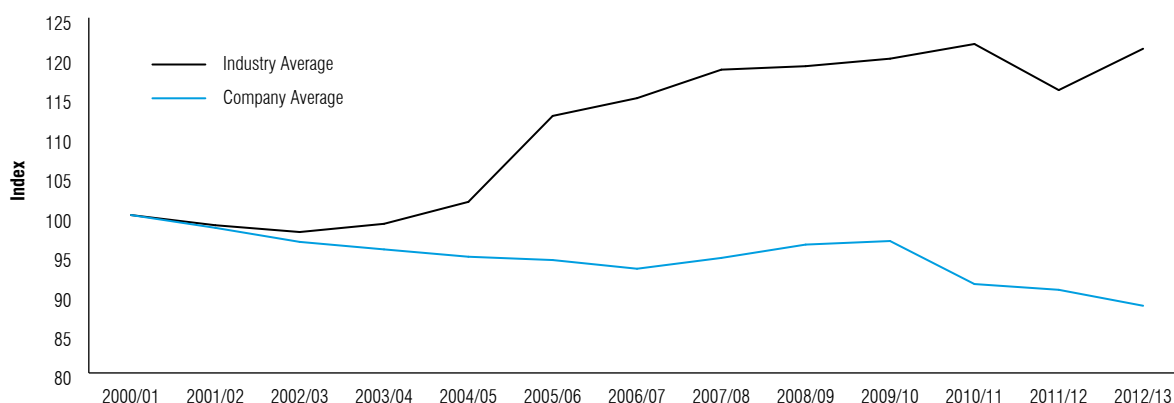
Water from the springs at Havant and Bedhampton is treated at the Farlington treatment works and there are also complex treatment works at the River Itchen, Lovedean, Soberton and Fishbourne. The last three works accounted for approximately 3% of supplies in 2012/13. Water from the remaining sources requires less sophisticated treatment.

Governance

The Board of Portsmouth Water Limited comprises three Executive Directors and three independent Non-Executive Directors. Portsmouth Water is part of the South Downs Capital Group whose ultimate controlling shareholder is an Employee Benefit Trust which owns 73% of the share capital. A majority of the Directors of the Employee Benefit Trust are independent and are not represented on the Board of Portsmouth Water. This ensures the independence of the Board of the Appointed Water Company. Full details of the Corporate Governance of the Company are published on pages 22 to 24 of this Report.

Portsmouth Water's charges are the lowest in England and Wales, the average annual bill for water being £94 per household, the equivalent of 26p per day. In real terms, the price of water for household customers has fallen by 11.5% over the last 12 years. This compares with a real increase of 21% for the industry as a whole, as illustrated in the chart below, where the 2000/01 prices are indexed at 100:

Comparison of Average Household Bills with Average Industry Tariffs



The water industry is subject to a range of UK and EU legislation. Standards, particularly those relating to the environment, are being tightened on a regular basis and require increasing levels of investment. The standards of service provided by Portsmouth Water are monitored by three main regulators - the Water Services Regulation Authority (Ofwat) for setting prices and to ensure value for customers, the Environment Agency (EA) for environmental protection and the Drinking Water Inspectorate (DWI) for drinking water quality. Customers are represented by the Consumer Council for Water (CCW), which monitors the quality of service provided by the Company. Portsmouth Water works closely with these and other organisations interested in the services it provides.

Ofwat is the water industry's economic regulator, and its principal duties are exercised through the price-setting process. Ofwat sets price limits for Portsmouth Water every five years. The last determination of prices was in November 2009 for the period 2010 to 2015. The price setting

OPERATING AND FINANCIAL REVIEW

Our Business

process is known as the Periodic Review and involves a series of consultations between water companies, Ofwat and the other regulators over a two year period. The review examines all aspects of the business and requires the Company to submit a detailed Business Plan to Ofwat. Water companies are allowed to increase prices to customers annually by inflation (RPI) plus or minus the price limit set by Ofwat. The price limits reflect the revenue, which the regulator believes an efficient company needs in order to finance its operations and capital programme, after making an assessment of potential future efficiency gains. The Company is currently preparing its plan for the next review period (2015 - 2020). We expect this to be submitted to Ofwat in December 2013.

The price limits set for the five year period to 2015 are as follows:

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

Long Term Resource Planning

In May 2013 the Company published its latest Water Resource Management Plan 2014 (WRMP) for consultation. The WRMP examines the factors which will impact upon the demand for water from its customers such as population change and climate change and identifies whether the Company will have sufficient water resources over the next 25 years to meet this demand.

In its plan the Company is projecting a water resource surplus in the period to 2040. As a result, the Company does not need to invest in new water resources to meet the needs of its own customers during this period. However, the Company has been approached by two neighbouring water companies to provide bulk supplies of water to meet the needs of their customers and these have been included in the Plan. To transfer water across the water company boundaries, Portsmouth Water needs to construct two transfer pipelines. These two options form the Company's 'Base Plan'.

The Water Resources in the South East (WRSE) group, comprising seven water companies in South East England and led by the Environment Agency, has been investigating the potential for regional solutions to meeting the water needs of South East England. This may require further schemes to be commissioned in the Portsmouth Water area in order to provide water to other communities in the South East. An 'Alternative Illustrative Plan' has been developed by the Company to show how its Base Plan may change, should regional solutions identified in WRSE be implemented in the company's operational area. The alternative plan could lead to the Company having to revisit its long held plans to develop the Havant Thicket Winter Storage Reservoir which was included in our previous Water Resource Management plan for development by 2033.



The River Meon at Soberton

OPERATING AND FINANCIAL REVIEW

Business Strategy

Mission Statement

'We aim to supply drinking water of the highest quality, providing high levels of customer service and excellent value for money'

Over the past year the Company has undertaken extensive research and engagement with stakeholders and customers. We have developed a number of outcomes that summarise our proposed business goals, our record to date and set out our aspirations over the coming years. These outcomes form the basis of our "Looking Ahead 2015 – 2040" document which was published in April 2013 for consultation. These Outcomes are outlined below:

- Provide a safe secure, sustainable and reliable supply of drinking water over the long term.
- We will deliver a high level of service and value for money
- Promote a high quality environment that supports biodiversity, public amenities and recreation.
- Support the community we serve by taking opportunities to support growth and development
- Continue to be attractive to investors and provide a long term financially sustainable business
- Have a culture of health and safety through all our activities and have a highly motivated and skilled workforce delivering a high quality service to our customers

Whilst some things can never be compromised, such as water quality and health and safety, a number of aspects of our service can be tailored to match customers' views. We are determined to put customers at the heart of our plans and value their feedback. Portsmouth Water is a longstanding local water supply business that is proud of its history and having been recognised as a low cost, highly efficient business. However, past performance is no guarantee of future success and we appreciate that we need to understand the changing world within which we and our customers live and plan for the future.

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



Presentation of RosSPA 2013 Gold Medal Award for Occupational Health and Safety to the Company's Human Resources Manager, Ian Limb

OPERATING AND FINANCIAL REVIEW

Current Development and Performance

Financial Performance

The results for 2012/13 reflect the 2009 Price Determination, made by Ofwat which included a real reduction in charges for customers in the year of 1.7%. Turnover for the year reduced by 1% to £36.3m. The fall in turnover is largely due to income from work to divert mains for residential and commercial developers which was £1.1m lower than the previous year. Activity on mains diversions was low during the year as less work was requested from developers. A major mains diversion project in Portsmouth, which was expected to commence in 2012/13 is now anticipated to start in 2013/14.

	2012/13 £m	2011/12 £m
Turnover	36.3	36.7
Operating costs excluding depreciation and the FRS17 pension charge	19.7	19.3
Operating profit before depreciation and FRS17 pension charge	16.6	17.4
Depreciation (including renewals)	8.9	8.6
FRS17 pension charge	1.4	2.3
Total Operating Profit	6.3	6.5

Operating costs, excluding depreciation and the FRS17 pension charge, increased by £0.4m in the year mainly due to higher employment costs of £1.3m. £1.0m of this increase related to payments made to employees from the Employee Benefit Trust. An additional £0.3m was incurred as a result of expenditure connected with the leakage recovery programme. These additional costs were offset to some extent by savings in water abstraction charges and electricity costs. As a result of the above operating profit was reduced slightly to £6.3m (2012 - £6.5m).

Interest receivable at £1.26m (2012 - £1.32m) relates mainly to interest received from group companies and is based on Libor plus 1%. Other finance income has reduced by £0.5m to £2.0m as a result of a decrease in the expected return on assets in the pension scheme.

Interest payable at £6.5m (2012 - £7.7m) includes £2.8m for indexation of the loan provided by Artesian Finance plc (2012 - £4.2m). The indexation of the loan for 2012 was based on RPI for July 2012 of 3.2%, whereas, RPI for July 2011 was 5%. Interest on the capital sum amounted to £3.4m (2012 - £3.2m).

As a result of these factors, profit before tax increased to £3.1m (2012 - £2.7m).

Taxation

The taxation credit of £0.5m was £0.5m lower than the previous year due to the current tax charge for the year of £0.4m (2012 - credit of £0.1m). The tax charge in 2012 was a credit of £0.1m largely due to credit adjustments relating to prior periods. The deferred tax liability also reduced during the year as a result of the proposed reduction to corporate tax rates resulting in a net credit to the profit and loss account of £0.9m (2012 - £0.9m).

Dividends

The dividends paid during the year amounted to £1.449m (2012 - £2.496m). Dividends are paid up to the parent company and largely used to service interest payments on an inter-company loan.

The breakdown of the dividend in the year is as follows:

Operational - £0.183m
Inter company - £1.266m

Cashflow and Balance Sheet

Net cash inflow from operating activities of £15.7m was in line with the previous year (2012 - £15.7m).

New borrowings amounting to £4.0m were drawn down during the year, principally to fund the much higher capital expenditure programme which resulted in cash expenditure (after contributions) of £14.3m in the year (2012 - £6.7m).



The Company provides a high level of customer service and will respond to customer contact promptly at any time of the day or night

OPERATING AND FINANCIAL REVIEW

Current Development and Performance

Net debt (excluding deferred arrangement costs) at £93.6m (2012 - £88.3m) includes an index linked loan with a value of £92.4m (2012 - £89.5m). The value is indexed each year by the previous July's recorded RPI. The increase in debt for the year is a result of this indexation. The level of gearing is an important ratio in the Company's loan covenants and is measured by the ratio of net debt to the Company's Regulatory Capital Value (RCV) which was determined by Ofwat at the 2009 Price Determination. The RCV is also indexed by RPI but at the March (year end) figure. The ratio is known as the Regulatory Asset Ratio. At the year end, the ratio was 77.9%.



Steelwork installation connected with a capital scheme to cover rapid gravity filters at one of the Company's treatment works.

