Portsmouth Water Limited

Preliminary results for the year ended 31 March 2016

Portsmouth Water Limited, a supplier of water to Hampshire and West Sussex, announced its results for the year to 31 March 2016.

Company Number: 2536455

> At just £98 our average household bill continues to be the lowest in England and Wales

> Number one ranked for customer service across the industry for the second successive year

> The Water Quality Team were successfully accredited ISO17025

> RoSPA Presidents Award winner for the second successive year

> No reportable health & safety accidents

Turnover

£39.8m

Cash generated from operations

£13.7m

Operating profit

£8.2m

Capital expenditure

£9.3m

2014 results have not been restated for FRS 102

Chairman's Statement

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

Our Customers

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

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

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

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

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

Our People

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

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

Our Environment

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

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

Our Business

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

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

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

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

Financial results

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

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

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

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

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

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

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

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

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

Mike Kirk
Chairman
27 May 2016

Financial Performance

Gearing and liquidity

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

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

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

Interest cover

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

Return on regulatory equity (RoRE)

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

New UK GAAP

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

Review of trading performance

Operating Profit

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

Revenue

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

Operating costs

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

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

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

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

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

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

Interest & other finance income

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

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

Taxation

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

Dividends

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

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

Capital investments

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

Mains activity

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

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

Major capital schemes

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

Capital contributions

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

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

Cash and Cash Flow

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

Pensions

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

Income Statement

For the year ended 31 March 2016

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

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

Statement of Other Comprehensive Income

For the year ended 31 March 2016

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

Statement of Financial Position

For the year ended 31 March 2016

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

The accompanying notes form an integral part of these accounts.

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

H. M. G. Orton
Director

Company Number: 2536455

Statement of Changes in Equity

For the year ended 31 March 2016

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

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

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

Statement of Cash Flows

For the year ended 31 March 2016

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

Notes

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

2. Statutory accounts for the Company for the financial year ended 31 March 2015, upon which the Auditors of the Company have given an unqualified report, have been delivered to the Registrar of Companies. Statutory accounts for the Company for the financial year ended 31 March 2016 will be delivered to the Registrar of Companies as soon as practicable after approval at the next Annual General Meeting.

For further information, please contact:
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