

# **Watlington Waterworks Limited**

Annual Report and  
Consolidated Financial Statements  
**December 31, 2010**

# Watlington Waterworks Limited

Directors Report to Shareholders

For the year ended December 31, 2010

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The Company made an incredible recovery from an extremely poor start to have a strong finish that resulted in a very satisfactory annual result. The Company experienced its lowest sales in over a decade in the first Quarter. This downward trend continued through the second Quarter with group earnings down more than a quarter of a million dollars or almost 22 percent less than the previous mid-year earnings. All sales in all divisions and departments were down.

The extreme winter weather with many winter storms and accompanying heavy rainfall extending into April had a significant negative effect and the downturn in the economy was undoubtedly another factor. Forecasts for the year were lowered after six months, and it was thought we would not manage to approach two million dollars earnings for the year. This continued to be the view until late in the year when a strong fourth quarter boosted income substantially beyond expectations.

In May, the Company entered into a Memorandum of Understanding (MOU) with the Ministry of Public Works for supplying water to the "west end." This will most likely be the most significant undertaking the Company has entered into since its inception. If the aims of the MOU are achieved, the Company will become the primary supplier of piped potable water for the western half of Bermuda, and the Ministry of Public Works will be responsible for the eastern half, thereby dividing Bermuda into two halves for public water supply.

The MOU has four phases. The first phase, commenced in July, requires the Company to make a link between its distribution system and the Ministry of Public Works Water Depot at Tudor Hill. This project was completed in early April 2011. The remaining phases will be a continuation of the pipeline to Somerset Village and a loop around East View and Sound View Roads. On completion of phase 1, the Ministry of Public Works and the Company will endeavour to agree a means by which the Company will acquire the Ministry's water related assets in the west end and thereby takeover as the primary potable water supplier for the western half of Bermuda.

Apart from all the new pipeline infrastructure envisaged, there will be future requirements to increase production and storage facilities to support the expanded distribution system. While the basic pipeline expansion described in the MOU is expected to be done in four years, this is only the beginning. The Company will go through a reiterative process of infrastructure expansion, consolidation and strengthening that will stretch over the next ten to twenty years or more. Financing for this growth will come from internal and external sources.

The Board feels that having been given the opportunity to increase our role in public water supply, the Company should do all that is necessary to deliver a reliable first class product to all its present and future customers. As it approaches its eightieth anniversary of founding, the Company is entering a new era for public water supply that was not envisaged twenty years ago let alone eighty years ago.

# Watlington Waterworks Limited

Unaudited

December 31, 2010

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## Summaries of the last 5 financial years

	Year ended December 31				
	2010	2009	2008	2007	2006
	\$	\$	\$	\$	\$
Revenue	10,377,822	10,601,159	10,073,794	9,977,561	9,612,674
Net earnings	2,107,701	2,454,912	1,980,400	2,320,671	2,056,588
Dividends	443,174	421,648	421,111	401,064	445,156
Shareholders' equity	19,816,186	18,147,177	16,100,883	14,530,331	12,569,831
Total assets	21,455,586	18,906,359	16,886,648	15,634,102	13,709,726

## Per share amounts:

Net earnings	2.00	2.33	1.88	2.20	2.16
Net earnings					
- adjusted for 2007 bonus issue	2.00	2.33	1.88	2.20	1.95
Dividends	0.42	0.40	0.40	0.38	0.40
Shareholders' equity	18.78	17.20	15.28	13.80	13.19

## 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, 2010 was 249,655 (2009 - 249,655) 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.

Consolidated Financial Statements  
**December 31, 2010**



May 4, 2011

## **Independent Auditors' Report**

### **To the Shareholders of Watlington Waterworks Limited**

We have audited the accompanying consolidated financial statements of **Watlington Waterworks Limited** and its subsidiary, which comprise the consolidated balance sheet as at December 31, 2010 and the consolidated statement of earnings and retained earnings and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Bermuda and Canada, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditors' responsibility**

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



**To the Shareholders of Watlington Waterworks Limited**  
May 4, 2011

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of **Watlington Waterworks Limited** and its subsidiary as at December 31, 2010 and of its financial performance 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, 2010