Comparison with the Final Determination in 2009

In the three years to date of this review period the turnover is 7.7m below that allowed in the Determination, indexed by RPI. The Company has largely offset this by lower taxation, savings in operating cost and lower dividends than assumed in the Determination.

In addition over the same period the Company has invested in I.T. infrastructure which was not allowed for in the Determination. This is to ensure that services to customers are maintained at a high level in the future.

Accounting Policies

The accounts have been prepared in accordance with the accounting policies described in note 1 to the accounts on pages 32 to 34 and with UK GAAP.

Under its licence of appointment, Portsmouth Water Limited, a private company, is required to publish information about its annual results as if it were a company covered by the Listing Rules of the Financial Conduct Authority. From April 2005, listed groups are required to prepare accounts in accordance with International Financial Reporting Standards (IFRS). It is the Company's view that these standards are not appropriate for a regulated water business and it has been granted exemption, by Ofwat, such that it need only adopt IFRS when non-listed companies are required by statute to do so.

Pensions

The Company takes account of the Brockhampton Pension Scheme, in which it is the principal employer, under the principles of FRS17. The latest actuarial valuation carried out for the purposes of FRS17 as at 31 March 2013 showed a surplus after deferred tax of £15.3m (2012 - £14.7m). The actuarial loss before deferred tax of £1.2m, which is shown in the Statement of Total Recognised Gains and Losses (STRGL) on page 29, results primarily due to changes in assumptions underlying the FRS17 value of scheme liabilities. The loss has arisen due to the decrease in the discount rate assumption and an increase in the RPI and CPI assumptions.

In the most recent triennial actuarial valuation conducted at March 2011, the Scheme had a surplus of £21.2m. Until March 2010, the Company had not made contributions for a number of years. For the year ended 31 March 2013, the Company made contributions of £0.7m, these being at a rate of 12.4% of earnings.

Key Financial Performance Indicators

Gearing (net debt/regulatory capital value) and cash interest cover are recognised as key indicators for the Company. Performance in 2012/13 against the target ratios is shown in the table below.

KPI - ¹	Target	Performance 2012/13	Performance 2011/12
Gearing - Debt/RCV ²	<80%	77.9%	76.2%
Cash interest cover ²	>1.6	1.80	1.89

¹ Each KPI is defined in the Appendix on page 46

² Definition of terms is contained in the Appendix on page 46

Customer Service

In October 2012 the Company successfully implemented a new billing and customer relationship management system. This represented a major challenge for the business as

OPERATING AND FINANCIAL REVIEW

Current Development and Performance

significant resource had to be channelled to the programme. Despite these challenges the Company was ranked 5th out of 21 companies for the whole of 2012/13 in a survey of customers conducted by Ofwat to assess how well the Company handled all types of contact. In addition the Company still expects to have had the lowest level of complaints in the industry.

Ofwat are now using the Service incentive Mechanism (SIM) to measure the performance of companies in relation to customer service. This places greater emphasis on the quality of service received rather than the speed of response. Part of this is a qualitative assessment survey and the results of this are shown below.

KPI - 2 Customer Service Measures

	Target	Performance 2012/13	Performance 2011/12
Number of properties at risk of inadequate pressure	≤120	66	66
Properties affected by unplanned interruptions to supply >12 hours	Nil	Nil	332*
Population subject to hosepipe bans	Nil	Nil	Nil
Billing contacts - answered within 5 days	100%	100%	100%
Written complaints - answered within 10 days**	100%	99.96%	99.6%
Bills for metered customers - number receiving bill based on meter reading	100%	100%	100%
Telephone contact - number of calls abandoned - all lines busy	≤2.5% ≤0.7%	7.21% 1.8%	3.3% 0.2%
Service Incentive Mechanism - qualitative survey element - position relates to 21 companies	<6th	5th	2nd
Number of written complaints per 10,000 connections***	<10	10.5	8

* 205 of these related to one incident.

** The Company had 320 written complaints. This equates to 10.5 complaints per 10,000 connections, compared with the industry average of 61.

*** For 2011/12, the Industry average was 61 complaints per 10,000 connections.



Testing a water sample in order to ensure that quality standards are being met

KPI - 3 Water Quality

The Company carries out an exhaustive programme of testing to ensure that water of the highest quality is supplied to customers. The table below shows the percentage number of samples which pass the strict standards set out in the Water Supply (Water Quality) Regulations.

Water Quality	Target	Performance 2012	Performance 2011
Compliance samples passing standards (mean zonal compliance)	99.95%	99.96%	99.95%

The water quality performance indicator relates to the calendar year.

Operating Efficiency

For many years Ofwat have published a report which included its assessment of the comparative operating efficiency of all water companies in England and Wales using econometric modelling. Portsmouth Water has always been ranked in Band A (mostly the highest or 2nd highest performing company). This benefited customers through relatively lower prices. Ofwat do not intend to publish this assessment in future, however they did use this relative performance to set efficiency targets for the 5 year period to 2015. As a result, Ofwat set an efficiency target of 0.25% per annum. The table below shows the outcome against this target.

OPERATING AND FINANCIAL REVIEW

Current Development and Performance

KPI - 4 Efficiency

Target	Performance 2012/13
To achieve the Ofwat efficiency target of 0.25% per annum	4.65%



View from the inside of the large compartment of Highwood raw water reservoir during capital scheme undertaken to construct a roof over the reservoir

Capital Investment

Gross capital investment during the year was £15.4m (2012 - £8.1m) and included £5.2m (2012 - £3.9m) on infrastructure renewals. After receiving capital contributions and infrastructure charges of £0.9m, net capital expenditure was £14.5m (2012 - £7.2m).

During the year the Company renewed 18.9km of mains (2012 – 23.2km) at a cost of £5.2m. The higher cost compared to the previous year was a result of a reduction in mains laying in the verge and open fields and a lower percentage (20.6%) of mains renewed in the year using no dig techniques compared with 24% in 2011/12.

Gross expenditure on above ground assets at £9.2m included £4.9m on the construction of a roof over the Highwood raw water reservoir and the clarifiers at the River Itchen and Farlington treatment works in order to provide security for the open water at these sites. A further £0.9m resulted from investment in small plant, vehicles and office equipment, including £0.3m for initial payments made in respect of the implementation of a new Work and Asset Management system. In the Final Determination the Company was given an allowance of 5,000 domestic meter options per year, and in 2012/13, 4,857 customers chose to switch to a measured supply. This resulted in a further £1.1m of capital expenditure. At March 2013, meter penetration for the Company was 21% of household customers.

Water Resources - Outlook for 2013

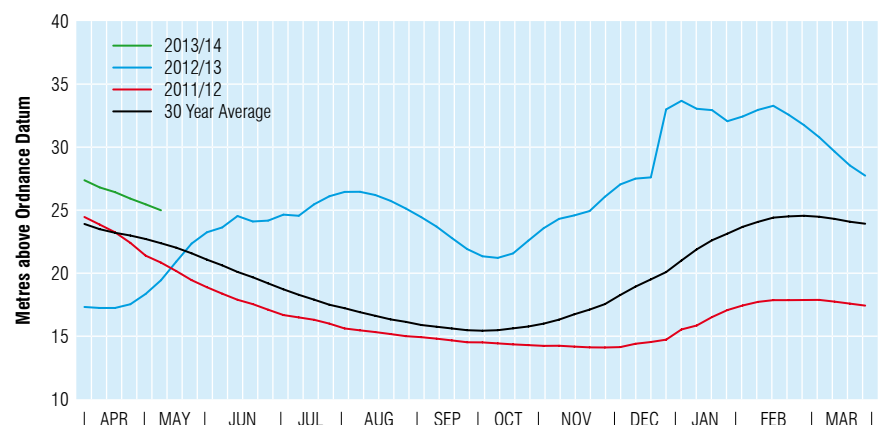
As detailed on page 6, 91% of water supplied to customers is from groundwater springs, boreholes and wells which abstract from the underground chalk of the South Downs. Groundwater levels are therefore critical to maintaining supplies to customers. The Company has for many years monitored the groundwater level at Idsworth Well, Rowlands Castle, which is unaffected by abstraction and is representative of groundwater conditions in the South Downs chalk.

During the drought of 2012 no water restrictions were applied to Portsmouth Water customers.

The drought was swiftly followed by heavy rain throughout the summer of 2012 which produced record groundwater levels for the time of year which remain above the long term average as we enter the summer of 2013. The Company has not had to impose restrictions on our customers since 1976 and, as a result of the current groundwater levels, it is unlikely to do so this year.

At the end of April 2013, groundwater levels were above the long term average as outlined on the graph below, which includes the thirty year long term average.

Idsworth Well



OPERATING AND FINANCIAL REVIEW

Current Development and Performance

Leakage

Leakage for the year was recorded at an average of 33.8MI/d. The leakage targets were set out in the Company’s Business Plan for the last Periodic Review and agreed by Ofwat as part of the Final Determination in 2009. This set the Company a leakage target of 30 MI/d. However during the year the Company carried out a full, independent review of its leakage calculation and methodology.

The review confirmed that there was an error in the methodology used to calculate leakage. By not adapting the leakage calculation methodology to take into account operational changes that had been made in day and night time water pressures, we determined that our leakage level was higher than we had been reporting by approximately 6.6 MI per day for 2011/12. The leakage target, therefore, was missed as a result of a calculation error, rather than as a result of a failure to undertake leakage prevention activity. This was reported immediately to Ofwat and the Company immediately put in place a programme to reduce leakage which began in November 2012.

The recovery programme is on schedule but the Company has missed its target for leakage for 2012/13 by approximately 13%. This programme will continue in 2013/14 and further reductions in leakage will be achieved. The cost of this will be met by the shareholders and not by our customers and will amount to £0.4m. of operating cost and £0.5m. of capital expenditure. Despite the expenditure the Company will remain comfortably within its covenants for interest cover and gearing.

Portsmouth Water is committed to reducing leakage and invests £5m annually on renewing our pipe network. Over the past ten years Portsmouth Water has reduced the number of burst mains from 900 to 300 per year.

KPI - 5 Leakage

Target	Performance 2012/13
Average leakage of less than 30MI/d	Average leakage of 33.8MI/d



Inspector taking a water sample at Portchester Castle

Employees

The Company employs 232 people and believes it recruits and retains the right people key to the successful performance of the business.

The Company is firmly committed to the development of its employees and that they should all have opportunities to reach their full potential and, as a result, a number during the year have undertaken Degrees, HNC’s, NVQ’s along with associated professional qualifications.

In line with this objective the Company fully supports the principle of Modern Apprenticeships; for example, all new employees within the Customer Services department aged under 25 are employed through the Modern Apprenticeship scheme which leads to a minimum NVQ level 2 qualification with many going on to achieve level 3.

