Portsmouth Water Limited

Preliminary results for the year ended 31 March 2017

Portsmouth Water Limited, a supplier of water to Hampshire and West Sussex, announced its results for the year to 31 March 2017.

Company Number: 2536455

- At £98 our average household bill continues to be the lowest in England and Wales
- Over 2,800 households joined our newly established Social Tariff
- RoSPA Presidents Award winner for the third successive year
- Top water company in the Institute of Customer Service survey
- Successfully implemented £3m ERP system
- Completed two out of three required environmental schemes
- An industry leader in customer service

Turnover

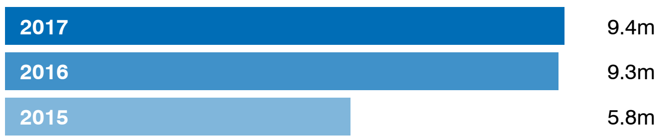
£40.3m

Cash generated from operations

£10.6m

Capital expenditure

£9.4m



Operating profit*

£5.6m

**After loss on disposal of fixed assets*

Chairman’s Statement

I have great pleasure in presenting the Annual Report and Accounts for what has been a busy and eventful year. We have continued to deliver excellent customer service, the lowest household bill in the country and a strong financial performance. We introduced a new tariff for those customers who find it difficult to pay their bills and other measures for those in vulnerable circumstances. The market for non-household customers opened on the1st April 2017 and, as highlighted in last year’s report, we completed the sale of our non-household retail business on the same date having exited the market. A significant element of our capital programme was completed, further enhancing the resilience of our infrastructure.

Our Customers

We were pleased to be ranked in the top three for customer satisfaction in the independent Service Incentive Mechanism (SIM) survey conducted for Ofwat. The survey contributes 75% of the overall SIM score, with the remainder relating to quantitative measures, measuring written complaints and unwanted telephone calls. In 2015/16 we were ranked first in the overall SIM and although the overall rankings for 2016/17 are not available until later in the year we would expect to, once again, be close to the top. We are members of the Institute of Customer Service who conducted a satisfaction survey of our customers for the first time this year. The results were very positive with our score being the highest of any Water Company who are members of the Institute. The number of complaints that we receive per 10,000 customers rose to 12.7, this compares to the industry average for 2015/16 of 33.7, and our 2015/16 score of 8.7, which was the lowest in the industry. The increase was associated with the successful implementation of a major new IT system, which had a small impact on operations.

In July we introduced a social tariff for those customers who have low household incomes and have genuine difficulty paying bills. In the year 2,800 customers signed up to this tariff which was ahead of our target. This is part of a range of services to help those in society that need additional support.

In the second year of the current regulatory period, we achieved all but two of our Outcome Delivery Incentives (ODI’S). Leakage for the year at 30.36Ml/day was slightly higher than the target of 29.95Ml/day, although the average for the two years is on target. Atypically dry ground conditions through late summer and autumn and cold snaps in January impacted leakage and bursts. Water quality contacts for taste and appearance whilst over our target, remain at a level which is one of the lowest in the industry. This is indicative of the high standards that we set ourselves. Water Quality is fundamental to our business and 99.99% of samples taken from customer taps met the standards set by the Drinking Water Inspectorate. The overall number of burst pipes and average interruption to supply experienced by our customers was better than the targets set.

We continue to work with local developers to understand both of their expectations and their experience of working with us. In our annual developer survey 85% indicated they were satisfied with our performance.

During the year we recruited a Customer Advisory Panel (CAP). This group of 20 customers is a representative cross section of our household customer base. The CAP has been established to help us gain greater insights into our customers’ needs and priorities in order to support our key business decisions.

Our Infrastructure

Over many years we have invested in the resilience of our infrastructure and have a robust network of pipes and treatment works. We are able to move water across our region and we are capable of providing water from more than one source to almost all of our customers. In the year we completed construction of an ultra violet (UV) treatment plant at our Eastergate and Westergate water treatment works, at a total cost of almost £5m. The improvements were made to address the risk of cryptosporidium, which, although low can, if left untreated, cause sickness. We are also close to completion of a £5m scheme to introduce UV treatment at our largest works at Farlington, and at the same time install a facility to recycle waste water from the works. Reusing this waste water will increase the amount of water available for supply making us more resilient to droughts.