	2010 \$	2009 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	3,907,387	4,264,937
Investments	1,570,359	1,500,000
Accounts receivable	1,120,904	849,045
Inventories (note 6)	1,165,734	1,127,269
Prepaid expenses and deferred costs	164,714	133,317
	<u>7,929,098</u>	<u>7,874,568</u>
<b>Property, plant and equipment</b> (note 3)	<u>13,526,488</u>	<u>11,031,791</u>
<b>Total assets</b>	<u>21,455,586</u>	<u>18,906,359</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	1,634,548	753,270
Deposits held	4,852	5,912
	<u>1,639,400</u>	<u>759,182</u>
<b>Shareholders' equity</b>		
Share capital	1,055,359	1,054,919
Share premium	1,373,938	1,369,896
Capital reserve	7,000,000	7,000,000
General reserve	1,000,000	1,000,000
Retained earnings	9,386,889	7,722,362
<b>Total shareholders' equity</b> (note 4)	<u>19,816,186</u>	<u>18,147,177</u>
<b>Total liabilities and shareholders' equity</b>	<u>21,455,586</u>	<u>18,906,359</u>

Approved by the Board of Directors



Director



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, 2010

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	2010	2009
	\$	\$
<b>Income</b>		
Water sales	9,347,532	9,417,279
Other operating revenues	927,216	1,037,699
Rentals	69,079	82,815
Interest	33,995	63,366
	<hr/> 10,377,822	<hr/> 10,601,159
<b>Expenses</b>		
Plant operation and distribution	4,800,314	4,944,220
Administration and general	2,395,575	2,207,714
Depreciation	1,074,232	994,313
	<hr/> 8,270,121	<hr/> 8,146,247
<b>Net earnings for the year</b>	2,107,701	2,454,912
<b>Retained earnings – Beginning of year</b>	<hr/> 7,722,362	<hr/> 5,689,098
	9,830,063	8,144,010
Dividends declared	<hr/> (443,174)	<hr/> (421,648)
<b>Retained earnings – End of year</b>	<hr/> <hr/> 9,386,889	<hr/> <hr/> 7,722,362

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, 2010

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	2010 \$	2009 \$
<b>Cash flows from operating activities</b>		
Net earnings for the year	2,107,701	2,454,912
Add items not affecting cash:		
Depreciation	1,074,232	994,313
Bad debt provision	(24,437)	35,277
Changes in items related to operations:		
Accounts receivable	(247,422)	420,040
Inventories	(38,465)	(19,456)
Prepaid expenses and deferred costs	(31,397)	2,263
Accounts payable and accrued liabilities	124,836	(25,830)
Deposits held	(1,060)	(753)
Net cash from operations	<u>2,963,988</u>	<u>3,860,766</u>
<b>Cash flows from investing activities</b>		
Purchase of property, plant and equipment	(2,812,487)	(978,428)
Investments - term deposits, net	(70,359)	(1,500,000)
Net cash used in investing activities	<u>(2,882,846)</u>	<u>(2,478,428)</u>
<b>Cash flows from financing activities</b>		
Proceeds of shares issued	4,482	13,030
Dividends paid	(443,174)	(421,648)
Net cash used in financing activities	<u>(438,692)</u>	<u>(408,618)</u>
<b>Increase (decrease) in cash and cash equivalents</b>	(357,550)	973,720
<b>Cash and cash equivalents - Beginning of year</b>	<u>4,264,937</u>	<u>3,291,217</u>
<b>Cash and cash equivalents - End of year</b>	<u><u>3,907,387</u></u>	<u><u>4,264,937</u></u>

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

# Watlington Waterworks Limited

Notes to Consolidated Financial Statements

December 31, 2010

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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, 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 is stated at cost. Property, plant and equipment other than freehold land are being depreciated on a straight-line basis over their estimated useful lives, which generally vary from 3 to 40 years. Expenditures for capital projects in progress are not depreciated until completed and put into service.

### (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 three months or less from the date of purchase.

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements

December 31, 2010

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(i) **Investments**

Investments consist of term deposits having a maturity of more than three months from the date of purchase.

(j) **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.

