

Watlington Waterworks Limited

Annual Report and
Consolidated Financial Statements
December 31, 2007

Watlington Waterworks Limited

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Watlington Waterworks Limited

Directors Report of Shareholders

For the year ended December 31, 2007

The year 2007 exceeded all expectations. The year started with high demand for our products and services due to a period of low rainfall that spanned late 2006 into early 2007. We experienced a substantial uplift from January that we were able to carry through the first half of the year, and then the second half of the year continued to build on the first half success by virtue of the benefits of our ongoing infrastructure strengthening. Rainfall for the year overall was average and well distributed so that there were no water shortages or crisis situations of note.

Higher electricity expense has become a significant cause for concern as it affects all aspects of our production. We are consequently researching and running pilot studies on more energy efficient pumps that may be combined with very efficient energy recovery equipment to counter the spiraling cost of power. We do not expect any quick remedies but are optimistic that we will be able to reduce our power consumption by a sufficient amount to generate operating savings that will justify the investment. As the price of oil climbs the inducement to invest in energy conservation grows but we must be certain that proposals will work on a reliable and continuous basis, and with a reasonable life expectancy.

The company carried out two major infrastructure projects and several smaller but very beneficial projects. The first was a joint project with BELCO that we led on to replace our water mains to the City of Hamilton. This was the second phase of the project that was initiated in 2006 when we replaced our pipelines from the Devonshire reservoir to Corkscrew Hill via Middle Road. The second phase was from Corkscrew to the eastern city boundary along Middle Road and Cavendish Road. The new pipe provides for substantial future growth in the City and beyond. The second project was also in association with BELCO who installed new underground cables from the KEMH to the Belmont sub-station via South and Middle Roads. This project presented an opportunity to service parts of Paget and Warwick that had no service and to link existing but distant pipelines together. It also enabled the Company to replace an important section of old main that had become problematic between Stowe Hill and Paget traffic lights due to the very high traffic volume on that stretch of road and the age and condition of the mechanical couplings on the old pipe. The several beneficial minor projects involved installing secondary mains in high-density residential areas. This led to a substantial increase in new accounts that are a source of new revenue.

Last year we were projecting a downturn in our business cycle that did not materialize. The basis for the projection was the closing of the Wyndham Sonesta in late 2006. We thought that we would be unable to replace the lost sales volume in the near term. We did manage to sell virtually the same volume in 2007 as we did in 2006. Had the Wyndham been open the result would have been exceptional. In the final analysis the year 2007 has been our most successful year ever.

We are maintaining our downturn projection for this year. Apart from the Wyndham closing in late 2006, there will not be any regular cruise ship visits to Hamilton this year and for the foreseeable future. The cruise ships were significant consumers and we feel it is impossible to replace them in the near term.

We will continue to invest in infrastructure that will lead to greater sales and/or gains in productivity. It is through such investment that the company will compensate for the loss of significant consumers. When these significant consumers are ultimately replaced through future proposed tourism growth and redevelopment, the company should be well placed to provide the product and service they will require.

Watlington Waterworks Limited

Unaudited

Summaries of the last 5 financial years

December 31, 2007

| | Year ended December 31 | | | | |
|----------------------|------------------------|------------|------------|------------|------------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| | \$ | \$ | \$ | \$ | \$ |
| Revenue | 9,977,561 | 9,612,674 | 9,058,987 | 9,045,783 | 8,294,674 |
| Net earnings | 2,320,671 | 2,056,588 | 2,135,670 | 2,286,775 | 1,946,889 |
| Dividends | 401,064 | 445,156 | 473,887 | 344,927 | 297,343 |
| Shareholders' equity | 14,530,331 | 12,569,831 | 14,739,360 | 13,051,459 | 11,074,223 |
| Total assets | 15,634,102 | 13,709,726 | 15,595,751 | 13,851,661 | 11,742,517 |

