

Watlington Waterworks Limited

Consolidated Financial Statements
December 31, 2005

March 17, 2006

Auditors' Report

To the Shareholders of Watlington Waterworks Limited

We have audited the consolidated balance sheet of **Watlington Waterworks Limited** as at December 31, 2005 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, 2005 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.



Chartered Accountants

Watlington Waterworks Limited

Consolidated Balance Sheet

As at December 31, 2005

| | 2005 | 2004 |
|---|-------------------|-------------------|
| | \$ | \$ |
| Assets | | |
| Current assets | | |
| Cash and short-term deposits | 3,753,318 | 3,646,847 |
| Accounts receivable | 975,377 | 1,148,555 |
| Inventories | 899,482 | 767,544 |
| Prepaid expenses and deferred costs | 96,142 | 110,453 |
| | <u>5,724,319</u> | <u>5,673,399</u> |
| Property, plant and equipment (note 3) | <u>9,871,432</u> | <u>8,178,262</u> |
| Total assets | <u>15,595,751</u> | <u>13,851,661</u> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 842,927 | 784,452 |
| Deposits held | 13,464 | 15,750 |
| | <u>856,391</u> | <u>800,202</u> |
| Shareholders' equity (note 4) | | |
| Share capital | 1,272,913 | 1,153,469 |
| Share premium | 2,253,232 | 1,020,071 |
| Contributed surplus | 103,237 | 103,237 |
| Capital reserve | 7,000,000 | - |
| General reserve | 1,000,000 | 700,000 |
| Retained earnings | 3,109,978 | 10,074,682 |
| | <u>14,739,360</u> | <u>13,051,459</u> |
| Total shareholders' equity | <u>14,739,360</u> | <u>13,051,459</u> |
| Total liabilities and shareholders' equity | <u>15,595,751</u> | <u>13,851,661</u> |

Approved by the Board of Directors

Nicholas B. Dill _____ Director

Michael Darling _____ Director

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

Watlington Waterworks Limited

Consolidated Statement of Earnings and Retained Earnings

For the year ended December 31, 2005

| | 2005 | 2004 |
|--|------------------|-------------------|
| | \$ | \$ |
| Income | | |
| Water sales | 7,973,213 | 7,925,427 |
| Other operating revenues | 989,917 | 1,041,775 |
| Rental | 61,725 | 61,308 |
| Interest | 34,132 | 17,273 |
| | <u>9,058,987</u> | <u>9,045,783</u> |
| Expenses | | |
| Plant operation and distribution | 4,193,781 | 4,015,040 |
| Administration and general | 1,787,491 | 1,707,590 |
| Depreciation and amortization | 942,045 | 1,036,378 |
| | <u>6,923,317</u> | <u>6,759,008</u> |
| Net earnings for the year | 2,135,670 | 2,286,775 |
| Retained earnings - Beginning of year | 10,074,682 | 8,832,834 |
| | 12,210,352 | 11,119,609 |
| Transfer to capital reserve | (7,000,000) | - |
| Transfer to general reserve | (300,000) | (700,000) |
| | 4,910,352 | 10,419,609 |
| Dividends paid | (473,887) | (344,927) |
| Bonus shares issued | (1,326,487) | - |
| Retained earnings - End of year | <u>3,109,978</u> | <u>10,074,682</u> |