(k) **New accounting pronouncements**

The CICA has decided to transition to International Financial Reporting Standards ("IFRS") for publicly accountable entities effective January 1, 2011. The Company currently meets the definition of a publicly accountable entity. The Company expects to adopt IFRS in its financial statements for the year ending December 31, 2011. The Company's transition date for the conversion to IFRS will be January 1, 2011 and will require the restatement of comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company is continuing to assess the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

### 3. **Property, plant and equipment**

Fixed assets comprise:

	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>2010 Net</b>	<b>2009 Net</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Freehold land	416,683	-	416,683	416,683
Production and distribution plant and facilities	21,626,541	10,285,304	11,341,237	10,324,406
Vehicles	621,243	597,953	23,290	47,338
Office equipment, computers, and rental equipment	1,400,167	1,233,153	167,014	223,006
Construction in progress	1,578,264	-	1,578,264	20,358
	<b>25,642,898</b>	<b>12,116,410</b>	<b>13,526,488</b>	<b>11,031,791</b>

During 2010 the Company entered into a Memorandum of Understanding with the Bermuda Government to extend its pipeline from Lighthouse Road in Southampton westwards to the Government's water treatment plant and reservoir at Tudor Hill, Southampton. At December 31, 2010 expenditure totaling \$1,472,205 had been incurred on this project which is included in capital expenditure as construction in progress. It is estimated that further expenditure of \$1,425,000 will be incurred in completing this project in 2011. This represents the Company's only capital commitment at December 31, 2010 and will be met from operations.

At December 31, 2010, construction in progress also includes \$107,000 incurred for initial evaluation costs for development of the Company's property.

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements

December 31, 2010

### 4. Shareholders' equity

	2010 \$	2009 \$
Authorised - 2,000,000 shares of the par value of \$1.00 each	2,000,000	2,000,000
Issued and fully paid - 1,055,359 (2009 - 1,054,919) shares of the par value of \$1.00 each	1,055,359	1,054,919

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, 2010 was \$18.78 (2009 - \$17.20).

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

	Share capital \$	Share premium \$	Capital reserve \$	General reserve \$	Retained earnings \$	Total \$
Balance, December 31, 2008	1,053,579	1,358,206	7,000,000	1,000,000	5,689,098	16,100,883
Net income for the year	-	-	-	-	2,454,912	2,454,912
Issuance of shares (note 4 (b))	1,340	11,690	-	-	-	13,030
Dividend paid	-	-	-	-	(421,648)	(421,648)
Balance, December 31, 2009	1,054,919	1,369,896	7,000,000	1,000,000	7,722,362	18,147,177
Net income for the year	-	-	-	-	2,107,701	2,107,701
Issuance of shares (note 4 (b))	440	4,042	-	-	-	4,482
Dividend paid	-	-	-	-	(443,174)	(443,174)
Balance December 31, 2010	1,055,359	1,373,938	7,000,000	1,000,000	9,386,889	19,816,186

#### (b) 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 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, 2010, employees subscribed for and were issued 440 common shares for proceeds of \$4,482 (2009 - 1,340 shares for proceeds of \$13,030). The excess of the purchase price over the par value of the shares is recorded as share premium (see (c) below).

#### (c) Share premium

The share premium balance relates to the excess of the purchase price over par value of shares of the Company.

#### (d) 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.

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements

December 31, 2010

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(e) **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. *Financial instruments*

The estimated fair values of the Company's cash and cash equivalents, investments, accounts receivable, accounts payable and accrued liabilities and deposits held approximate their carrying values.

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, investments and accounts receivable.

Cash and cash equivalents and investments consist mainly of cash deposits. The Company has deposited the cash and cash equivalents and investments with reputable financial institutions, from which management believes the risk of loss to be remote.

The Company's credit risk with respect to its accounts receivable is minimised by the Company's large customer base, which covers consumer and business sectors in Bermuda. The Company follows a programme 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:

	2010 \$	2009 \$
Accounts receivable	1,268,704	1,021,282
Allowance for doubtful debts	(147,800)	(172,237)
	1,120,904	849,045

### 6. *Inventories*

	2010 \$	2009 \$
Spares and production parts	776,342	783,449
Goods for resale	341,082	333,952
Water bottling supplies	102,606	72,766
Inventory provision	(54,296)	(62,898)
	1,165,734	1,127,269

The cost of inventories recognised as an expense and included in plant operation and distribution expenses is \$581,536 (2009 - \$604,619).

### 7. *Capital disclosures*

The Company's objectives in managing capital are to ensure sufficient liquidity to enable the internal financing of capital projects and working capital needs, thereby facilitating its expansion, to maintain a strong capital base so as to maintain investor, creditor and market confidence and to provide an adequate return to shareholders.