Per share amounts:

| | | | | | |
|---------------------------------|-------|-------|-------|-------|------|
| Net earnings | 2.20 | 2.16 | 1.68 | 1.98 | 1.70 |
| Net earnings | | | | | |
| - adjusted for 2005 bonus issue | 2.20 | 2.16 | 1.68 | 1.80 | 1.54 |
| - adjusted for 2007 bonus issue | 2.20 | 1.95 | 1.56 | 1.67 | 1.42 |
| Dividends | 0.38 | 0.40 | 0.37 | 0.30 | 0.26 |
| Shareholders' equity | 13.80 | 13.19 | 11.58 | 11.31 | 9.65 |

April 16, 2008

Auditors' Report

To the Shareholders of Watlington Waterworks Limited

We have audited the consolidated balance sheet of **Watlington Waterworks Limited** as at December 31, 2007 and the consolidated statements of earnings and retained earnings and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Bermuda and Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in Bermuda and Canada.

PricewaterhouseCoopers

Chartered Accountants

Watlington Waterworks Limited

Consolidated Balance Sheet

As at December 31, 2007

| | 2007 \$ | 2006 \$ |
|---|-------------------|-------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 2,228,083 | 630,836 |
| Accounts receivable (note 7) | 992,276 | 1,212,931 |
| Inventories | 1,006,942 | 1,006,264 |
| Prepaid expenses and deferred costs | 120,243 | 135,989 |
| | <u>4,347,544</u> | <u>2,986,020</u> |
| Property, plant and equipment (note 3) | <u>11,286,558</u> | <u>10,723,706</u> |
| Total assets | <u>15,634,102</u> | <u>13,709,726</u> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 1,095,474 | 828,945 |
| Deposits held | 8,297 | 11,000 |
| Term loan (note 5) | - | 299,950 |
| | <u>1,103,771</u> | <u>1,139,895</u> |
| Shareholders' equity | | |
| Share capital | 1,052,629 | 953,343 |
| Share premium | 1,347,893 | 10,101 |
| Capital reserve | 7,000,000 | 7,000,000 |
| General reserve | 1,000,000 | 1,000,000 |
| Retained earnings | 4,129,809 | 3,606,387 |
| Total shareholders' equity | <u>14,530,331</u> | <u>12,569,831</u> |
| Total liabilities and shareholders' equity | <u>15,634,102</u> | <u>13,709,726</u> |

Approved by the Board of Directors

h. B. Dell Director

M. J. [Signature] Director

The accompanying notes are an integral part of these consolidated financial statements.

Watlington Waterworks Limited

Consolidated Statement of Earnings and Retained Earnings For the year ended December 31, 2007

| | 2007 | 2006 |
|--|------------------|------------------|
| | \$ | \$ |
| Income | | |
| Water sales | 8,828,915 | 8,438,779 |
| Other operating revenues | 1,062,420 | 1,081,425 |
| Rental | 70,457 | 34,669 |
| Interest | 15,769 | 57,801 |
| | <u>9,977,561</u> | <u>9,612,674</u> |
| Expenses | | |
| Plant operation and distribution | 4,616,627 | 4,585,803 |
| Administration and general | 1,926,977 | 1,888,282 |
| Depreciation and amortization | 1,101,918 | 1,059,166 |
| Bank interest | 11,368 | 22,835 |
| | <u>7,656,890</u> | <u>7,556,086</u> |
| Net earnings for the year | 2,320,671 | 2,056,588 |
| Retained earnings – Beginning of year | 3,606,387 | 3,109,978 |
| | 5,927,058 | 5,166,566 |
| Repurchase of shares (note 4 (b)) | - | (1,115,023) |
| | 5,927,058 | 4,051,543 |
| Dividends paid | (401,064) | (445,156) |
| Bonus shares issued (note 4 c)) | (1,395,556) | - |
| Bonus shares – fractions (note 4 c)) | (629) | - |
| Retained earnings – End of year | <u>4,129,809</u> | <u>3,606,387</u> |

The accompanying notes are an integral part of these consolidated financial statements.