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

Watlington Waterworks Limited

Consolidated Statement of Cash Flows

For the year ended December 31, 2005

| | 2005 \$ | 2004 \$ |
|---|-------------------------|-------------------------|
| Cash flows from operating activities | | |
| Net earnings for the year | 2,135,670 | 2,286,775 |
| Add items not affecting cash: | | |
| Depreciation | 942,045 | 1,036,378 |
| Changes in non-cash items | | |
| Accounts receivable | 173,178 | (173,642) |
| Inventories | (131,938) | (64,753) |
| Prepaid expenses and deferred costs | 14,311 | 30,208 |
| Accounts payable and accrued liabilities | 58,475 | 150,909 |
| Deposits held | (2,286) | (19,001) |
| Net cash from operations | <u>3,189,455</u> | <u>3,246,874</u> |
| Cash flow from investing activity | | |
| Purchase of property, plant and equipment | <u>(2,635,215)</u> | <u>(1,683,912)</u> |
| Net cash used in investing activity | <u>(2,635,215)</u> | <u>(1,683,912)</u> |
| Cash flows from financing activities | | |
| Proceeds of shares issued | 26,609 | 35,388 |
| Dividend paid | (473,887) | (344,927) |
| Bonus issue | (491) | - |
| Net cash used in financing activities | <u>(447,769)</u> | <u>(309,539)</u> |
| Increase in cash and short-term deposits | 106,471 | 1,253,423 |
| Cash and short-term deposits - Beginning of year | <u>3,646,847</u> | <u>2,393,424</u> |
| Cash and short-term deposits - End of year | <u><u>3,753,318</u></u> | <u><u>3,646,847</u></u> |

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

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

For the year ended December 31, 2005

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. 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 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.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

For the year ended December 31, 2005

3. Property, plant and equipment

| | 2005 \$ | 2004 \$ |
|---|------------------|------------------|
| Utility plant, buildings, building improvements, installations and equipment - at cost | 17,902,978 | 16,903,585 |
| Less: Accumulated depreciation | (8,606,533) | (9,276,626) |
| Net book value | 9,296,445 | 7,626,959 |
| Freehold land and houses | 416,683 | 416,683 |
| Construction in progress | 158,304 | 134,620 |
| | <u>9,871,432</u> | <u>8,178,262</u> |

During the year, property, plant and equipment, primarily comprising reverse osmosis plant, with cost and accumulated depreciation of \$1,607,523 (2004 - \$123,404) were written off.

As at December 31, 2005, the Company had capital commitments in respect of plant and equipment of \$153,135 (2004 - \$1,149,830). These commitments will be met from operations.

4. Share capital

| | 2005 \$ | 2004 \$ |
|--|------------------|------------------|
| 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 - 1,272,913 shares (2004 - 1,153,469 shares) of the par value of \$1.00 each | <u>1,272,913</u> | <u>1,153,469</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, 2005 was \$11.58 (2004 - \$11.31).

Bonus issue

On February 24, 2005 the Board of Directors of the Company approved the issuance of bonus shares to shareholders of record on March 15, 2005 on the basis of 1 common share of \$1 par value for every 10 common shares held. The number of qualifying shares on March 15, 2005 before the bonus issue was 1,154,969 and the number of bonus shares issued on March 31, 2005 was 115,304 (allowing for fractions - see below). The book value of each common share at that date was \$11.50 and this reduced retained earnings by \$1,325,996 and increased share capital by \$115,304 and share premium by \$1,210,692.

If the number of shares held by each shareholder at March 15, 2005 was not evenly divisible by ten, a cash payment for such fractional entitlement calculated on the basis of the book value of \$11.50 per common share was made on June 27, 2005 amounting in total to \$491.

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Notes to Consolidated Financial Statements

For the year ended December 31, 2005

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 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, 2005, employees subscribed for and were issued 4,140 common shares for proceeds of \$26,609 (2004 - 6,100 shares for proceeds of \$35,388). The surplus of the purchase price over the par value of the shares is taken to share premium (see below).

Share premium and contributed surplus

The contributed surplus balance refers to the excess value of shares acquired over the nominal value of shares issued in 1977 in the acquisition of the remaining shares in a subsidiary company, Watlington Ionics Ltd., resulting in it being wholly owned. The share premium balance relates to the excess over par value of shares of the Company sold for cash.

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.

General reserve

General reserve is an appropriation from retained earnings as a contingency for unexpected future expenditures. In the event that this reserve needs to be used it will be done by a transfer to retained earnings to offset the impact on retained earnings of the expense incurred.

5. Related party transactions

In accordance with the terms of an agreement dated January 13, 1988 Ionics (Bermuda) Ltd. ("IBL") installed an electro dialysis reversal desalination system purchased from a shareholder, Ionics Incorporated (now GE Ionics Incorporated). The Company is committed to paying the operating costs and to purchasing the water output of the plant. The level and price at which the Company will purchase water from IBL is governed by the agreement. The agreement is for a twenty-five year period. During the year to December 31, 2005 the total cost incurred by the Company in respect of this agreement was \$572,535 (2004 - \$582,031) of which \$310,857 (2004 - \$326,806) was in respect of the water output of the plant.