A key part of staff development is the Company involvement with the Institute of Water. The Institute of Water is a professional body whose purpose is to promote the advancement of knowledge within the water industry. To this end, Area and National Committees organise meetings, seminars, technical visits and conferences, as well as a variety of social events. These activities provide a shop window for the latest technological developments in the industry and a forum for the discussion of major topics. The Company encourages its staff to belong to the IoW and gain the benefit for both their personal and professional development by attending these events.

Total absence for 2012/13 (days per employee per year) was 5.5 (2012 – 4.3). The increase over the prior year can be attributed to a small number of employees who have been on long term sick. However this figure still compares favourably with the average for private sector employers, which stands at 5.8 (Source: CIPD: Absence Survey Report 2012).

Health and Safety

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

Considerable time and resources have continued to be directed into raising the awareness of Health and Safety and the statistical results for the year 2012 show very positive results from these efforts, with only one reportable accident (accident causing more than three days' absence) being recorded.

Total Accidents and Reportable Accidents



Total Accidents and Reportable Accidents

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

OPERATING AND FINANCIAL REVIEW

Corporate Responsibility

Water Efficiency

2010 saw Ofwat set the Company an annual target of achieving water savings, through water efficiency, of 0.29 mega litres per day (Ml/d). This equated to an overall five year target of 1.45 Ml/d.

Pleasingly this year the Company has again exceeded the target by claiming overall savings of 0.35 Ml/d. In the three years of the current regulation period the Company has achieved a cumulative surplus of 0.09 Ml/d against the Ofwat target.

This excellent result was achieved by initiatives such as supplying free water saving packs and subsidised water efficient devices such as shower heads to customers. This was in conjunction with a number of proactive water saving campaigns in the local media such as the "Water Saving Challenge" which is designed to encourage customers to change their behaviour when it comes to water use. The Water Saving Challenge has seen customers save over 1 million litres of water every day.

Catchment Management

Portsmouth Water have established 'The Downs and Harbours Clean Water Partnership' with Natural England and the Environment Agency. The partnership's objective is to protect and improve drinking water quality and both river and coastal water quality.

A key issue for the Partnership is to try and ensure that there is no deterioration in the quality of our drinking water supplies which are taken from underground aquifers. This is achieved by advising land owners and farmers on the best practice for use of fertilisers and overall land management. This will prevent us in the future having to use expensive treatment processes to remove chemicals such as nitrate (found in fertilisers) from drinking water.

Work in the community

2012/13 has seen the Company continue to play a valuable role in supporting the local community such as supporting the Hampshire Water Festival held in Havant and the continued sponsorship of the Portsmouth in Bloom competition.

As part of our 'Water for Health' initiative, which promotes the benefits to children of drinking water, we again made available drinking water bottles at the subsidised cost of 30p per bottle to every child in a local primary, infant and junior school. This initiative remains very popular with 30,000 bottles delivered last year and which has seen nearly 330,000 water bottles delivered to local school children over a number of years.

The Company continues to offer community talks to local schools, colleges, clubs and groups such as Age Concern, Rotary and the Women's Institute as well as supporting local schools in activities such as Science Days.

WaterAid

The Company continues to support and promote the charity WaterAid to customers and staff. Over the last 30 years donations from our customers, together with fundraising efforts of our employees have raised a staggering £425,000 for WaterAid. It is estimated the average cost is only £15 per person for supplying a safe water supply to a village, combined with sanitation and hygiene education for life.

Environmental Performance

The Company recognises its impact on the environment and seeks to carry out its activities in a sustainable manner, which is highlighted by the initiatives shown below.

Conservation

The Company's total licensed area of supply covers an attractive part of Southern England between the South Downs and the coastal areas of Hampshire and West Sussex. It includes the historic cities of Portsmouth and Chichester, and the popular holiday resorts of Bognor Regis, Selsey and Hayling Island. The harbours of Portsmouth, Langstone, Chichester and Pagham have a number of important environmental designations under the EU Habitats Directive and are popular water activity venues.

Following the implementation of abstraction licence reductions at Havant and Bedhampton Springs and several sources in Sussex in order to protect habitats, the Company has agreed in principle a licence reduction for its Gaters Mill abstraction with the Environment Agency to preserve the River Itchen.

Biodiversity Action Plan

The Company's policy is to conserve and enhance the natural environment of its land and to preserve historic buildings and equipment, so far as is consistent with the primary duty of providing a sufficient supply of wholesome water at reasonable cost.

Sustainable Procurement

In procuring goods and services, the Company has a policy which seeks to ensure that its impact on the environment is minimised. This includes the use of low sulphur content diesel fuel, timber from replanted forests and predominantly recycled material for reinstatement.



Bluebell display following coppicing work undertaken at the River Itchen treatment works

OPERATING AND FINANCIAL REVIEW

Risks and Uncertainties

Risk Management

The Company identifies risks under ten main headings - Operational, Water Quality, Financial, Environmental, Regulatory, Information Technology, Health and Safety of Employees, Human Resources, Legal (including whistleblowing and fraud) and Business Continuity. Individual risks facing the Company are identified and recorded in a risk register. For each risk the consequences, impact and likelihood of failure are identified, together with the management controls in place. The register also clearly allocates management responsibility and whether any further actions are required to control the risks. As a result of changing our insurers this year we have undertaken a thorough review of our risk register as well as taking out some additional insurance policies.

The Board reviews the risk register and the controls established to mitigate these risks on an annual basis. It also receives regular reports on operational matters, including a monthly review of water quality matters directly with the Water Quality Manager and a quarterly review of health and safety matters with the HR Manager. The Directors also receive reports from independent regulatory bodies, which comment on the performance of the core water business.

During the year, the Board has reviewed its tolerance for risk and has initiated a programme to ensure risk management is embedded in the business.

The Audit Committee meets at least three times a year, monitors the effectiveness of the systems which are in place and reports to the Board as a whole.

Operational Risk

The key operational risks facing the Company are the loss of a treatment works or part of the mains network, which would result in a failure to supply water to customers. To mitigate this risk, the supply network has been enhanced over several years to connect different supply areas, such that in most situations water can be transferred to compensate for a failure at a treatment works. The Company also has a fully documented Emergency Plan which is initiated in the event of an incident, impacting either its ability to supply water to the public or resulting in a water quality issue.

Water Quality Risk

To ensure water quality standards are maintained, the Company has a fully documented Drinking Water Safety Plan which identifies the potential risks throughout the supply process. Water quality is also monitored by a comprehensive sampling regime in accordance with statutory legislation. Furthermore, a telemetry system linked to all treatment works provides an alarm to our 24 hour Operations Centre if there is a failure of equipment. The Company also maintains two days storage of treated water in service reservoirs to provide sufficient time for any water quality issues at treatment works to be rectified before supply to customers. In addition, it has membrane filtration at five treatment works considered most at risk from cryptosporidium being present in the raw water.

Financial Risk

Interest Rate, Liquidity, Capital and Credit Risk

The major financial risks faced by the Company are interest rate, liquidity, capital and credit risks. The Company assesses these risks on an ongoing basis and its policies for managing them remain unchanged from previous periods.

The Company's exposure to interest rate fluctuations is now limited by the fixed interest rate applicable to the index-linked loan drawn in 2002, with inflation risks on the cost of the loan being effectively hedged against regulated revenues which are also linked to the RPI. Interest is charged at a fixed rate of 3.635% on the indexed amount of the loan. The indexed value of the loan at 31 March 2013 was £92.4m (2012 - £89.5m).

The Company seeks to manage financial risk, to ensure sufficient liquidity is available to meet foreseeable needs through an appropriate borrowing structure and to invest cash assets safely and profitably on the short term market. In 2012/13 all of the short term cash was deposited with the Company's Bankers, RBS. Short term liquidity is achieved through a £10m working capital facility and an overdraft arrangement. At the end of the year, £5.0m of this facility had been drawn (2012 - £1.0m), while the overdraft arrangement remained unutilised. The £10m facility was rearranged during the year and now terminates in August 2015.

The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern, so it can provide returns for shareholders and benefit to customers.

The Company's exposure to credit risk results from the continuing impact of bad debt on its ability to collect water revenues. It seeks to minimise this risk by utilising all available means, including the use of a dedicated debt recovery section, agencies for collecting outstanding debt and the following of best practice guidelines.

Financial Loss

The risk of financial loss is addressed through comprehensive insurance cover for a range of risks, including damage to property, public and employee liability, fraud and terrorism. A system of internal controls is in place to manage the risks, the details of which are included in the Statement on Corporate Governance on pages 22 to 24. In early 2007, the Auditors conducted a special review of the Company's internal control systems. The review did not reveal any significant weaknesses and it has recently been updated to reflect system changes. Following the implementation of the Company's new billing system during the year, the Auditors undertook a specific review of the new system. This review did not reveal any material weaknesses. A disaster recovery plan is also in place to enable the Company to operate in the event of an incident disrupting its computer systems. At a remote site ten miles from its Head Office, the Company has an additional mainframe computer, which is 'backed up' every evening, and several workstations for employees to operate.

Energy now represents around 10% of total operating costs and fluctuating prices can have a material impact on profitability. To mitigate against the impact of price movements we fixed the wholesale price of energy in October 2011 until December 2014 at a price considerably lower than we paid in 2010/11.

Environmental Risk

The major environmental risk faced by the Company at the present time is a potential loss of abstraction licence resulting from measures that may be required by the EA to allow the UK to comply with the Water Framework Directive. Over the next few years the Company is undertaking a study to identify the impact of its abstraction at key points and to identify solutions where required.

The flooding in various parts of the UK during the summer of 2007

OPERATING AND FINANCIAL REVIEW

Risks and Uncertainties

and more recently in 2012 has prompted several national reports. Whilst the Company was not affected in those years, it has conducted an assessment of the risks at each of its sites and included a small amount of expenditure which was allowed in the Final Determination of prices to remedy those sites where there is a risk of damage as a result of flooding.

Regulatory Risk

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

Ofwat are currently reviewing their approach to Regulation and Future Price setting in their Programme 'Sustainable Water' and in October 2011 they published their consultation document on "Regulatory Compliance". A key objective of this review is to reduce the regulatory burden and we support their efforts in this. We also support their proposals to focus on overall outcomes rather than continue with the intensive requirement for information and increasingly complex price reviews. More recently Ofwat have published further consultations on their proposals for the 2014 price review and will be publishing their final methodology in summer 2013. We will use this as the basis of the formulation of our Business Plan for 2015 – 2020. For future price reviews Ofwat are proposing to include separate price limits for retail and wholesale elements. We support the approach being taken by Ofwat.

Competition in the Water Industry

Following the publication of the draft Water Bill in July 2012, the Government announced in the Queen's speech in May 2013 that it would introduce a full bill this year. The proposals will allow greater choice of water supplier for business customers, make it easier for Water Companies to trade water and put resilience at the heart of decisions made in the water sector.

