Company Registration No. 4677985

ARTESIAN FINANCE II PLC

Report and Financial Statements

Year ended 31 March 2007

ARTESIAN FINANCE II PLC

REPORT AND FINANCIAL STATEMENTS 2007

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REPORT AND FINANCIAL STATEMENTS 2007

OFFICERS AND PROFESSIONAL ADVISORS

DIRECTORS

Jonathan Vickers
Capita Trust Corporate Services Limited

SECRETARY

Capita Trust Secretaries Limited
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

REGISTERED OFFICE

Phoenix House
18 King William Street
London
EC4N 7HE

BANKERS

The Royal Bank of Scotland plc
Corporate Banking
8th Floor
135 Bishopsgate
London EC2M 3UR

AUDITORS

Deloitte & Touche LLP
London

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements for Artesian Finance II plc ("the Company") for the year ended 31 March 2007

ACTIVITIES

The principal activity of the Company is to hold loans advanced to water companies

The Company is authorised to issue loans and bonds up to £500,000,000 (2006 £500,000,000) The Company has no intention to change the business activities

REVIEW OF DEVELOPMENTS

The Company was incorporated in Great Britain and commenced operations on 25 February 2003 It is registered as a public limited company under the Companies Act 1985

The loan portfolio of the Company consists of fixed rate and index-linked loans, which are funded by fixed rate bonds A total return swap was entered by the Company to exchange index-linked interest it receives on the loans for the fixed coupon amount payable on the bond Net interest income is a key performance indicator for the Company Due to the effects of indexation, net interest income for 2007 has increased by 6 25% which is in line with expectations

PAYMENT TO SUPPLIERS

Given the nature of the business, there are no trade creditors and therefore no policy or trade creditor days have been disclosed

RESULTS AND DIVIDENDS

The results for the year and the state of the Company's affairs as at 31 March 2007 are set out in the accompanying financial statements The Directors do not recommend the payment of a dividend (2006 £nil)

RISK MANAGEMENT POLICIES

The company's risk management policies are stated in Note 10

DIRECTORS

The Directors who served throughout the year are as follows

Jonathan Vickers
Capita Trust Corporate Services Limited

EMPLOYEES

The Company had no employees in the current year or prior period

DIRECTORS' REPORT (continued)

AUDITORS

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting

DISCLOSURE OF INFORMATION TO AUDITORS

Each of the persons who is a director at the date of approval of this report confirms that

(1) so far as the director is aware, there is no relevant audit information of which the Company s auditors are unaware, and

(2) the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of S234ZA of the Companies Act 1985

Approved by the Board of Directors
and signed on behalf of the Board
Director

Name Capita Trust Corporate Services Limited
(Director)

Date 13/12/07 .

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year The directors are required by the IAS Regulation to prepare the group financial statements under IFRSs (IFRSs) as adopted by the European Union The financial statements are also required by law to be properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements' In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs However, directors are also required to

- properly select and apply accounting policies,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information, and
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ARTESIAN FINANCE II PLC

We have audited the financial statements of Artesian Finance II plc for the year ended 31 March 2007, which comprise the income statement, the balance sheet, the statement of changes in equity, the cash flow statement and the related notes numbered 1 to 12 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of Directors and Auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any further information outside the Annual Report

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with those IFRSs as adopted by the European Union, of the state of the company s affairs as at 31 March 2007 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

London

14th December 2007

INCOME STATEMENT
For the year ended 31 March 2007

	Note	2007 £'000	2006 £'000
Interest income	3	20,791	20,093
Interest expense		(20,757)	(20,061)
Net interest income		34	32
Operating expenses	4	(57)	(65)
Other operating income	4	45	82
Change in fair value of loans	10	33,368	26,744
Change in fair value of bonds	10	20,516	(25,890)
Change in fair value of swaps	10	(53,850)	(338)
OPERATING PROFIT AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	5	56	565
Tax on profit on ordinary activities	6	(108)	(12)
(LOSS)/ PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		(52)	553

The accompanying notes are an integral part of this profit and loss account

The results above arose wholly from continuing operations in the current and prior year

BALANCE SHEET
At 31 March 2007

	Note	2007 £'000	2006 £'000
NON-CURRENT ASSETS			
Loans to customers	10	491,518	458,150
CURRENT ASSETS			
Cash at bank	10	221	204
TOTAL ASSETS		491,739	458,354
CURRENT LIABILITIES			
Trade creditors and other payables	7	(25)	(27)
NON-CURRENT LIABILITIES			
Bonds issued maturing after more than one year	10	(396,943)	(417,459)
Derivatives at fair value	10	(93,860)	(40,010)
Deferred tax liability	6	(105)	-
		(490,908)	(457,469)
TOTAL LIABILITIES		(490,933)	(457,496)
NET ASSETS		806	858
EQUITY			
Share capital	8	13	13
Retained earnings	9	793	845
EQUITY SHAREHOLDERS' FUNDS		806	858

These financial statements were approved and authorised for issue by the Board of Directors on 13/12/07

