

# **Watlington Waterworks Limited**

Consolidated Financial Statements  
December 31, 2006

April 4, 2007

**Auditors' Report**

**To the Shareholders of  
Watlington Waterworks Limited**

We have audited the consolidated balance sheet of **Watlington Waterworks Limited** as at December 31, 2006 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, 2006 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, 2006

	2006	2005
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	630,836	3,753,318
Accounts receivable	1,212,931	975,377
Inventories	1,006,264	899,482
Prepaid expenses and deferred costs	135,989	96,142
	<u>2,986,020</u>	<u>5,724,319</u>
<b>Property, plant and equipment</b> (note 3)	<u>10,723,706</u>	<u>9,871,432</u>
<b>Total assets</b>	<u>13,709,726</u>	<u>15,595,751</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	828,945	842,927
Deposits held	11,000	13,464
Term loan (note 5)	299,950	-
	<u>1,139,895</u>	<u>856,391</u>
<b>Shareholders' equity</b> (note 4)		
Share capital	953,343	1,272,913
Share premium	10,101	2,253,232
Contributed surplus	-	103,237
Capital reserve	7,000,000	7,000,000
General reserve	1,000,000	1,000,000
Retained earnings	3,606,387	3,109,978
<b>Total shareholders' equity</b>	<u>12,569,831</u>	<u>14,739,360</u>
<b>Total liabilities and shareholders' equity</b>	<u>13,709,726</u>	<u>15,595,751</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, 2006

	2006 \$	2005 \$
<b>Income</b>		
Water sales	8,438,779	7,973,213
Other operating revenues	1,081,425	989,917
Rental	34,669	61,725
Interest	57,801	34,132
	<u>9,612,674</u>	<u>9,058,987</u>
<b>Expenses</b>		
Plant operation and distribution	4,585,803	4,193,781
Administration and general	1,888,282	1,787,491
Depreciation and amortization	1,059,166	942,045
Bank interest	22,835	-
	<u>7,556,086</u>	<u>6,923,317</u>
<b>Net earnings for the year</b>	2,056,588	2,135,670
<b>Retained earnings - Beginning of year</b>	3,109,978	10,074,682
	5,166,566	12,210,352
Transfer to capital reserve	-	(7,000,000)
Transfer to general reserve	-	(300,000)
Repurchase of shares (note 4)	(1,115,023)	-
	4,051,543	4,910,352
Dividends paid	(445,156)	(473,887)
Bonus shares issued	-	(1,326,487)
<b>Retained earnings - End of year</b>	<u>3,606,387</u>	<u>3,109,978</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, 2006

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	2006	2005
	\$	\$
<b>Cash flows from operating activities</b>		
Net earnings for the year	2,056,588	2,135,670
Add items not affecting cash:		
Depreciation	1,059,166	942,045
Changes in non-cash items		
Accounts receivable	(237,554)	173,178
Inventories	(106,782)	(131,938)
Prepaid expenses and deferred costs	(39,847)	14,311
Accounts payable and accrued liabilities	(13,982)	58,475
Deposits held	(2,464)	(2,286)
Net cash from operations	<u>2,715,125</u>	<u>3,189,455</u>
<b>Cash flow from investing activity</b>		
Purchase of property, plant and equipment	<u>(1,911,440)</u>	<u>(2,635,215)</u>
Net cash used in investing activity	<u>(1,911,440)</u>	<u>(2,635,215)</u>
<b>Cash flows from financing activities</b>		
Proceeds of shares issued	11,151	26,609
Dividends paid	(445,156)	(473,887)
Bonus issue	-	(491)
Repurchase of shares	(3,792,112)	-
Proceeds from term loan	<u>299,950</u>	<u>-</u>
Net cash used in financing activities	<u>(3,926,167)</u>	<u>(447,769)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	(3,122,482)	106,471
<b>Cash and equivalents at beginning of year</b>	<u>3,753,318</u>	<u>3,646,847</u>
<b>Cash and equivalents at end of year</b>	<u>630,836</u>	<u>3,753,318</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, 2006

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## 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.

### (h) **Cash and cash equivalents**

Cash and cash equivalents include deposits having a maturity of less than three months.

# Watlington Waterworks Limited

Notes to Consolidated Financial Statements  
For the year ended December 31, 2006

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### 3. Property, plant and equipment

	2006 \$	2005 \$
Utility plant, buildings, building improvements, installations and equipment - at cost	19,840,489	17,902,978
Less: Accumulated depreciation	(9,533,466)	(8,606,533)
Net book value	10,307,023	9,296,445
Freehold land and houses	416,683	416,683
Construction in progress	-	158,304
	<u>10,723,706</u>	<u>9,871,432</u>

As at December 31, 2006, the Company had capital commitments in respect of plant and equipment of \$94,151 (2005 - \$153,135). These commitments will be met from operations.

### 4. Shareholders' equity

	2006 \$	2005 \$
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 - 953,343 shares (2005 - 1,272,913 shares) of the par value of \$1.00 each	<u>953,343</u>	<u>1,272,913</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, 2006 was \$13.19 (2005 - \$11.58).