During the year we invested £4.2m replacing 21km of pipes to improve the long term reliability of our network. Over the five years of this regulatory period we expect to replace 110km of pipe representing 3.3% of the network. We have also conducted a study of the resilience of all our resources to pollution and flooding. Although the study showed we have strong resilience, we have identified the requirement for some further investment, which we will bring forward in the next regulatory period.

Our Business

On 1st April 2017 the non-household water market opened to competition. This allows business customers to choose who will provide their retail services. As I reported last year, the board decided to exit the retail market for business customers and agreed to sell these activities to Castle Water and this was completed for market opening.

There is of course no change to the infrastructure, that delivers drinking water to all customers, and Portsmouth Water continues to supply clean water to businesses in our area and is responsible for emergencies. Despite having decided to exit the retail market, there was still a tremendous amount of work needed to be ready for the market opening as a wholesaler. This was successfully achieved thanks to the dedication of our staff.

In October 2016 we implemented a new £2.8m company-wide IT system, which will handle almost all of our business activities except for customer billing. The new system will enable us to improve services to customers and to provide us with the information we need to maintain our assets effectively and our planning capability. The implementation was a large undertaking and a major change for our staff, but I am pleased to report that there was no major impact on customers, although we did have some minor delays to works, which resulted in a small increase in our normal level of complaints. This system was the final element of our strategy to move away from mainframe technology, which was becoming very expensive to maintain.

Although we do not have to submit our Business Plan until September 2018, we have begun our preparations for the Periodic Review which will be concluded in 2019. Our customer engagement programme is underway and we expect to consult on our draft Water Resource Management Plan later this year.

Our People

We were delighted for the third consecutive year to receive the President’s Award from the Royal Society for the Prevention of Accidents (RoSPA). This recognises 13 consecutive years of winning 10 Gold Awards and three President’s Awards. Healthy and Safety is our number one priority and we are immensely proud of this achievement.

This has been a busy year for our staff, implementing a major IT system change, preparing successfully for the new Retail market, whilst at the same time achieving high levels of customer's service. On behalf of the Board I would like to thank our staff for the hard work and dedication that has made this possible.

Our Environment

Over recent years we have seen increasing levels of nitrates in some of our water sources resulting from fertiliser use and other agricultural activities. We are seeking to reduce nitrate levels by working direct with farmers. In 2016/17 our work has established the potential sources and pathways of nitrate pollution to our boreholes. We will now focus on actions to address the areas of higher risk.

Associated with this, the Catchment Management Team has been a partner involved in developing an Anglo-French European Union Interreg project bid to trial 'payments for ecosystems services' across our area of supply. This involves looking at innovative ways of supporting farmers and landowners to alter their practices to deliver cleaner groundwater in our catchments.

There were no restrictions to customer supplies last year. Although the winter has been very dry, our groundwater levels have recovered and we do not expect any restrictions this summer.

As a result of our relatively strong water resource position we have been providing a bulk supply to Southern Water on our eastern boundary since 2004. We have reached agreement with Southern Water to continue this bulk supply for a further 10 years and also to provide a new supply from our River Itchen works, in the west of our region. The new supply, expected to commence later in 2017, comes as a result of our work as part of Water Resources in the South East, a collaborative programme involving the six water companies in the South East of England.

Financial Results

The financial results for the period show a return to more typical levels of profitability with an operating profit of £5.6m (2016: £7.6m). The 2016 results benefitted from lower infrastructure renewals expenses and these have now returned to a more typical annual expense of £4.2m (2016: £1.8m). Other net movements were as follows:

- A £0.5m increase in turnover
- Net reductions in depreciation and amortisation of £0.6m
- Higher staff costs (including pension) of £0.7m
- £0.5m non recurring outsourcing costs for non-household retail activity

The increase in turnover reflects the allowed regulatory price increase together with 2,100 new properties and higher measured consumptions, offset by lower chargeable work of £0.4m.