Signed on behalf of the Board of Directors

Director

Name Capita Trust Corporate Services Limited (Director)

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 March 2007

	Share capital £'000	Accumulated profit £'000	Total £'000
Balance at 1 April 2005	13	292	305
Profit for the financial year	-	553	553
Balance at 1 April 2006	13	845	858
Profit for the financial year	-	(52)	(52)
Balance at 31 March 2007	13	793	806

CASH FLOW STATEMENT
For the year ended 31 March 2007

	Notes	2007 £'000	2006 £'000
Operating profit		56	565
Adjustments for			
Derivatives at fair value	10	53,850	338
Fair value of loans	10	(33,368)	(26,744)
Fair value of bonds	10	(20 516)	25 890
Net cash inflow from trading activities		22	49
Changes in operating assets		-	40
Changes in operating liabilities		3	(67)
Net cash flows from operating activities before tax		25	22
Tax paid		(8)	(6)
Net cash flows from operating activities after tax		17	16
Investing activities			
Loans advanced		-	(112,377)
Net cash flows from investing activities		-	(112,377)
Financing activities			
Issue of bonds		-	112,377
Net cash flows from financing activities		-	112,377
Net increase in cash and cash equivalents		17	16
Cash and cash equivalents at the beginning of the year		204	188
Cash and cash equivalents at the end of the year		221	204

The accompanying notes form an integral part of this cash flow statement

NOTES TO THE ACCOUNTS
For the year ended 31 March 2007

1. ACCOUNTING POLICIES

A summary of the principal accounting policies, all of which have been applied consistently throughout the current year, are set out below

General information

Artesian Finance II PLC (the Company") is a company incorporated in the United Kingdom under the Companies Act 1985 The nature of the Company's operations and its principal activities are set out in the Directors' Report

Basis of accounting

The financial statements have been prepared in accordance with IFRSs adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation

The financial statements have been prepared on the historical cost basis as modified by International Accounting Standard 39 'Financial Instruments Recognition and Measurement" (IAS 39") for financial instruments held at fair value

Due to the fact that the nature of the business is to provide finance, the directors are of the opinion that it is more appropriate to use interest income and interest expense rather than turnover and cost of sales in preparing the income statement

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective

- IFRS 7 — Financial Instruments Disclosures, and the related amendments to IAS 1 on capital disclosures
- IFRS 8 — Operating Segments
- IAS 1 — Presentation of Financial Statements
- IFRIC 10 — Interim Reporting and Impairments
- IFRIC 11 — IFRS 2 – Group and Treasury Share Transactions
- IFRIC 12 — Service Concession Arrangements
- IFRIC 13 — Customer Loyalty Programmes
- IFRIC 14 — IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Company except for additional disclosures on capital and financial instruments when the relevant standards come into effect for the year ending 31 March 2008

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expense, in particular over recoverability of assets The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements on carrying values of assets and liabilities that are not readily apparent from other sources Actual results may differ from the estimates used in the financial statements

The estimates and underlying assumptions are reviewed on an ongoing basis Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both the current and future periods

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

1 ACCOUNTING POLICIES (CONTINUED)

Loans to customers

The loans have been designated at fair value through profit or loss and are accounted for at fair value

Bonds

The bonds issued have been designated at fair value through profit or loss and are accounted for at fair value

Derivatives

The company does not enter into speculative derivative contracts Derivative financial instruments are recorded at fair value, with any gain or loss on re-measurement being recognised in the Income Statement

Revenue recognition

Financial assets and financial liabilities are recorded at fair value Changes in fair value are recognised in profit or loss together with dividends and interest receivable and payable All investment income arises in the United Kingdom

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date Timing differences are differences between the company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date Deferred tax assets and liabilities are not discounted

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

2. DIRECTORS AND EMPLOYEES

None of the Directors received any emoluments for their services to the Company during the year (2006 £nil)

None of the Directors have any interests in the Company as at the year end (2006 £ nil)

None of the Directors had any material interest in any contract of significance in relation to the business of the Company (2006 £ nil)

The Company does not have any employees (2006 none)

3. INTEREST INCOME

	2007 £'000	2006 £'000
Interest income on loans	13,939	13,318
Interest received on swaps	6,852	6,775
	20,791	20,093

4 OPERATING EXPENSES

	2007 £'000	2006 £'000
Administrative expenses incurred	57	65
Other Operating Income (expenses recharged)	(45)	(82)
	12	(17)

5 OPERATING PROFIT AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2007 £'000	2006 £'000
The profit on ordinary activities before taxation is stated after charging		
Auditors' fees for the audit of the Company s accounts	23	18

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

6. TAXATION

The difference between total current tax shown on the face of the Income Statement and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows

a) Tax on profits on ordinary activities

	2007 £'000	2006 £'000
Current tax		
UK Corporation tax at 19% (2006 19%)	4	9
Adjustments in respect of prior years	(1)	3
Current tax charge for the year	3	12