In December 2011 Ofwat published its paper "Water Industry Act 1991, Section 13 proposals to modify the conditions of appointment of all water only and water and sewerage companies". The Company responded to this consultation in February 2012 and, in common with all the other water companies in the industry, rejected its proposals. Following this rejection, further negotiations between Ofwat and the Industry took place and agreement was reached in January 2013. The agreed changes allow for separation of retail and wholesale price controls and the wholesale price control will continue to be indexed by RPI.

For its part the Company has participated in the discussions on the issues involved in market reform and is considering how it will respond to the changes in the Bill. The Company is supportive of wider water trading which can be used to improve water resources regionally. With a projected surplus of resources and low cost of supply the Company is in a good position to play its part in this. We also recognise that the introduction of retail competition for a greater number of business customers may well yield overall benefits, however it believes that wider market reform should only be pursued where the net benefit can be clearly demonstrated.

Information Technology Risk

The Company's computer systems are crucial to the smooth running of the business. Should these systems fail it could have important implications for the business. Therefore the Company seeks to minimise these risks by having a Disaster Recovery (DR) programme in place to enable us to continue working should the systems fail, ensuring all software and hardware is compliant and supported by the manufacturer and that a succession plan is in place for key staff. It is also crucial to manage any change in the business by assessing the IT implications of any such change.

Human Resources Risk

The Company could face risks from a Human Resource perspective. This could be the result of losing key staff for long or short term periods, industrial unrest or breaches of employment or other staff related legislation. The Company mitigates against these risks through its programme of employee development, cross training, succession reviews working and consulting with the unions and having control procedures and policies in place to ensure that all legislation is complied with.

Governance/Legal Risk

The Company considers that the main legal risks that would be likely to arise would be if it failed to fulfil its responsibilities regarding its licence conditions, legal responsibilities, data protection requirements or failure to demonstrate an appropriate level of governance. The consequence could be prosecution, fines, compensation claims or bad publicity / loss of reputation. The Company mitigates against these risks by continually reviewing and updating policies and procedures, including governance procedures and regularly reviewing the performance of the Company's Reporter and Auditors.

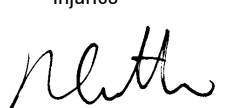
Business Continuity Risk

The risks to business continuity relate primarily to the loss of computer systems (as covered under Information Technology risks above) or water supplies. To mitigate the risk of losing water supplies the Company has a defined Emergency Plan in place which utilises Drinking Water Safety Plan (DWSP) risk assessments.

Health and Safety

The health and safety of employees is taken very seriously and a number of initiatives have been introduced over several years to reduce the number of accidents and the impact of injury. These include:

- A Health and Safety Committee comprising Management and the Trade Unions
- A risk assessment programme that has seen over 500 assessments produced
- A system of workplace inspection ensuring that all manned premises are inspected at least twice per year
- Specific training for those at high risk of injury
- A limited free physiotherapy service for employees to deal with injuries



N Smith
Managing Director



N Sheeran
Finance and Regulation Director

29 May 2013

COMPANY INFORMATION

Registered Office

PO Box 8
West Street
Havant
Hampshire
PO9 1LG

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

Company Number: 2536455
Company Secretary: Christopher Hardyman ACIS

Facts and Figures

Area of Supply	868 km ²
Population	693,000
Number of Properties Served	307,000
Length of Mains	3,283 km
Average Daily Output	172 MI

Auditors

Saffery Champness
Lion House
Red Lion Street
London WC1R 4GB

Bankers

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

Insurance Brokers

Willis UK
International House
Southampton International Business Park
George Curl Way
Southampton SO18 2RZ

AREA OF SUPPLY



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

The Company provides high quality public water supplies to a domestic population of 675,000, as well as many important industries, large defence establishments and varied commercial businesses.

DIRECTORS' REPORT

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 March 2013.

Principal Activity and Business Review

The Company is a water supplier operating under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991.

Water is supplied to 693,000 domestic and commercial customers in an area of 868 square kilometres in Hampshire and West Sussex through a mains network of 3,283 kilometres.

The Company's Area of Supply is shown on page 19 of this report.

A detailed review of operations for the year is provided in the Chairman's Statement and the Operating and Financial Review on pages 4 to 17.

Financial Risk Management Objectives and Policies

A detailed review of the Company's financial risk management objectives and the policies employed are set out in the Operating and Financial Review on page 16 and in note 18 to the accounts on page 40.

Financial Results and Dividends

The Company's profit before taxation amounts to £3.117m (2012 - £2.650m). After adding the tax benefit of £0.527m which mainly arises from reductions to tax rates (2012 - tax benefit of £1.016m), a profit of £3.644m has been transferred to reserves (2012 - £3.666m).

The Directors are recommending the payment of a final dividend of £0.556m (2012 - £0.848m).

Fixed Assets

Capital expenditure on tangible fixed assets was £15.357m (2012 - £8.127m), including £5.202m on infrastructure renewals (2012 - £3.913m). Information relating to these and other changes in fixed assets is shown in note 10 to the accounts on page 37.

The Directors are of the opinion that the current market value of the land and buildings included in tangible fixed assets is in excess of the value shown in the balance sheet.

As they are held for operational purposes, no professional valuation has been obtained and the excess has not, therefore, been quantified.

Board of Directors

The Directors who held office at 29 May 2013 are shown on page 3.

Mr. T. M. Lazenby MBE, Mr. M. P. Kirk and Mrs. H. V. Benjamin who retire by rotation, offer themselves for election.

Mr. A. R. Neve retired on 30 April 2012 and Mr. R. C. Porteous was appointed on 1 May 2012. Mr. R. L. Sullivan and Mr. R. J. Tennant resigned on 1 November 2012 and Mr. M. P. Kirk and Mrs. H. V. Benjamin were appointed on the same date.

The interests of the Directors in Group shares are detailed in the Report on Remuneration on page 25.

The Company maintains appropriate Directors' indemnity insurance.

Creditor Payment Policy

The Company does not intend to follow any specific code or standard in relation to payment practice. In the absence of dispute, bills will be settled in accordance with the suppliers' terms. Where such terms are considered unreasonable, the Company will seek to agree alternative payment arrangements to suit both parties. At 31 March 2012, the Company's creditor days were 19 (2012 - 22).

Substantial Shareholder

At 31 March 2013, Portsmouth Water Holdings Limited owned the entire voting capital of the Company.

Regulatory Accounts

A set of accounts for regulatory purposes is required by the Water Services Regulation Authority. These accounts relate solely to the regulated water supply business and copies may be obtained on request from the Registered Office.

Employees

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

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

The Company has, for the last eight years, been awarded seven Gold Awards in the RoSPA Occupational Health and Safety Awards and was also awarded an Industry Sector Award in 2009.

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

All Company employees are provided life assurance cover and are entitled to join a Company pension scheme.

Environment

The Company is aware of its obligations to both customers and the environment. In recent years, it has adopted an active approach to environmental issues and further information is set out in the Operating and Financial Review on pages 6 to 17.

Donations

The Company actively supports the Water Industry charity WaterAid and, during the year, customers were invited to make donations to WaterAid at the time of paying their water bills. The Company also made charitable donations during the year amounting to £260 (2012 - £600).

Licence Requirement

In accordance with its Instrument of Appointment under the

DIRECTORS' REPORT

Water Industry Act 1991, the Directors are of the opinion that the Company is in compliance with paragraph 3.1 of Condition 'K' of that Instrument.

Auditors

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

In so far as the Directors are aware:

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

Annual General Meeting

A Special Resolution is being proposed at the Annual General Meeting to amend the Articles of Association and which, if passed, will determine that all Directors are required to retire by rotation. This will enable the Company to comply with provision B.7.1. of the UK Corporate Governance Code.

By order of the Board

C. Hardyman ACIS

Secretary

Havant

29 May 2013

CORPORATE GOVERNANCE

The Directors are committed to high standards of corporate governance and support the principles set out in the UK Corporate Governance Code (the 'Code'). This report and the Report on Remuneration describe how the Company complies with those principles.

COMPLIANCE

The Company has complied throughout the year with the provisions of the Code, other than as indicated below:

As the ultimate shareholders of the Company have representation at Board meetings, it has not been considered necessary to have a Senior Independent Non-Executive Director (Code provision A.4.1). However in May 2013 Mr. M. P. Kirk was appointed Senior Independent Non-Executive Director and will be available to shareholders where necessary.

In accordance with the Company's Articles of Association, the Managing Director is not required to retire by rotation and seek re-election (Code provision B.7.1). A Special Resolution is being proposed at the Annual General Meeting which will amend this Article and ensure compliance.

Mr. T. M. Lazenby MBE, has served on the Board for more than nine years from the date of his first election. The Office of Water Services (Ofwat) has agreed that Mr. T. M. Lazenby may remain in office until May 2014 to ensure continuity on the Board with the new Non-Executive Directors having been appointed in 2012 (Code provision B.7.1).

DIRECTORS

The Board

The Board of Directors retains full and effective control of the Company and is collectively responsible for setting its strategy, ensuring appropriate resources are in place to meet objectives and monitoring performance.

The Non-Executive Directors play a full part by constructively challenging and contributing to the development of strategy. They are responsible for determining appropriate levels of remuneration for the Executive Directors and for recommending new appointments to the Board.

The members of the Board and the roles of each Director are shown on page 3, together with biographical notes. The Chairman is Mr. T. M. Lazenby MBE and the Managing Director is Mr. N. Smith. The Board Senior Independent Non-Executive Director is Mr. M. P. Kirk.

The Board meets monthly and has a schedule of matters specifically reserved to it for decision. It has control of the Company, but delegates the day to day conduct of business to the Executive Directors and their senior management colleagues. However, there are a number of matters which must only be decided by the Board as a whole, including strategy, all contracts over £150,000, dividend policy and certain regulatory matters.

Committee membership, number of formal meetings held during the year and attendance are shown in the following table:

	Number of meetings held	Number of meetings attended
Audit		
M. P. Kirk (Chairman)	3	2
H. V. Benjamin	3	2
T. M. Lazenby MBE	3	3
R. L. Sullivan	3	1
R. J. Tennant	3	1
Nomination		
T. M. Lazenby MBE (Chairman)	1	1
H. V. Benjamin	1	-
M. P. Kirk	1	-
N. Smith	1	1
R. L. Sullivan	1	1
R. J. Tennant	1	1
Remuneration		
H. V. Benjamin (Chair)	1	-
M. P. Kirk	1	-
T. M. Lazenby MBE	1	1
R. L. Sullivan	1	1
R. J. Tennant	1	1
Full Board		
T. M. Lazenby MBE (Chairman)	12	12
H. V. Benjamin	12	5
M. P. Kirk	12	5
A. R. Neve	12	1
R. C. Porteous	12	12
N. J. Sheeran	12	11
N. Smith	12	12
R. L. Sullivan	12	7
R. J. Tennant	12	7

The number of meetings attended in the above table is affected by the appointments and resignations of different Directors during the year. Mr. A. R. Neve retired on 30 April 2012. Mr. M. P. Kirk and Mrs. H. V. Benjamin were appointed on 1 November 2012 and Mr. R. L. Sullivan and Mr. R. J. Tennant resigned on the same date. The Nomination Committee and Remuneration Committee did not meet during the time Mr. M. P. Kirk and Mrs. H. V. Benjamin were Directors during the year.