Watlington Waterworks Limited

Consolidated Statement of Cash Flows

For the year ended December 31, 2007

| | 2007 \$ | 2006 \$ |
|---|-------------|-------------|
| Cash flows from operating activities | | |
| Net earnings for the year | 2,320,671 | 2,056,588 |
| Add items not affecting cash: | | |
| Depreciation and amortization | 1,101,918 | 1,059,166 |
| Changes in non-cash items | | |
| Accounts receivable | 220,655 | (237,554) |
| Inventories | (678) | (106,782) |
| Prepaid expenses and deferred costs | 15,746 | (39,847) |
| Accounts payable and accrued liabilities | 266,529 | (13,982) |
| Deposits held | (2,703) | (2,464) |
| Net cash from operations | 3,922,138 | 2,715,125 |
| Cash flow from investing activity | | |
| Purchase of property, plant and equipment | (1,664,770) | (1,911,440) |
| Net cash used in investing activity | (1,664,770) | (1,911,440) |
| Cash flows from financing activities | | |
| Proceeds of shares issued | 41,522 | 11,151 |
| Dividends paid | (401,064) | (445,156) |
| Bonus issue | (629) | - |
| Repurchase of shares | - | (3,792,112) |
| Repayment/proceeds of term loan | (299,950) | 299,950 |
| Net cash used in financing activities | (660,121) | (3,926,167) |
| Net increase (decrease) in cash and cash equivalents | 1,597,247 | (3,122,482) |
| Cash and cash equivalents at beginning of year | 630,836 | 3,753,318 |
| Cash and cash equivalents at end of year | 2,228,083 | 630,836 |
| Supplemental cash flow: | | |
| Cash paid for interest | 11,368 | 22,835 |

The accompanying notes are an integral part of these consolidated financial statements.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2007

1. Nature of business

Watlington Waterworks Limited ("the Company") and Bermuda Waterworks Limited ("the Subsidiary") (note 2(b)) are incorporated under the laws of Bermuda and are primarily engaged in the production and distribution of water and purification of drinking water for sale at the retail and wholesale level. The group is also engaged in the provision of customer services, plumbing supplies and the supply of coolers for sale and rental.

2. Significant accounting policies

These financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada. The significant accounting policies adopted by the Company are as follows:

- (a) **Basis of presentation**
The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates.
- (b) **Principles of consolidation**
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Bermuda Waterworks Limited. All significant intercompany transactions and balances are eliminated on consolidation.
- (c) **Water sales**
Water sales comprise wholesale water and bottled water sales. Wholesale water sales are based on consumption recorded by meter readings taken monthly during the year.
- (d) **Other operating revenues**
Other operating revenues comprise income from sales of plumbing supplies, sales and rental of water coolers and related equipment and utility connection fees.
- (e) **Property, plant and equipment**
Freehold land and houses are stated at cost. Property, plant and equipment other than freehold land and houses are being depreciated on a straight-line basis over their estimated useful lives, which generally vary from 3 to 40 years.
- (f) **Inventories**
Inventories which comprise essential utility parts, plumbing supplies and bottled water supplies are carried at the lower of average cost and net realisable value.
- (g) **Fair values of financial instruments**
Fair values of financial instruments are disclosed in the notes to the financial statements when they differ from the carrying values. Where amounts receivable and payable are subject to normal credit terms, their carrying values are used as an approximation of their fair values.
- (h) **Cash and cash equivalents**
Cash and cash equivalents include deposits having a maturity of less than three months from the date of purchase.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2007

(i) **Pension plan**

The Company sponsors a defined contribution pension plan (the "Plan") covering all eligible employees. The cost of the Plan is expensed as related benefits are earned by the employees. The Company makes monthly contributions in accordance with the Plan Agreement to the employees individual accounts, which are administered by an insurance company pursuant to and in accordance with the National Pension Scheme (Occupational Pensions) Act.

(j) **Accounting standards effective for 2007**

During the year the following standards were adopted by the Company, however they do not have an impact on the current year's financial statements, as the Company does not have any investments affected by these standards.

Section 1530 – Comprehensive Income, Section 3855 – Financial Instruments – Recognition and Measurement and Section 3865 – Hedges.