	2007 £'000	2006 £ 000
Deferred tax		
Temporary differences on revaluation of financial instruments	6	-
Adjustments in respect of prior years	99	-
	105	-
Total tax charge as per income statement	108	12

b) Reconciliation of the total tax charge

The tax charge for the year on the profit from continuing operations is more than the notional tax charge on those profits calculated at the UK corporation tax rate of 19% The differences are explained below

	2007 £ 000	2006 £ 000
Profit before tax	56	565
Profit before tax multiplied by the applicable rate of corporation tax at 19% (2006 19%)	10	108
Effects of		
Other permanent differences	-	(99)
Adjustments in respect of prior years	98	3
Total tax charge for the year	108	12

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

c) Deferred tax

Deferred tax (asset)/ liability

	2007 £ 000	2006 £ 000
Balance brought forward	-	-
Arising on fair value adjustments in financial instruments at 19%	105	-
Balance carried forward	105	-

7 CURRENT LIABILITIES

	2007 £'000	2006 £'000
Other creditors	21	18
Corporation tax creditor	4	9
	25	27

8 SHARE CAPITAL

	2007 £	2006 £
Authorised		
50,000 (2006 50,000) ordinary shares of £1 each	50,000	50,000
Called up, allotted and partly paid		
50,000 (2006 50,000) ordinary shares paid up at 25p each	12,500	12,500

49,999 shares of the Company are held by Capita IRG Trustees Limited under a Charitable Trust and one share by Capita Trust Company Limited under a Charitable Trust These shares were issued on 1 March 2003 for consideration of 25p cash each

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

9 RETAINED EARNINGS

	2007 £'000	2006 £'000
At start of year	845	292
Retained profit for year	(52)	553
At end of year	793	845

10. FINANCIAL INSTRUMENTS

The Company's financial instruments principally comprise loans advanced to water companies, bonds issued, total return swap contracts, cash, accrued interest income, accrued interest payable and other items arising directly from the Company's operations

It is and has been throughout the year the Company's policy that no trading in financial instruments shall be undertaken

Credit risk

The main risk arising from the Company's financial instruments is credit risk This risk has been mitigated though a facility with Financial Security Assurance (U K) Limited, which provides default insurance over the loans advanced

Liquidity risk

The Company has entered into total return swaps which are backed by loans to borrowers In order to ensure that the Company has sufficient cash at maturity to redeem the bonds, the swaps pay any difference between the principal repayment from the borrower and the total amount due to the bond holders

Interest rate risk

The Company finances its operations through the issue of bonds at a fixed rate of 6 00% The loan to Bristol water company carries a fixed rate of interest of 6 01% The loans to Southern, BWHW and Mid Kent carry a fixed rate of interest of 4 076%, 3 0837% and 2 8010% respectively, adjusted for RPI indexation on a semi-annual basis However the company has entered into a total return swap in which the company exchanges the indexation-linked interest it receives on the loans for the fixed coupon amount payable on the bond, hence no interest rate risk exists The loans mature on 30 September 2033

Foreign exchange risk

All transactions and financial instruments are denominated in sterling and consequently no currency exposure arises

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

10 FINANCIAL INSTRUMENTS (continued)

Maturity of financial assets and liabilities

The maturity profile of the Company s financial assets at 31 March was as follows

	2007 £'000	2006 £'000
In one year or less, or on demand	14,058	19,594
In more than one year but not more than two years	13,521	12,502
In more than two years but not more than five years	38,529	35,638
In more than five years	425,631	390,620
	491,739	458,354

The maturity profile of the Company s financial liabilities at 31 March was as follows

	2007 £'000	2006 £'000
In one year or less, or on demand	9,675	13,002
In more than one year but not more than two years	9,959	8,841
In more than two years but not more than five years	30,834	27,313
In more than five years	440,335	408,313
	490,803	457,469

Fair values of financial assets and financial liabilities

The comparison of book and fair values of all the Company's financial instruments is set out below For the fixed rate bonds issued, market values have been used to determine fair values For other financial instruments where no market values are available, fair values have been calculated by discounting cash flows at prevailing interest rates In the calculation of discount factors for the fixed rate and RPI linked loans, a spread consistent with that on the fixed rate bonds issued has been applied RPI linked cash flows have been forecast using rates derived from Sterling Index Linked Gilts

	Opening fair value £'000	Additions at cost £'000	Movement in fair value £'000	Closing fair value £'000
Cash at bank	204	17	-	221
Loans to customers - fixed rate	69,475	-	(3,414)	66,061
Loans to customers – RPI indexed	388,675	-	36 782	425,457
Fixed rate bonds	(417,459)	-	20,516	(396,943)
Total return swaps	(40 010)	-	(53,850)	(93,860)
	885	17	34	936

NOTES TO THE ACCOUNTS (Continued)
For the year ended 31 March 2007

11 RELATED PARTY TRANSACTIONS

There have been no related party transactions during the year (2006 £nil)

12. ULTIMATE PARENT AND CONTROLLING PARTY

The ultimate parent company and controlling party is Capita IRG Trustees Limited which holds a majority shareholding under the terms of a declaration of a Charitable Trust