The Chairman talks with and holds meetings on an informal basis with the other Non-Executive Directors without the executives present. The Non-Executive Directors meet without the Chairman present annually to appraise his performance.

There were no circumstances arising during the year where it was necessary to record unresolved concerns in the Board minutes.

Chairman and Managing Director

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

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

CORPORATE GOVERNANCE

Board Balance and Independence

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

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

Appointments to the Board

The Nomination Committee comprises the Managing Director, Mr. N. Smith, and the three independent Non-Executive Directors, Mr. T. M. Lazenby MBE (Chairman), Mr. M. P. Kirk and Mrs. H. V. Benjamin. It is responsible for recommending new appointments to the Board. Decisions regarding the appointment of Directors are taken by the Board as a whole. The Nomination Committee met once during the year.

The terms and conditions of appointment of Non-Executive Directors are available for inspection.

Information and Professional Development

Information is circulated to the Board in a timely fashion to ensure that all Directors are fully briefed on all issues arising at Board meetings. They are free to seek any further information considered necessary.

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

Performance Evaluation

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

Re-Election

In accordance with the Company's Articles of Association, all Directors, with the exception of the Managing Director, are required to retire by rotation and one third of the Board must seek re-election each year. At the Annual General Meeting a Special Resolution is proposed which, if passed, will remove the exception of the Managing Director not having to retire by rotation. All Directors are subject to election at the first Annual General Meeting after their appointment.

REMUNERATION

Policy and practice in relation to Directors' remuneration is dealt with in full in the Report on Remuneration on pages 25 and 26.

ACCOUNTABILITY AND AUDIT

Financial Reporting

The Board believes that the Annual Report and Accounts play an important part in presenting a clear, balanced and understandable assessment of the Company's position and prospects. This is supported by the Chairman's Statement, together with a more detailed analysis of operations and financial matters in the Operating and Financial Review.

Internal Control

The Directors are responsible for the Company's system of internal control and for reviewing its effectiveness. Such a system is designed to minimise the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. There has been no significant changes in the system of internal control during the year.

The Board is of the view that there is an ongoing process for identifying, evaluating and managing the Company's significant risks, that it has been in place for the year ended 31 March 2013 and up to the date of approval of the Annual Report and Accounts, that it is regularly reviewed by the Directors and that it accords with the internal control guidance for Directors in the UK Corporate Governance Code.

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

Organisation

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

Budgetary Control

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

Investment Appraisal

The Company has a clearly defined framework for assessing capital expenditure needs and options, while post project appraisal looks at relevant improvement in the internal control procedures. Board approval is required for any project exceeding a quantified expenditure level.

Business, Operational and Compliance Risks

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

CORPORATE GOVERNANCE

At the April 2013 Board meeting, the Directors carried out their annual assessment for the year to 31 March 2013, including consideration of events since the year end.

Audit Committee and Auditors

The Audit Committee comprises the three Non-Executive Directors Mr. M. P. Kirk (Chairman), Mr. T. M. Lazenby MBE and Mrs. H. V. Benjamin.

It meets at least three times during the year. The purpose of the Committee is to ensure the preservation of good financial practices throughout the Company, to monitor that controls are in force to ensure the integrity of those practices, to review the interim and annual financial statements and to provide, by way of timely meetings, a line of communication between the Board and the external auditors. During these meetings with the external auditors the Audit Committee have asked to be made aware of significant issues, discovered by the Auditors on the financial statements, of which there were none.

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

The Committee reviews the independence and objectivity of the external auditors. This includes reviewing the nature and extent of non-audit services supplied by the external auditors to the Company, seeking to balance objectivity and value for money. The only non-audit services provided during the year were those expected to be provided by the external auditors.

The review of the Auditors included consideration of the audit process, the effectiveness and the performance of the audit team, and the output quality and cost effectiveness of the audit. The current Auditors have been in tenure for six years, at which time the last formal tender was conducted.

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

GOING CONCERN

The Operating and Financial Review on pages 6 to 17 along with note 18 to the accounts sets out the Company's financial position; cash flows; liquidity position; borrowing facilities; objectives, policies and processes for managing capital; financial risk management objectives; exposures to credit and liquidity risk.

As highlighted on page 16 the Company meets its day-to-day working capital requirements through a £10m working capital facility that was arranged in August 2012, and terminates in August 2015.

The Company's financial projections, taking into account expected changes in trading performance show that the Company is forecast to operate within the level of its current facility.

Therefore the Directors report that, following the above review, they have a reasonable expectation that the Company has adequate

resources to continue in operation for the foreseeable future. Accordingly they continue to adopt the going concern basis of accounting in preparing the accounts.

REPORT ON REMUNERATION

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

INFORMATION NOT SUBJECT TO AUDIT

Remuneration Committee

The Remuneration Committee met once during the year to consider and approve, on behalf of the Board, the conditions of service of the Executive Directors of the Company. It comprises the three independent Non-Executive Directors, Mrs. H. V. Benjamin (Chair of the Remuneration Committee), Mr. T. M. Lazenby MBE and Mr. M. P. Kirk. During the year the previous Chairman of the Remuneration Committee, Mr. R. L. Sullivan retired and Mrs. H. V. Benjamin was appointed as the new Chair.

The Level and Make-up of Remuneration

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

The remuneration package of the Executive Directors, as reported in the accounts, 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.

The Executive Directors have one year service contracts with the Company, which are in accordance with the UK Corporate Governance Code (the 'Code'). None of the Executive Directors serves as a Non-Executive Director for another company. The Non-Executive Directors do not have service contracts.

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

Fees payable to the Non-Executive Directors are determined by the Board as a whole and reflect the time, commitment and responsibilities of the role.

No Director is involved in deciding his own remuneration.

INFORMATION SUBJECT TO AUDIT

Directors' remuneration:	2013	2012
	£000	£000
Total remuneration	505	515
Highest paid Director	153	137

Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Total 2013 £000	Total 2012 £000
Executive:				
A. R. Neve (retired 30 April 2012)	10	14	24	124
N. J. Roadnight (retired 16 December 2011)	-	-	-	135
R. C. Porteous (appointed 1 May 2012)	108	12	120	-
N. J. Sheeran (appointed 9 December 2011)	113	10	123	41
N. Smith	135	18	153	137
Non-Executive:				
H. V. Benjamin (appointed 1 November 2012)	9	-	9	-
M. P. Kirk (appointed 1 November 2012)	9	-	9	-
T. M. Lazenby MBE (Chairman)	35	-	35	34
R. L. Sullivan (resigned 1 November 2012)	16	-	16	22
R. J. Tennant (resigned 1 November 2012)	16	-	16	22
	451	54	505	515

Fees paid in respect of Mr. T. M. Lazenby MBE are paid to Seamab Consultancy Limited, and in respect of Mr. M. P. Kirk are paid to Mike Kirk Photography Limited.

Benefits comprise company cars and medical insurance.

Long-term incentive schemes

The Company operates a long-term performance linked bonus scheme. This element of incentive is linked to three year targets and is based upon achievements at the end of that three year period.

REPORT ON REMUNERATION

Share options

The Company does not operate an Executive Share Option Scheme.

Directors' interests

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

	'C' Ordinary Shares
N. Smith	450

There have been no changes to this shareholding between the 31 March 2013 and the date of this report.

Pensions

The Company participates in the Brockhampton Pension Scheme to provide pension benefits for its employees, including the Executive Directors.

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

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

	Increase in Accrued Pension During Year to 31 March 2013 £000	Transfer Value of Increase £000	Accumulated Accrued Pension at 31 March 2013 £000	Accumulated Accrued Pension at 31 March 2012 £000
A. R. Neve ¹	1	10	*83	*82
R. C. Porteous ²	7	137	41	34
N. Smith ³	6	119	77	69

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

The increase in accrued pension excludes any increase for inflation, as measured by the Consumer Price Index.

The transfer value has been calculated on the basis of actuarial advice in accordance with the basis adopted by the Trustees of the Scheme for calculating cash equivalent transfer values (which was agreed by the Trustees on 22 December 2011). The transfer value of the increase is then reduced by the amount of each member's contribution paid during the year.

¹Mr A. R. Neve left service on 30 April 2012 therefore his closing benefit is his actual benefit at his date of leaving. His increase in accrued pension over 31 March 2013 does not exclude CPI inflation as he was only a member for one month during the period.

²Mr. R. C. Porteous was appointed as a Director on 1 May 2012 therefore his opening accrued pension 'as at 31 March 2012' is his accrued pension at the date he became a Director. The pensionable salary used to calculate his accrued pension excludes £22,000 of non-pensionable salary.

³The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes £6,000 of non-pensionable salary.

*In accordance with the rules, Mr. A. R. Neve's pension has been capped at two-thirds of his pensionable earnings.

By order of the Board

T. M. Lazenby MBE
Chairman
Havant
29 May 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

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

The Directors are responsible for:

- keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 2006;
- safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities; and
- under applicable law and regulations, including the Disclosure and Transparency Rules, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the requirements of that law and those regulations. In relation to the latter, the Directors represent that, to the best of their knowledge and belief:
 - the financial statements give a true and fair view of the assets, liabilities, financial position and financial result for the year ended 31 March 2013; and
 - the Directors' Report and information referenced therein, taken together, includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

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

By order of the Board

C. Hardyman ACIS
Secretary
Havant
29 May 2013

AUDIT REPORT

Independent Auditors' report to the members of Portsmouth Water Limited

We have audited the financial statements of Portsmouth Water Limited for the year ended 31 March 2013, which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

Respective Responsibilities of Directors and Auditors

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

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all of the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of affairs of the company as at 31 March 2013 and its profit for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

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

for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Nicholas Kelsey

Senior Statutory Auditor

For and on behalf of

Saffery Champness

Chartered Accountants

Statutory Auditors

Lion House

Red Lion Street

London

WC1R 4GB

8 July 2013

PROFIT AND LOSS ACCOUNT

For the year ended 31 March 2013

	Notes	2013 £000	2012 £000
Turnover	2	36,282	36,665
Cost of sales		(19,454)	(20,301)
Gross profit		16,828	16,364
Net operating expenses	3	(10,497)	(9,850)
Operating profit		6,331	6,514
Profit/(loss) on sale of fixed assets		1	(21)
Profit on ordinary activities before interest		6,332	6,493
Interest receivable	5	1,264	1,317
Other finance income	28	1,984	2,492
		9,580	10,302
Interest payable and similar charges	6	(6,463)	(7,652)
Profit on ordinary activities before taxation	7	3,117	2,650
Taxation on profit on ordinary activities	8	527	1,016
Profit for the financial year	20	3,644	3,666

The profit and loss account has been prepared on the basis that all operations are continuing operations.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 March 2013

	Notes	2013 £000	2012 £000
Profit for the financial year		3,644	3,666
Actuarial (loss) on pension scheme	28	(1,215)	(10,245)
Deferred tax relating to actuarial loss on pension scheme	17	280	2,561
Effect of change to corporation tax rate on pension asset		(360)	(155)
Total recognised gains and losses relating to the year		2,349	(4,173)

The accompanying notes form an integral part of these accounts.