#### 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 US\$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 BD\$3,792,112 including foreign exchange adjustments and bank charges which represented a final price of \$11.83 per share. The shares repurchased have been cancelled. 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. (see 6 below).

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

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

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements For the year ended December 31, 2006

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### **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.

### **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, 2006, employees subscribed for and were issued 1,050 common shares for proceeds of \$11,151 (2005 – 4,140 shares for proceeds of \$26,609). 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 share premium balance relates to the excess over par value of shares of the Company sold for cash. 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 balances on both share premium and contributed surplus accounts were reduced to zero at June 30, 2006 by the effects of the repurchase of shares from GE Ionics Inc. referred to above.

### **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.

## **5. Bank borrowing**

During the year 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. (see 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. The borrowing under facility (b) has not been utilized.

An interest rate of 2% over the Bank's Base Rate applies to both facilities. The rate at December 31, 2006 was 7¼%. As security the Bank holds a First Legal Mortgage over the Company's property at 82, North Shore, Devonshire (the Sea Water Reverse Osmosis Plant) and the title deeds to that property are held by the Bank.



# Watlington Waterworks Limited

Notes to Consolidated Financial Statements

For the year ended December 31, 2006

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## 6. *Related party transactions*

The effect of the repurchase of shares from GE Ionics at June 30, 2006 was to cause that company and its associated companies to cease to be related parties. Therefore the information shown below refers only to the first six months of the year.

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 six months to June 30, 2006 the total cost incurred by the Company in respect of this agreement was \$290,746 (2005 - \$572,535) of which \$154,032 (2005 - \$310,857) was in respect of the water output of the plant.

Amounts due to and from related parties at June 30, 2006 and 2005 were as follows:

	2006	2005
	\$	\$
Amounts due to GE Ionics Incorporated	24,397	24,397
Amounts due from GE Ionics Incorporated	10,077	10,077
Amounts due to IBL	26,876	22,471
Amounts due from IBL	38,188	18,884

## 7. *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, 2006 was 210,836 (2005 – 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.

## 8. *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.

## 9. *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, 2006

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The demand for the Company's products and services increased marginally over the previous year. This was despite another year of above average rainfall that was well distributed through the year. Our overall result for the year was stronger than had been predicted earlier in the year due to a substantial surge in demand during the last third of the year. This surge was due to external environmental factors improving for the Company and we were well positioned through our infrastructure strengthening to seize the opportunities presented.

We experienced expenses rising faster than revenue through 2006 due primarily to high electricity expense and higher labour costs. Increasing labour costs remain worrisome because awards made elsewhere that significantly exceed the inflation rate, combined with our over-heated economy in general, are placing substantial pressure on our company to remain competitive as an employer of choice.

The most significant financial event during the year was the repurchase of 25% of our issued shares from GE Ionics Inc. G.E. Ionics decided to divest themselves of our shares and gave us the first option to repurchase their shares. The Board felt it was in the best long-term interest of shareholders to repurchase the shares and an agreement to repurchase was made in late June at a price of \$11.80 per share. This was financed by a combination of the Company's working capital and an overdraft facility with The Bank of N.T. Butterfield & Son Limited.

During the year the Company continued to invest in new infrastructure with three new pipelines installed in Warwick parish and one in Southampton East, and also the first phase of the replacement of the two old pipelines from the Middle Road reservoir to Hamilton. The first phase replacement was from the reservoir to Corkscrew Hill, and the second phase on to Hamilton is being completed during the first quarter of 2007. These pipeline replacements and additional projects are intended to continue strengthening the Company's infrastructure. A glimpse of the long-term benefits of this strategy was seen in the strength of our rebound in the last four months of the year when environmental conditions were more favourable.

We maintain that we are in downturn in the business cycle compared to a few years ago. The Wyndham Sonesta closure late in the year represents a significant revenue loss for the Company. It is impossible to immediately replace a loss of that magnitude. We are well positioned to benefit from proposed future tourism growth but it will be some time before that actually comes on line. We remain of the opinion that our best course is to continue to invest in mains expansion and to strengthen other infrastructure where possible to improve efficiencies.

**Watlington Waterworks Limited**  
Notes to Consolidated Financial Statements  
December 31, 2006

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	Year ended December 31				
	2006	2005	2004	2003	2002
	\$	\$	\$	\$	\$
Revenue	9,612,674	9,058,987	9,045,783	8,294,674	7,471,475
Net earnings	2,056,588	2,135,670	2,286,775	1,946,889	1,011,718
Dividends	445,156	473,887	344,927	297,343	136,938
Shareholders' equity	12,569,831	14,739,360	13,051,459	11,074,223	9,398,197
Total assets	13,709,726	15,595,751	13,851,661	11,742,517	10,015,953
<b>Per share amounts:</b>					
Net earnings	2.16	1.68	1.98	1.70	0.89
Net earnings (adjusted for 2005 bonus issue)	2.16	1.68	1.80	1.54	0.81
Dividends	0.40	0.37	0.30	0.26	0.12
Shareholders' equity	13.19	11.58	11.31	9.65	8.24