Gross capital investment in the year remained stable at £9.4m. In addition the Company renewed 21.4km of mains at a cost of £4.2m which is charged to the income statement under FRS102. Two new UV treatment plants were largely completed and commissioned and a further UV plant is substantially underway resulting in total spend on these schemes of £5.1m in the year.

Cash generated from operations of £10.6m fell by £3.1m on 2016 driven by higher infrastructure renewals activity of £2m, adverse working capital movements of £0.9m on non-household trade debtors and other smaller movements in operating expenses and working capital.

The net cash increase in the year of £2.4m was further effected by receipts from the revolving credit facility of £4.0m and a £2.9m payment in advance for the disposal of non-household retail activities (which includes the fair value of future meter reading activities for five years).

Gearing at the year end of 68.6% (2016 - 70.2%) improved primarily as a result of growth in Regulatory Capital Value (RCV). The cash interest cover ratio of 1.44 times remains above the target of 1.4. Return on Regulatory Equity (RORE) of 7.5% has fallen primarily due to lower operating profit as discussed above.

Mike Kirk
Chairman
25 May 2017

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 68.6% (2016 - 70.2%) improved as a result of the increase in Regulatory Capital Value (RCV) driven by higher indexation and the significant capital programme. This remained comfortably within the 86% ceiling imposed by the bond covenants.

As a consequence of cash flow requirements (discussed further on page 23) the Company utilised £4m of the £10m revolving credit facility at the year end (2016 - £nil). The £4m committed overdraft facility was unused at the year end (2016 - unused). Both facilities are currently provided by Lloyds Bank. The overdraft is renewable annually and the revolving credit facility in May 2022. 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.

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 3 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 1.44 times (2016 - 1.96 times) remains above the 1.4 times covenant required.

Return on regulatory equity (RoRE)
This is the primary ratio used by our equity shareholders. The reduction from 10.8% to 7.5% reflects the lower operating profit discussed below.

New UK GAAP
This is the second annual accounts since the Company adopted FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (typically referred to as "new UK GAAP". During the year the tax position relating to deferred infrastructure contributions, received by the Company since 1990, was recalculated as part of finalising the 2015/16 corporation tax computation. This change in tax treatment followed the change in accounting treatment under new UK GAAP and resulted in a significant credit to 2015/16 corporation tax charges and deferred tax movements. This is set out further in note 9. There are no further changes to the accounts related to the FRS102 transition.

Review of trading performance

Operating Profit
Operating profit at £5.6m (2016 - £7.6m) returned to a more consistent level following the one off favourable impact in 2015/16 of lower infrastructure renewals (2015/16 impact £1.9m reduction). In addition increased turnover in the year of £0.5m was offset by other operating costs discussed further below.

Revenue
The increase in turnover reflects the allowed regulatory price increase together with 2,100 new properties and higher measured consumptions, offset by lower chargeable work of £0.4m.

Operating costs
Total operating costs increased by £3m which resulted from a number of movements.

As noted above during 2015/16 infrastructure renewals were atypically low following change-over of our main contractor during the year. In 2016/17 infrastructure renewals activity returned to normal levels resulting in an increase of £2.4m on 2015/16.

Depreciation during the year has fallen by £0.9m this is primarily as a result of the £0.7m accelerated depreciation included within 2015/16. Offsetting this is an increase of amortisation on intangible fixed assets of £0.3m following commissioning of our ERP system.

Staff costs, charged to the income statement, have increased by £0.7m. This reflects increased headcount from 251 to 255 driven by operational requirements, particularly the impact of preparation for non-household retail competition and the staff involved in the implementation of the new ERP system (which went live in October 2016). Together with the annual salary increase of 2%, continued increases in pension costs of £0.3m and lower capitalised costs of £0.1m this caused the incremental cost.