3. *Property, plant and equipment*

Fixed assets comprise: Fixed assets comprise:

| | Cost | Accumulated | 2007 | 2006 |
|--|-------------------|---------------------|-------------------|-------------------|
| | \$ | Depreciation | Net | Net |
| | | \$ | \$ | \$ |
| Freehold land and houses | 416,683 | - | 416,683 | 416,683 |
| Production and distribution plant and facilities | 19,533,639 | 9,043,055 | 10,490,584 | 9,988,884 |
| Vehicles | 618,293 | 484,139 | 134,154 | 177,877 |
| Office equipment, computers, and rental equipment | 1,123,960 | 1,025,750 | 98,210 | 140,262 |
| Construction in progress | 146,927 | - | 146,927 | - |
| | <u>21,839,502</u> | <u>10,552,944</u> | <u>11,286,558</u> | <u>10,723,706</u> |

As at December 31, 2007, the Company had capital commitments in respect of plant and equipment of \$312,492 (2006 - \$94,151). These commitments will be met from operations.

4. *Shareholders' equity*

| | 2007 | 2006 |
|---|------------------|------------------|
| | \$ | \$ |
| Authorised - 2,000,000 shares of the par value of \$1.00 each | <u>2,000,000</u> | <u>2,000,000</u> |
| Issued and fully paid - 1,052,629 (2006 - 953,343) shares of the par value of \$1.00 each | <u>1,052,629</u> | <u>953,343</u> |

The net asset value attributable to each share, calculated on the basis of the book value as disclosed in the Company's consolidated balance sheet as at December 31, 2007 was \$13.80 (2006 - \$13.19).

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2007

(a) **Changes in shareholders' equity**

| | Share capital \$ | Share premium \$ | Contributed surplus \$ | Capital reserve \$ | General reserve \$ | Retained earnings \$ | Total \$ |
|--|------------------------|------------------------|------------------------------|--------------------------|--------------------------|----------------------------|-------------|
| Balance, December 31, 2005 | 1,272,913 | 2,253,232 | 103,237 | 7,000,000 | 1,000,000 | 3,109,978 | 14,739,360 |
| Net income for the year | - | - | - | - | - | 2,056,588 | 2,056,588 |
| Repurchase of shares (note 4 (b)) | (320,620) | (2,253,232) | (103,237) | - | - | (1,115,023) | (3,792,112) |
| Dividend paid | - | - | - | - | - | (445,156) | (445,156) |
| Issuance of shares (note 4 (d)) | 1,050 | 10,101 | - | - | - | - | 11,151 |
| Balance, December 31, 2006 | 953,343 | 10,101 | - | 7,000,000 | 1,000,000 | 3,606,387 | 12,569,831 |
| Net income for the year | - | - | - | - | - | 2,320,671 | 2,320,671 |
| Issuance of bonus shares (note 4 (c)) | 95,586 | 1,299,970 | - | - | - | (1,395,556) | - |
| Dividend paid | - | - | - | - | - | (401,064) | (401,064) |
| Cash paid for fraction shares (note 4(c)) | - | - | - | - | - | (629) | (629) |
| Issuance of shares (note 4 (d)) | 3,700 | 37,822 | - | - | - | - | 41,522 |
| Balance, December 31, 2007 | 1,052,629 | 1,347,893 | - | 7,000,000 | 1,000,000 | 4,129,809 | 14,530,331 |

(b) **GE Ionics Inc.**

On June 30, 2006 the Company entered into an agreement to repurchase the entire holding of 320,620 shares held by GE Ionics Inc. at a valuation of BD\$11.80 per share. A deposit of \$1,000,000 was paid on June 30, 2006 and the balance on July 5, 2006. The total amount paid to GE Ionics Inc. was \$3,792,112 including foreign exchange adjustments and bank charges which represented a final price of \$11.83 per share. The cost of this transaction was met from the Company's working capital and an overdraft facility granted by The Bank of N.T. Butterfield & Son Limited (Note 5 below).

The effect of the repurchase has been to reduce balance sheet values in 2006 as follows:

| | |
|---------------------|------------------|
| | \$ |
| Share capital | 320,620 |
| Share premium | 2,253,232 |
| Contributed surplus | 103,237 |
| Retained earnings | 1,115,023 |
| | <u>3,792,112</u> |

The shares repurchased have been cancelled.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2007

(c) **Bonus issue**

On April 11, 2007 the Board of Directors of the Company approved the issuance of bonus shares to shareholders of record on August 31, 2007 on the basis of 1 common share of \$1 par value for every 10 common shares held. The bonus shares were issued on September 14, 2007 and were valued at book value as at August 31, 2007. The number of qualifying shares on August 31, 2007 before the bonus issue was 956,293 and the number of bonus shares issued on September 14, 2007 was 95,586 (allowing for fractions – see below). The book value of each common share at August 31, 2007 was \$14.60 and this reduced retained earnings by \$1,395,556 and increased share capital by \$95,586 and share premium by \$1,299,970.