BALANCE SHEET

As at 31 March 2013

	Note	2013 £000	2013 £000	2012 £000	2012 £000
Fixed assets					
Tangible assets	10	100,003		94,469	
Investments	11	59,468	159,471	59,468	153,937
Current assets					
Stocks		589		596	
Debtors	12	5,077		6,516	
Investments	13	4		4	
Cash at bank and in hand	14	4,059		2,563	
		9,729		9,679	
Creditors: amounts falling due within one year	15	(18,945)		(15,546)	
Net current liabilities			(9,216)		(5,867)
Total assets less current liabilities			150,255		148,070
Creditors: amounts falling due after more than one year	16		(91,369)		(88,924)
Provisions for liabilities	17		(9,414)		(9,940)
Net assets excluding pension asset			49,472		49,206
Pension asset	28		15,308		14,674
Net assets including pension asset			64,780		63,880
Capital and reserves					
Called up share capital	19		1,078		1,078
Share premium account	20		1,539		1,539
Capital redemption reserve	20		3,250		3,250
Profit and loss account	20		58,913		58,013
Shareholders' funds	21		64,780		63,880

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 29 May 2013, and signed on its behalf by;

T. M. Lazenby MBE
Chairman

Company Number: 2536455

CASH FLOW STATEMENT

For the year ended 31 March 2013

	Notes	2013 £000	2013 £000	2012 £000	2012 £000
Net cash inflow from operating activities	22		15,672		15,718
Returns on investments and servicing of finance					
Interest received		1,263		1,312	
Interest paid		(3,550)	(2,287)	(3,354)	(2,042)
Taxation					
UK corporation tax paid		-		(14)	
Payments for group relief		(96)	(96)	(179)	(193)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(15,237)		(7,593)	
Sale of tangible fixed assets		6		6	
Capital contributions received		887	(14,344)	917	(6,670)
Equity dividends paid			(1,449)		(2,496)
Cash (outflow)/inflow before management of liquid resources and financing			(2,504)		4,317
Management of liquid resources					
(Purchase) of short term deposits			(58)		(65)
Financing					
New loans/(repayment) of loans			4,000		(3,500)
Increase in cash in the year	23		1,438		752

The accompanying notes form an integral part of these accounts.

NOTES TO THE ACCOUNTS

1 Accounting Policies

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) and with the provisions of the Companies Act 2006, except for the treatment of capital contributions as detailed in note 1.(c).

In view of the licence conditions under which the Company operates as a water supplier, it has to publish information about its annual results as if it were a company covered by the Listing Rules of the Financial Conduct Authority, except where it is considered inappropriate to do so. Earnings per share disclosures required by FRS 22 are not presented as the Company is a wholly owned subsidiary.

The principal accounting policies, which have been applied consistently, are as follows:

(a) Turnover

Turnover, which excludes value added tax, represents the income receivable for goods and services provided to external customers in the ordinary course of business. It comprises the value of water supplied and other related charges. Turnover from the regulated water business includes amounts billed for the year, together with an estimation of amounts unbilled at the year end, for measured water customers. Unmeasured income bills are based on the rateable value of properties. Measured income arises from customers who have meters fitted at their premises and amounts billed, therefore, are based on actual water consumption. The estimation of the amounts unbilled at the year end uses a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

(b) Fixed assets

(i) Infrastructure assets - mains

Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated as an addition and included in tangible fixed assets at cost. The 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 depreciation charge on infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, based on an independently certified asset management plan.

(ii) Other assets

Other assets comprise buildings and reservoirs, pumping plant, vehicles, mobile plant and office equipment. The cost of other assets is their purchase cost together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company. Depreciation is provided on all other fixed assets with the exception of freehold land. It is calculated to write off the cost of assets less estimated residual values over their estimated useful economic lives using the straight line method. Those lives are estimated as follows:

Buildings and Reservoirs	100 years
Pumping Plant	15-25 years
Vehicles and Mobile Plant	5-7 years
Office Equipment	5-10 years

(iii) 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.

(c) Capital contributions

(i) Mains contributions

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. They are treated as capital contributions and the Directors consider it appropriate that, in order to present a true and fair view, they should be deducted from fixed assets, as shown in note 10 to the accounts on page 37. In accordance with the Companies Act 2006 requirement to include fixed assets at cost, such contributions would normally be treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets. However, the assets to which they relate do not have determinable finite lives and, accordingly, no basis exists on which to recognise those contributions as deferred income.

(ii) Infrastructure charges

Infrastructure charges are made in respect of new connections in accordance with Condition 'C' of the Instrument of Appointment. These charges are treated as capital contributions and deducted from fixed assets, as more fully explained in note 1.(c)(i) above.

NOTES TO THE ACCOUNTS

(d) Investments

Investments are stated at the lower of cost or net realisable value.

(e) Stocks

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

(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 balance sheet 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 balance sheet date. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the balance sheet date.

The deferred tax balances have been discounted using a post-tax yield to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to when the timing differences are expected to reverse.

(g) Leases

All leases are regarded as operating leases. Operating lease payments are charged to the profit and loss account on a straight line basis over the period of the lease.

(h) Pension costs and other post retirement benefits

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

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

Pension scheme liabilities are measured on an actuarial basis using the projected unit method and are discounted to their present value using the AA corporate bond rate. Pension scheme assets are valued at market value at the balance sheet date. The pension scheme surplus is recognised in full on the balance sheet.

The deferred tax relating to a defined benefit asset is offset against the defined benefit asset and not included with other deferred tax liabilities. Detailed information regarding the surplus and actuarial position of the scheme is given in note 28 to the accounts on pages 43 and 44.

The Company also operates a defined contribution pension scheme. The charge to the profit and loss account amounts to the contributions payable to the scheme in respect of the accounting period.

(i) Financial instruments

When a financial asset or liability is recognised initially it is measured at its fair value plus or minus transaction costs. The Company subsequently categorises financial instruments as follows:

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

The Company's financial liabilities consist of fixed rate borrowings in the form of perpetual debentures and an index linked loan. These instruments are classified as other liabilities and are measured at amortised cost.

NOTES TO THE ACCOUNTS

(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, except in the case of deferred tax as mentioned in note (f) above, is not material and therefore the provisions are not discounted.

2 Turnover	2013	2012
	£000	£000
Unmeasured supplies	21,681	21,385
Measured supplies	13,332	12,872
Bulk supply to Southern Water Services	513	517
Chargeable work	756	1,891
	36,282	36,665

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

3 Net operating expenses	2013	2012
	£000	£000
Administrative expenses	10,866	10,134
Other operating income	(369)	(284)
	10,497	9,850

4 Directors and employees

Employment costs:	2013	2012
	£000	£000
Wages and salaries	7,349	6,160
Social security costs	618	495
	7,967	6,655
Defined benefit pension costs (note 28)	1,412	2,297
Defined contribution pension costs (note 28)	26	2
	9,405	8,954
Transferred to capital schemes	(465)	(446)
Net employment costs charged to the profit and loss account	8,940	8,508

Average numbers employed during year:	2013	2012
	Number	Number
Operations	147	144
Administration	85	79
	232	223

Directors' remuneration:	2013	2012
	£000	£000
Total remuneration	505	515
Highest paid Director	153	137

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 25 and 26. The information set out in that Report which is subject to audit forms part of these financial statements.

5 Interest receivable	2013	2012
	£000	£000
Loan to Group company	1,244	1,298
Interest on short term deposits	19	16
Other interest receivable	1	3
	1,264	1,317

NOTES TO THE ACCOUNTS

6 Interest payable and similar charges	2013	2012
	£000	£000
£66.5m. loan		
- interest	3,357	3,215
- indexation	2,826	4,236
- amortisation of fees	57	57
- administration expenses	25	24
	6,265	7,532
Other bank loans and overdraft	185	104
Debenture stocks	10	10
Other interest payable	3	6
	6,463	7,652

7 Profit on ordinary activities before taxation	2013	2012
	£000	£000
Profit on ordinary activities is after charging:		
Depreciation		
- infrastructure assets	5,059	4,955
- non infrastructure assets	3,862	3,621
Rates	2,254	2,285
Water abstraction charges	1,327	1,785
Hire of plant and machinery	8	9
Other operating leases	339	339
Auditors' remuneration:		
Fees payable to the Company's auditor for the audit of the annual accounts	31	29
Fees payable to the Company's auditor for other services:		
- audit-related assurance services	11	12
- taxation compliance services	3	6
- taxation advisory services	1	-
- other assurance services	5	-
Fees in respect of the Brockhampton Pension Scheme		
- audit*	3	2

* These fees are not paid by Portsmouth Water Limited.