Amounts due to and from related parties at December 31, 2005 are as follows:

| | 2005 | 2004 |
|---|--------|--------|
| | \$ | \$ |
| Amounts due to GE Ionics Incorporated | 24,397 | 24,397 |
| Amounts due from GE Ionics Incorporated | 10,077 | 10,077 |
| Amounts due to IBL | 22,471 | 27,714 |
| Amounts due from IBL | 18,884 | 13,390 |

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Notes to Consolidated Financial Statements

For the year ended December 31, 2005

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 interests of all directors and officers of the Company as at December 31, 2005 were 183,338 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 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.

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.

Watlington Waterworks Limited

Directors Report to Shareholders

For the year ended December 31, 2005

There was some slippage in the demand for the Company's products and services through three-quarters of the year compared to the previous year. It was only during the early summer drought that demand exceeded the previous year. The slippage was attributed to more severe winter weather in the early part of the year and then average to above average rainfall well distributed through the last half of the year. Despite the decline in demand the company did produce a very favourable result for the year overall. The company recorded its second best year on record with earnings exceeding two million dollars. This result was despite significant increases in operating expenses, particularly for electricity.

During the year a new reservoir was built on Jubilee Road to substitute operationally for the old reservoir on Middle Road that needs to be either replaced or refurbished. An additional sea water reverse osmosis unit was acquired to increase desalting capacity and to operate as a pilot test for a more efficient power train system to reduce energy consumption. If the pilot performs according to specifications over the next twelve months we will proceed to retrofit the more efficient power train to our other seawater reverse osmosis units. The company continues to expand its water mains distribution system and strengthen infrastructure where appropriate. Much of the company's older infrastructure now varies from 40 to 73 years old. It will be necessary to progressively upgrade and replace the old infrastructure as and when opportunities present themselves while balancing with infrastructure growth as the company's customer base expands. The company's ability to provide public water supply at the least operational cost possible improves each year with a combination of infrastructure replacement and strengthening.

The company has entered a less favourable business cycle that may run for a period of time. This is due to an ongoing shift in the Utility Division's customer base as the trend away from individual large consumers to multiple smaller consumers' continues. This is due to the time lag between a larger consumer going off-line and multiple smaller consumers coming on-line in substitution. This trend derives from the decline in tourism that has seen many tourist-oriented properties close or change their use. The change of use inevitably requires less supplementary water supply. Also layered on to these trends are temporary hotel closures either for renovations or lack of winter business. The company is diversifying its utility customer base as it expands the distribution system but there are no quick fixes for the loss of a major consumer. The company expects to benefit in the longer term from having a more diversified customer base that will remain a key aim of the Utility Division.

Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2005

| | Year ended December 31 | | | | |
|----------------------|------------------------|------------|------------|------------|-----------|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| | \$ | \$ | \$ | \$ | \$ |
| Revenue | 9,058,987 | 9,045,783 | 8,294,674 | 7,471,475 | 7,205,026 |
| Net earnings | 2,135,670 | 2,286,775 | 1,946,889 | 1,011,718 | 540,600 |
| Dividends | 473,887 | 344,927 | 297,343 | 136,938 | 137,018 |
| Shareholders' equity | 14,739,360 | 13,051,459 | 11,074,223 | 9,398,197 | 8,524,139 |
| Total assets | 15,595,751 | 13,851,661 | 11,742,517 | 10,015,953 | 9,646,766 |

Per share amounts:

| | | | | | |
|---|-------|-------|------|------|------|
| Net earnings | 1.68 | 1.98 | 1.70 | 0.89 | 0.47 |
| Net earnings (adjusted for 2005 bonus issue) | 1.68 | 1.80 | 1.54 | 0.81 | 0.43 |
| Dividends | 0.37 | 0.30 | 0.26 | 0.12 | 0.12 |
| Shareholders' equity | 11.58 | 11.31 | 9.65 | 8.24 | 7.47 |