If the number of shares held by each shareholder at August 31, 2007 was not evenly divisible by ten, a cash payment for such fractional entitlement calculated on the basis of the book value of \$14.60 per common share was due. This payment was made on October 26, 2007 and amounted in total to \$629.

(d) **Employee share purchase plan**

In June 1999, the Company introduced an employee share purchase program whereby employees with a minimum of one year's continuous service may subscribe to purchase up to a maximum of 1,000 common shares in any one calendar year. The purchase price of the common shares is 85% of the market price on the plan's subscription date. The shares purchased are issued from authorised, unissued share capital. Employees are restricted from selling the shares for a period of one year from the issuance date. During the year ended December 31, 2007, employees subscribed for and were issued 3,700 common shares for proceeds of \$41,522 (2006 – 1,050 shares for proceeds of \$11,151). The excess of the purchase price over the par value of the shares is recorded as share premium (see (e) below).

(e) **Share premium and contributed surplus**

The share premium balance relates to the excess of the purchase price over par value of shares of the Company. The balances on both share premium and contributed surplus accounts were reduced to nil at June 30, 2006 by the effects of the repurchase of shares from GE Ionics Inc. referred to in (b) above.

(f) **Capital reserve**

The amount transferred from retained earnings to capital reserve represents the Company's investment in infrastructure renovations and improvements, including pipelines and reservoirs, in order to maintain the permanent capital of the Company and has been approved by the Board of Directors.

(g) **General reserve**

General reserve is an appropriation from retained earnings as a contingency for unexpected future expenditures and has been approved by the Board of Directors.

5. **Bank borrowing**

During 2006 the Company negotiated a credit facility with The Bank of N.T. Butterfield & Son Limited of up to \$1.6 million comprising (a) \$1.1 million to assist with the repurchase of shares from GE Ionics Inc. (Note 4(b) above) and (b) an overdraft facility of \$500,000 to assist in financing ongoing working capital requirements. The facility in (a) initially took the form of an overdraft and was activated on July 5, 2006 with the completion of the repurchase of the GE Ionics shares. This facility was converted to a term loan on December 28, 2006 at which time the borrowing was \$299,950, having been reduced by subsequent repayments. This loan was repaid in full on September 7, 2007. The borrowing under facility (b) has not been utilized.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2007

6. *Directors' share interests and service contracts*

Pursuant to Regulation 6.8(3) of Section 11B of the Bermuda Stock Exchange Listing Regulations, the total interest of all directors and officers of the Company as at December 31, 2007 was 231,918 (2006 – 210,836) shares. No rights to subscribe for shares in the Company have been granted to or exercised by any director or officer, except for the managing director who qualifies under the employee share purchase plan.

There are no contracts with the Company in which a director has a material interest, either directly or indirectly.

7. *Financial instruments*

Credit risk

The Company is exposed to credit risk with respect to its accounts receivable. However, this risk is minimised by the Company's large customer base, which covers consumer and business sectors in Bermuda. The Company follows a program of credit evaluations of customers and limits the amount of credit extended when deemed necessary. The Company maintains provisions for potential credit losses and any such losses to date have been within management's expectations.

Accounts receivable consists of the following:

| | 2007 \$ | 2006 \$ |
|------------------------------|----------------|------------------|
| Accounts receivable | 1,101,195 | 1,350,218 |
| Allowance for doubtful debts | (108,919) | (137,287) |
| | <u>992,276</u> | <u>1,212,931</u> |

8. *Contingent liability*

A legal proceeding is pending against the Company and its subsidiary, which arose in the normal course of business. Management, after reviewing the action involving the Company and its subsidiary, cannot predict with certainty the final outcome, however it is management's opinion, based on legal advice, that the resolution of this matter would not be material to the consolidated financial statements.