NOTES TO THE ACCOUNTS

8 Taxation	2013	2012
	£000	£000
Current tax		
United Kingdom corporation tax at 24% (2012 - 26%)	403	98
Adjustment in respect of prior periods	(5)	(177)
	398	(79)
Deferred tax		
Origination and reversal of timing differences	202	133
Decrease in discount	75	96
Effect of change to corporation tax rate	(803)	(770)
Effect of change to capital allowance pool rates	-	62
Difference between pension cost charge and pension cost relief	352	271
Effect of change to corporation tax rate on pension asset	(751)	(729)
	(925)	(937)
Tax on profit on ordinary activities	(527)	(1,016)

The tax charge for the year is lower (2012 - lower) than the standard rate of corporation tax in the UK of 24% (2012 - 26%). The difference is explained as follows:

	2013	2012
	£000	£000
Profit on ordinary activities before tax	3,117	2,650
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 24% (2012 - 26%)	748	689
Effect of:		
Expenses not deductible for tax purposes	8	17
Capital allowances for the period in excess of depreciation	(3)	(229)
Revenue items charged to capital	17	(7)
Unrelieved pension contributions 2010/11	-	(90)
Difference between pension cost charge and pension cost relief	(367)	(282)
Adjustments to tax charge in respect of prior periods	(5)	(177)
Current tax charge for year	398	(79)

9 Dividends	2013	2012
	£000	£000
Equity: Ordinary/'A' Ordinary		
Interim paid	601	1,304
Final paid	848	1,192
	1,449	2,496

The Directors are proposing the payment of a final dividend of £0.556m for the year ended 31 March 2013. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

NOTES TO THE ACCOUNTS

10 Tangible fixed assets	Freehold land, buildings & reservoirs £000	Mains £000	Pumping plant £000	Vehicles, mobile plant & office equipment £000	Total £000
Cost					
At 1 April 2012	46,144	128,779	38,378	15,444	228,745
Additions	5,759	6,110	1,496	1,992	15,357
Disposals	-	(280)	-	(68)	(348)
At 31 March 2013	51,903	134,609	39,874	17,368	243,754
Depreciation					
At 1 April 2012	9,641	76,445	16,797	10,269	113,152
Charge for year	517	5,059	1,869	1,476	8,921
Disposals during year	-	(280)	-	(53)	(333)
At 31 March 2013	10,158	81,224	18,666	11,692	121,740
Net book value					
At 31 March 2013	41,745	53,385	21,208	5,676	122,014
At 31 March 2012	36,503	52,334	21,581	5,175	115,593
Capital contributions					
At 1 April 2012	-	21,124	-	-	21,124
Received during year	-	887	-	-	887
At 31 March 2013	-	22,011	-	-	22,011
Net book value after deducting capital contributions					
At 31 March 2013	41,745	31,374	21,208	5,676	100,003
At 31 March 2012	36,503	31,210	21,581	5,175	94,469

Included within vehicles, mobile plant and office equipment is an asset in the course of construction amounting to £0.331m (2012 - nil). It has thus far not been depreciated.

11 Fixed asset investments

	Loans to Group undertakings £000
At 1 April 2012 and 31 March 2013	59,468

NOTES TO THE ACCOUNTS

12 Debtors	2013	2012
	£000	£000
Trade debtors	1,671	2,874
Amounts owed by Group companies	29	37
Prepayments and accrued income	2,985	3,118
Other debtors	392	487
	5,077	6,516

All of the above amounts fall due within one year.

As at 31 March 2013, trade debtors had a carrying value of £4.270m (2012 - £5.352m) before provision for bad debt. Trade debtors in arrears are provided for in full, but only an element of current debt is provided for. The amount of the provision was £2.599m as at 31 March 2013 (2012 - £2.478m).

The ageing of these debtors was as follows:

	2013	2012
	£000	£000
Up to 12 months	1,940	3,146
Over 12 months	2,330	2,206
	4,270	5,352

The debtors provided for are mainly in respect of water charges for household customers where experience in the water industry has shown over time that it is likely that there will be difficulties in recovering the water charges for the periods concerned.

Movements on the provision for bad debt are as follows:

	2013	2012
	£000	£000
At 1 April 2012	2,478	2,248
Provision for bad debt required in the year	467	535
Debt written off in the year as uncollectable	(346)	(305)
At 31 March 2013	2,599	2,478

The other classes within debtors do not contain balances that may be irrecoverable. The maximum exposure to credit risk at the reporting date is the fair value of each class of debtor mentioned above. The Company does not hold any collateral as security.

13 Current asset investments

Unlisted investments: £4,000 (2012 - £4,000).

14 Cash at bank and in hand

Of the total amount shown of £4.059m, £1.713m (2012 - £1.655m) is held specifically for the payment of the next half yearly loan interest charges.

15 Creditors: amounts falling due within one year	2013	2012
	£000	£000
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Bank loan	5,000	1,000
Payments received on account	2,156	2,474
Trade creditors	1,635	1,392
Amounts owed to Group companies	1,765	1,555
Corporation tax	95	-
Social security and other taxation	230	229
Other creditors	2,478	3,003
Accruals	613	557
Water rates in advance	4,689	5,052
	18,945	15,546

The £5.0m bank loan is part of a three year £10m working capital facility, which is secured upon the assets of the Company and bears interest at London Interbank rates.

NOTES TO THE ACCOUNTS

16 Creditors: amounts falling due after more than one year	2013	2012
	£000	£000
Due within one to two years:		
Payments received on account	110	548
In five years or more:		
Bank loan	92,368	89,542
Less: deferred arrangement costs	1,109	1,166
	91,259	88,376
	91,369	88,924

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

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

17 Provisions for liabilities	2013	2012
	£000	£000
Deferred taxation:		
At 1 April 2012	9,940	10,419
Provided during the year in profit and loss account	(526)	(479)
At 31 March 2013	9,414	9,940

The total deferred tax balance before the effect of discounting is £9.997m (2012 - £10.640m). The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

	2013	2012
	£000	£000
Deferred tax excluding that relating to pension asset:		
Accelerated capital allowances	9,414	9,940
Pension asset (note 28)	4,572	4,891
Total provision for deferred tax	13,986	14,831
At 1 April 2012	14,831	18,174
Deferred tax charge in profit and loss account (note 8)	(925)	(937)
Deferred tax charged to the statement of total recognised gains and losses	80	(2,406)
At 31 March 2013	13,986	14,831

A reduction in the UK corporation tax rate from 24% to 23% with effect from 1 April 2013 was enacted during the period. As a consequence the deferred tax charge includes a decrease in the deferred tax liability of £0.803m.

In addition to the reduction in the rates of corporation tax mentioned above, the UK Government has announced its intention to further reduce the rate of corporation tax to 20% by 2015. If this reduction to 20% had been enacted by 31 March 2013 the deferred tax liability would have been reduced by a further £1.228m to £8.186m.

If the tax rate changes had been enacted at the balance sheet date the deferred tax liability of £9.414m (see note 17) would have been reduced by £1.228m to £8.186m and the deferred tax liability relating to the pension asset of £4.572m (see note 28) would have been reduced by £0.596m to £3.976m. The reduction in the deferred tax liability would have been dealt with in the profit and loss account. The reduction in the deferred tax liability relating to the pension asset would have been dealt with in the statement of total recognised gains and losses. The reductions in deferred tax are expected to be implemented over the period to 2015 in line with legislative changes.

No provision has been made for deferred tax on gains recognised on the sale of properties where potentially taxable gains have been rolled over into replacement assets. Such tax would become payable only if the property were sold without it being possible to claim rollover relief. The total amount unprovided for is £0.570m (2012 - £0.619m). At present it is not envisaged that any tax will become payable in the foreseeable future.

NOTES TO THE ACCOUNTS

18 Financial instruments

The Financial Review on page 9 provides an explanation of the objectives and policies for holding financial instruments. The numerical disclosures in this note deal with financial assets and liabilities. Short term debtors and creditors have been excluded from all disclosures. The fair value of all financial instruments is not materially different to the book value.

Financial assets

The financial assets of the Company are detailed below. The fixed asset investment earns interest based on London Interbank rates. Cash at bank and in hand includes a sterling cash deposit of £1.713m, which is placed on the money market at a six monthly rate and is held specifically for the payment of the next half yearly loan interest charges. The remaining cash balances on bank accounts receive interest at commercial rates.

Financial liabilities

The Company has no foreign currency contracts. The interest rate profile of its financial liabilities at 31 March 2013 is detailed below:

Sterling	2013 £000	2012 £000
Assets		
Fixed asset investment	59,468	59,468
Current asset investments	4	4
Cash at bank and in hand	4,059	2,563
	63,531	62,035

Sterling	Fixed Rate 2013 £000	Fixed Rate 2012 £000	Floating Rate 2013 £000	Floating Rate 2012 £000	Total 2013 £000	Total 2012 £000
Liabilities						
Bank loans and overdraft	91,259	88,376	5,000	1,000	96,259	89,376
Debenture stock	284	284	-	-	284	284
	91,543	88,660	5,000	1,000	96,543	89,660

Fixed rate	Weighted Average Interest Rate %	Weighted Average Interest Rate %	Weighted Average Period for which Rate is Fixed Years	Weighted Average Period for which Rate is Fixed Years
Sterling	2013	2012	2013	2012
	3.6	3.6	19	20

Interest on the floating rate financial liability is based on London Interbank rates.

The maturity profile of the Company's financial liabilities at 31 March 2013 is detailed below:

	2013 £000	2012 £000
In one year or less	5,284	1,284
In more than five years	91,259	88,376
	96,543	89,660

The Company had undrawn committed borrowing facilities at 31 March 2013, in respect of which all conditions precedent had been met, as follows:

	2013 £000	2012 £000
Expiring between one and two years	-	9,000
Expiring in more than two years	9,000	4,000

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

NOTES TO THE ACCOUNTS

19 Called up share capital	2013	2012
	£000	£000
Authorised:		
Equity:		
6,000,000 Ordinary Shares of 10p each	600	600
10,500,000 'A' Ordinary Shares of 10p each	1,050	1,050
	1,650	1,650
Non-equity:		
3,250,000 Redeemable Preference Shares of £1 each	3,250	3,250
	4,900	4,900
Allotted, called up and fully paid:		
Equity:		
4,265,177 Ordinary Shares of 10p each	427	427
6,509,162 'A' Ordinary Shares of 10p each	651	651
	1,078	1,078

The Ordinary and 'A' Ordinary Shareholders are entitled to receive dividends pari passu according to the amount paid up or credited as paid up on their shares. The Ordinary Shares are the only class of share to carry voting rights.

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

20 Reserves	Share Premium £000	Capital Redemption £000	Profit and Loss £000
At 1 April 2012	1,539	3,250	58,013
Profit for the financial year	-	-	3,644
Dividends	-	-	(1,449)
Actuarial (loss) on pension scheme	-	-	(1,215)
Movement on deferred tax relating to pension scheme	-	-	280
Effect of change to corporation tax rate on pension asset	-	-	(360)
At 31 March 2013	1,539	3,250	58,913

21 Reconciliation of movements in shareholders' funds	2013	2012
	£000	£000
Profit for the financial year	3,644	3,666
Dividends	(1,449)	(2,496)
	2,195	1,170
Actuarial (loss) on pension scheme	(1,215)	(10,245)
Movement on deferred tax relating to pension scheme	280	2,561
Effect of change to corporation tax rate on pension asset	(360)	(155)
Net addition/(reduction) to shareholders' funds	900	(6,669)
Opening shareholders' funds	63,880	70,549
Closing shareholders' funds	64,780	63,880

22 Reconciliation of operating profit to net cash inflow from operating activities	2013	2012
	£000	£000
Operating profit	6,331	6,514
Notional pension costs	454	1,406
Depreciation charge	8,921	8,576
Loss on disposal of asset	10	14
Decrease/(increase) in stocks	7	(76)
Decrease/(increase) in debtors	1,440	(1,813)
(Decrease)/increase in creditors	(1,491)	1,097
Net cash inflow from operating activities	15,672	15,718

NOTES TO THE ACCOUNTS

23 Reconciliation of net cash flow to movement in net debt	2013	2012
	£000	£000
Increase in cash in the year	1,438	752
Cash outflow from increase in liquid resources	58	65
Cash (inflow)/outflow from (increase)/decrease in debt	(4,000)	3,500
Change in net debt resulting from cash flows	(2,504)	4,317
Non cash movement	(2,883)	(4,293)
Movement in net debt in the year	(5,387)	24
Net debt at 1 April 2012	(87,093)	(87,117)
Net debt at 31 March 2013	(92,480)	(87,093)

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

24 Analysis of changes in net debt	At 1 April 2012	Cash Flow	Non cash Movements	At 31 March 2013
	£000	£000	£000	£000
Cash at bank and in hand	908	1,438	-	2,346
Debt falling due within one year	(1,284)	(4,000)	-	(5,284)
Debt falling due after one year	(88,376)	-	(2,883)	(91,259)
	(89,660)	(4,000)	(2,883)	(96,543)
Short term deposits	1,655	58	-	1,713
Current asset equity investments	4	-	-	4
	1,659	58	-	1,717
	(87,093)	(2,504)	(2,883)	(92,480)

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

25 Capital commitments	2013	2012
	£000	£000
Contracted for but not provided in these financial statements	2,520	6,489

The Company has a further commitment under operating leases relating to computer hardware and associated software of £0.339m per annum (2012 - £0.339m) which expire as set out below:

	2013	2012
	£000	£000
Within one year	339	-
Within one to two years	-	339

26 Contingent liabilities

There were no reportable contingent liabilities at 31 March 2013 or at 31 March 2012.