In addition there were incremental costs of £0.5m (2016 £nil) under the operating agreement to outsource non-household retail activities to Castle Water for the year. This was a one off cost and will not recur in 2017/18.

Interest & other finance income
Interest payable shows an overall increase of £0.9m which is primarily due to £0.8m higher indexation on the £66.5m index linked loan driven by RPI levels. Other finance income reflects movements in the net pension scheme position and is set out further in note 25.

Taxation
The tax credit in the period of £0.4m includes a current tax credit of £0.6m and deferred tax charge of £0.2m. The reduction in current tax charge was driven by a £0.8m prior year credit in connection with the treatment of previous infrastructure contributions on FRS 102 conversion. In addition loses elsewhere in the group were used to relieve trading profits in the year. Deferred tax charges increased as a result of a number of net movements including the reduction in corporation tax rate and prior year adjustments (as noted above).

Dividends
The dividends paid during the year totalled £1.2m (2016 - £1.2m). Dividends are paid up to the parent company with part of the payment being used to service interest payments on an inter-company loan of £0.8m (2016 - £0.7m) 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 £0.5m.

Capital investments
Gross capital investment in the year was £9.3m (2016 - £9.3m).

Mains activity

	2016/17 £m	2015/16 £m
Renewals charged in the income statement	**4.2**	1.8
New mains capitalised	**1.4**	1.7
Total mains investment	**5.6**	3.5

During the year the Company renewed 21.4km of mains (2016 - 11.6km) at a cost of £4.2m charged to the income statement. The increase represents a return to typical run rates of activity in 2016/17. A further 13.9km (2016 - 7.6km) of new mains were capitalised at a cost of £1.4m.

Major capital schemes
The Company continued the programme of capital schemes that were agreed in the Business Plan. The two new UV treatment plants commenced in 2015/16 were largely completed in the year with additional capital spend of £1.7m. In addition, we are close to completing a further UV treatment plant at our Farlington works with a spend of £3.4m during the year.

Capital contributions
The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.2m (2016 - £1.2m). These contributions

are deferred and amortised to the Income Statement.

Cash and Cash Flow

Cash generated from operations of £10.6m fell by £3.1m on the prior year. This was driven by the return to normal levels of infrastructure renewals with a cash flow impact of £2m together with other smaller movements in operating expenses. In addition there were a number of working capital movements, the most significant of which related to a £0.9m increase in non-household trade debtors following the outsourcing of this activity during 2016/17. The overall £2.4m increase in cash at the year-end was driven by a draw down on our revolving credit facility of £4.0m, together with a £2.9m payment received in advance in connection with our disposal of the non-household retail operation (this includes the fair value of future meter reading services for five years - note 30). These were offset by higher expenditure on fixed and intangible assets totalling £3.3m.

Pensions

The Company operates both a defined contribution and a defined benefit pension scheme, the latter of which has been closed to new members since 2011. The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2017 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £11.4m (2016 - £14.6m). The overall decrease in the surplus on actuarial valuation has largely been driven by the fall in AA corporate bond rates.

Income Statement

For the year ended 31 March 2017

	notes	2017 £000	2016 £000
Turnover	3	**40,342**	39,795
Cost of sales		**(22,872)**	(19,756)
Gross profit		**17,470**	20,039
Net operating expenses	4	**(11,720)**	(11,837)
Operating profit before loss on disposal of fixed assets		**5,750**	8,202
Loss on disposal of fixed assets	6	**(143)**	(562)
Operating profit after loss on disposal of fixed assets and profit on ordinary activities before interest		**5,607**	7,640
Investment income	7	**953**	996
Other finance income	25	**625**	382
Interest payable and similar charges	8	**(5,696)**	(4,778)
Profit on ordinary activities before taxation	6	**1,489**	4,240
Taxation of profit on ordinary activities	9	**368**	(712)
Profit for the financial year		**1,857**	3,528

The accompanying notes form an integral part of these accounts.
The income statement has been prepared on the basis that all operations are continuing operations (note 30).