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements

December 31, 2010

The Company's capital is comprised of shareholders' equity. The Company's primary uses of capital are to fund increases in non-cash working capital, along with capital expenditure for new production processes and distribution networks. The Company currently funds these requirements out of its internally generated cash flows. The Board of Directors does not establish quantitative return on capital criteria for management, but rather promotes year-over-year sustainable profitable growth. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders. The Company is not subject to any externally imposed capital requirements.

### 8. Segmentation disclosures

#### (a) Description

The principal activity of the Company is the production and distribution of water. There are two primary revenue earning divisions, the Utility Division and the Bottled Water Division. The Utility Division distributes drinking water through a network of underground pipelines to the central and western parishes of Bermuda. The Bottled Water Division manufactures the Pure Water product which is distributed throughout Bermuda and is sold in supermarkets and grocery stores and from the Company's premises and is also delivered directly to customers' premises.

#### (b) Income and expenditure by division

	2010				2009			
	Utility \$	Bottled Water \$	Other \$	Total \$	Utility \$	Bottled Water \$	Other \$	Total \$
<b>Revenue</b>								
External revenues	6,205,352	3,659,325	410,071	10,274,748	6,241,063	3,752,222	461,693	10,454,978
Intersegment revenues	58,162	-	-	58,162	53,656	-	-	53,656
Rentals	-	-	69,079	69,079	-	-	82,815	82,815
Interest	-	-	33,995	33,995	-	-	63,366	63,366
Total revenue	6,263,514	3,659,325	513,145	10,435,984	6,294,719	3,752,222	607,874	10,654,815
<b>Expenditures</b>								
External costs	3,700,978	2,818,048	676,863	7,195,889	3,815,608	2,648,970	687,356	7,151,934
Depreciation	882,293	56,847	135,092	1,074,232	792,142	79,345	122,826	994,313
Intersegment expenditure	-	58,162	-	58,162	-	53,656	-	53,656
Total expenditure	4,583,271	2,933,057	811,955	8,328,283	4,607,750	2,781,971	810,182	8,199,903
Net earnings by division (segment)	1,680,243	726,268	(298,810)	2,107,701	1,686,969	970,251	(202,308)	2,454,912

External revenues for the Utility Division include connection fees and for the Bottled Water Division sales and rentals of coolers and related equipment are included. Intersegment revenues and expenditure refer to water supplied by the Utility Division to the Bottled Water Division and further processed to make the Pure Water product. This supply is billed at normal business rates.

Administrative costs have been charged to reporting segments on an actual basis wherever possible. The residue of non-allocable administrative expenditure is allocated to segments on an estimated usage basis.

# Watlington Waterworks Limited

## Notes to Consolidated Financial Statements

December 31, 2010

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(c) **Non-reportable segments**

Revenue includes sales from the Company's plumbing supplies retail outlet, external rentals from the Company's properties and interest on invested funds. Expenditure includes the operating costs of the Plumbing Store, depreciation on equipment used jointly by all divisions of the Company, e.g. computer hardware and software, and unallocated administrative costs.

(d) **Assets and expenditure on capital assets by division (segment)**

Total assets for reportable segments was \$15,236,163 (2009 - \$12,313,191). This is comprised as follows:

	2010 \$	2009 \$
Utility	14,574,540	11,635,900
Bottled Water	661,623	677,291
	<u>15,236,163</u>	<u>12,313,191</u>

Expenditure on capital assets for reportable segments is as follows:

	2010 \$	2009 \$
Utility	3,395,606	873,821
Bottled Water	5,906	17,091
	<u>3,401,512</u>	<u>890,912</u>

(e) **Reconciliation of revenues, assets and capital asset expenditure**

	2010 \$	2009 \$
(i) <b>Revenues</b>		
Total revenue for reportable segments	9,922,839	10,046,941
Other revenues	513,145	607,874
Elimination of intersegment revenues	(58,162)	(53,656)
Total revenues	<u>10,377,822</u>	<u>10,601,159</u>
(ii) <b>Assets</b>		
Total assets for reportable segments	15,236,163	12,313,191
Other assets	6,219,423	6,593,168
Total assets	<u>21,455,586</u>	<u>18,906,359</u>
(iii) <b>Capital asset expenditure</b>		
Total capital asset expenditure for reportable segments	3,401,512	890,912
Other capital asset expenditure	167,416	87,516
Total capital asset expenditure	<u>3,568,928</u>	<u>978,428</u>