27 Ultimate parent undertaking

Portsmouth Water Limited is a wholly-owned subsidiary of Portsmouth Water Holdings Limited and has, therefore, taken advantage of the exemption under FRS 8 : Related Party Disclosures not to provide information on related party transactions with other undertakings within the Group. The ultimate parent undertaking is South Downs Capital Limited and is the largest and smallest company for which Group accounts are prepared. Copies of these accounts can be obtained on request from the Registered Office.

NOTES TO THE ACCOUNTS

28 Pensions

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

The formal actuarial valuation as at 31 March 2011 was updated to the accounting date by an independent qualified actuary in accordance with FRS 17. As required by FRS 17, the value of the defined benefit liabilities has been measured using the projected unit method.

The estimated Company contributions expected to be paid to the Scheme for the year commencing 1 April 2013 is £1.0m (2012 actual: £1.0m). Of this amount, £0.7m is contributed directly by the Company and £0.3m is contributed by employees by salary sacrifice under the SMART arrangement.

The key FRS 17 assumptions used for the scheme were as follows:

	2013	2012	2011
	% per annum	% per annum	% per annum
RPI inflation	3.5	3.4	3.5
CPI inflation	2.6	2.5	2.8
Discount rate	4.3	4.6	5.5
Pension increases	2.6	2.5	2.8
Salary growth	5.75	5.65	5.75

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 65 would be expected to live for a further 23.6 years (2012 - 23.5 years). Allowance is made for future improvements in life expectancy.

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

	2013	2013	2012	2012	2011	2011
	Expected	Fair	Expected	Fair	Expected	Fair
	Return %	Value	Return %	Value	Return %	Value
	per annum	£000	per annum	£000	per annum	£000
Equities	6.9	63,599	7.2	74,294	7.6	77,654
Absolute return fund	6.2	8,420	-	-	-	-
Bonds	2.9	50,361	3.2	44,154	4.1	40,353
Property	4.9	3,611	-	-	-	-
Cash	0.4	6,930	0.7	5,214	2.1	2,030
	4.9	132,921	5.5	123,662	6.3	120,037

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

	2013	2012
	£000	£000
Total fair value of scheme assets	132,921	123,662
FRS 17 value of scheme liabilities	113,041	104,097
Gross pension asset	19,880	19,565
Related deferred tax liability	4,572	4,891
Net pension asset	15,308	14,674

Under FRS 17, the scheme is represented on the balance sheet at 31 March 2013 as an asset of £19.880m (2012 - £19.565m), which amounts to £15.308m net of deferred tax (2012 - £14.674m).

The Company paid contributions at a rate of 12.4% 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 £25,538 (2012 - £2,454).

NOTES TO THE ACCOUNTS

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

	2013 £000	2012 £000
Opening scheme liabilities	104,097	91,313
Employer's part of current service cost	1,412	2,297
Interest cost	4,705	4,992
Contributions by scheme participants	-	96
Benefits paid	(5,102)	(3,520)
Actuarial loss	7,929	8,919
Closing scheme liabilities	113,041	104,097

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

	2013 £000	2012 £000
Opening fair value of scheme assets	123,662	120,037
Expected return on assets	6,689	7,484
Contributions by scheme participants	-	96
Contributions by the Company	958	891
Benefits paid	(5,102)	(3,520)
Actuarial gain/(loss)	6,714	(1,326)
Closing fair value of scheme assets	132,921	123,662

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

	2013 £000	2012 £000
Current service cost (employer's part only)	1,412	2,297
Past service cost	-	-
Total operating charge	1,412	2,297

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

	2013 £000	2012 £000
Expected return on pension scheme assets	6,689	7,484
Interest on pension scheme liabilities	(4,705)	(4,992)
Net return	1,984	2,492
Total return recognised in the profit and loss account	572	195

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

	2013 £000	2012 £000
Actual return less expected return on scheme assets	6,714	(1,326)
Experience gains arising on scheme liabilities	-	1,783
(Loss) due to changes in assumptions underlying the FRS 17 value of scheme liabilities	(7,929)	(10,702)
Actuarial (loss) recognised in the STRGL	(1,215)	(10,245)

The actual return on plan assets was an increase of £13.403m in the year to 31 March 2013 (2012 - increase of £6.158m).

The history of experience gains and losses is:

	2013	2012	2011	2010	2009
Present value of scheme liabilities (£000)	(113,041)	(104,097)	(91,313)	(100,268)	(69,808)
Total fair value of scheme assets (£000)	132,921	123,662	120,037	113,843	86,724
Gross pension asset (£000)	19,880	19,565	28,724	13,575	16,916
Actual return less expected return on scheme assets (£000)	6,714	(1,326)	1,181	24,665	(25,132)
Percentage of scheme's assets	5%	(1%)	1%	22%	(29)%
Experience gains arising on scheme's liabilities (£000)	-	1,783	-	-	4,722
Percentage of the FRS 17 value of the scheme's liabilities	0%	1%	0%	0%	7%
Total amount recognised in the STRGL (£000)	(1,215)	(10,245)	14,904	(2,636)	(13,020)
Percentage of the FRS 17 value of the scheme's liabilities	(1%)	(10%)	16%	(3%)	(19)%

The cumulative amount of actuarial gains and losses recognised in the STRGL as at 31 March 2013 was a loss of £19.189m (2012 - loss of £17.974m).

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

NOTICE OF MEETING

Notice is hereby given that the Annual General Meeting of Portsmouth Water Limited will be held at the Company's Registered Office, PO Box 8, West Street, Havant, Hants, at 11.00 am on Thursday, the 25th day of July 2013, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2013 and the Auditors' Report thereon.
2. To elect Mr. M. P. Kirk a Director of the Company.
3. To elect Mrs. H. V. Benjamin a Director of the Company.
4. To re-elect Mr. T. M. Lazenby MBE a Director of the Company.
5. To reappoint Saffery Champness as Company Auditors and to authorise the Directors to fix their remuneration.
6. To consider and, if thought fit, to pass the following as a Special Resolution:

That the Articles of Association of the Company (the 'Articles') be amended as follows:

In Article 104, the words 'A Managing Director shall not be subject to retirement by rotation.' shall be deleted.

Registered Office

PO Box 8
West Street Havant
Hants PO9 1LG
29 May 2013

By order of the Board
C. Hardyman ACIS
Secretary

Notes:

- i) Debenture holders are reminded that the holding of debenture stock does not entitle them to attend or vote at the meeting.
- ii) Shareholders are reminded that no voting rights attach to the 'A' Ordinary Shares. 'A' Ordinary Shareholders are not entitled to attend the meeting.
- iii) A proxy form is enclosed for Shareholders entitled to vote at the meeting.
- iv) To be valid proxies must reach the Company's Registered Office not later than forty-eight hours before the time fixed for the meeting.

APPENDIX - KEY PERFORMANCE INDICATORS

KPI - 1	2013	2012
a) Gearing - Debt/RCV	£000	£000
(i) Debt		
Bank loan (note 16)	92,368	89,542
Bank loan (note 15)	5,000	1,000
Debenture stock (note 15)	284	284
Cash at bank and in hand	(4,059)	(2,563)
	93,593	88,263

For the purposes of this ratio, debt excludes the deferred arrangement costs of £1.109m (note 16) and the current asset investment of £0.004m (note 13).

(ii) Regulatory Capital Value (RCV)

Value established by Ofwat in Final Determination in 2009

One of the elements considered by Ofwat in assessing revenues required by the Company is a return on the capital investment in the business. The value of the capital base of each company for the purposes of setting price limits is the RCV. The RCV is widely used by the investment community as a proxy for the market value of the regulated business. For Portsmouth Water the RCV is a key element of its bond covenants.

	2013	2012
	£000	£000
Regulatory capital value indexed to 31 March	120,071	115,785
(iii) Gearing - Debt/RCV ratio (i) ÷ (ii)	77.9%	76.2%

b) Cash interest cover

This ratio represents the number of times cashflow of the business covers interest payments.

(i) Cashflow before interest paid is derived from the cashflow statement on page 31 and is calculated as follows:

	2013	2012
	£000	£000
Operating profit, after adding back Employee Benefit Trust payments	7,316	6,514
Notional pension costs	454	1,406
Depreciation charges	8,921	8,576
Other items	10	14
Interest received, excluding amounts for inter-company loan	20	19
Taxation, excluding payments for group relief	-	(14)
Capital expenditure	(14,344)	(6,670)
New loans/(repayment) of loans	4,000	(3,500)
	6,377	6,345
(ii) Interest paid	3,550	3,354
(iii) Cash interest cover ratio (i) ÷ (ii)	1.80	1.89

KPI - 2 Customer Service Measures

Indicators are based on information supplied to Ofwat and confirmed in the Ofwat publication 'Levels of Service for the Water Industry in England and Wales Report'.

KPI - 3 Water Quality

This indicator is based on figures reported to the DWI.

KPI - 4 Efficiency

The results for this indicator are provided by Ofwat in its publication 'Water and Sewerage Unit Costs and Efficiency'.

KPI - 5 Leakage

This indicator is based on figures supplied to Ofwat and confirmed in its report 'Security of Supply, Leakage and the Efficient Use of Water'. The figures for 2012/13 have been supplied to Ofwat, but will not be confirmed in the Ofwat document until later in 2013.