Statement of Other Comprehensive Income

For the year ended 31 March 2017

	notes	2017 £000	2016 £000
Profit for the financial year		**1,857**	3,528
Remeasurement of net defined benefit asset	25	**(4,147)**	6,274
Movement on deferred tax relating to pension asset	21	**705**	(1,129)
Effect of change to corporation tax rate on pension asset	21	**63**	225
Total comprehensive (loss)/income for the year		**(1,522)**	8,898

Statement of Financial Position

For the year ended 31 March 2017

	notes	**2017 £000**	**2017 £000**	2016 £000	2016 £000
Fixed assets					
Intangible fixed assets	11	**2,237**		77	
Investment properties	12	**440**		440	
Tangible fixed assets	13	**125,255**		123,003	
Investments	14	**55,484**		55,984	
			183,416		179,504
Current assets					
Investments	15	**2**		2	
Stocks		**474**		592	
Debtors	16	**10,903**		7,897	
Cash at bank and in hand	17	**11,644**		9,206	
		23,023		17,697	
Creditors: Amounts falling due within one year	18	**(22,864)**		(16,817)	
			159		880
Total assets less current liabilities			**183,575**		180,384
Creditors: Amounts falling due after more than one year	19		**(99,613)**		(97,724)
Accruals and deferred income: Capital contributions	20		**(25,012)**		(24,429)
Provisions for liabilities	21		**(6,703)**		(6,386)
Net assets excluding pension asset			**52,247**		51,845
Pension asset	25		**11,446**		14,575
Net assets including pension asset			**63,693**		66,420
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			**57,826**		60,553
Shareholder' funds			**63,693**		66,420

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 25 May 2017 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 2017

	Called up share capital £000	Share Premium account £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Balance as at 1 April 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
Profit for the year				1,857	1,857
Remeasurement of net defined benefit asset	-	-	-	(4,147)	(4,147)
Movement on deferred tax relating to pension scheme	-	-	-	705	705
Effect of change to corporation tax rate on pension asset	-	-	-	63	63
Total comprehensive loss for the year	-	-	-	(1,522)	(1,522)
Dividends	-	-	-	(1,205)	(1,205)
Balance at 31 March 2017	1,078	1,539	3,250	57,826	63,693

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 2017 £57.538m (2016 - £60.265m) was distributable in accordance with company law and £0.288m (2016 - £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 2017

	notes	2017 £000	2017 £000	2016 £000	2016 £000
Cash generated from operations	24		**10,589**		13,651
UK corporation tax paid		**(555)**		(180)	
Net payments for group relief		**(167)**		(107)	
			(722)		(287)
Net cash inflow from operating activities			**9,867**		13,364
Cash flows from investing activities					
Purchase of tangible assets		**(11,144)**		(8,613)	
Purchase of intangible fixed assets		**(823)**		-	
Capital contributions received		**1,165**		1,194	
Sale of tangible fixed assets		**37**		34	
Interest received		**953**		1,001	
Net cash used in investing activities			**(9,812)**		(6,384)
Cash flows from financing activities					
Proceeds from sale of non-household retail activities*	30	**2,900**		-	
Loan repayment from group companies		**500**		350	
Receipts from borrowings		**4,000**		-	
Equity dividends paid		**(1,205)**		(1,165)	
Interest paid		**(3,812)**		(3,735)	
Net cash generated/(used in) financing activities			**2,383**		(4,550)
Net increase in cash and cash equivalents			**2,438**		2,430
Cash and cash equivalents at beginning of year			**9,206**		6,776
Cash and cash equivalents at end of year	17		**11,644**		9,206

*Payment in advance which includes the fair value of future meter reading services (note 30).

Notes

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

2. Statutory accounts for the Company for the financial year ended 31 March 2016, upon which the Auditors of the Company have given an unqualified report, have been delivered to the Registrar of Companies. Statutory accounts for the Company for the financial year ended 31 March 2017 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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