

**Company Registration No. 4677985**

**ARTESIAN FINANCE II PLC**

**Annual Report and Financial Statements**

Year ended 31 March 2020

# ARTESIAN FINANCE II PLC

## ANNUAL REPORT AND FINANCIAL STATEMENTS 2020

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# **ARTESIAN FINANCE II PLC**

## **ANNUAL REPORT AND FINANCIAL STATEMENTS 2020**

### **OFFICERS AND PROFESSIONAL ADVISERS**

#### **DIRECTORS**

Colin Benford  
Apex Trust Corporate Limited  
Apex Corporate Services (UK) Limited

#### **SECRETARY**

Apex Trust Corporate Limited  
6th Floor  
125 Wood Street  
London  
United Kingdom  
EC2V 7AN

#### **REGISTERED OFFICE**

125 Wood Street  
London  
United Kingdom  
EC2V 7AN

#### **BANKERS**

The Royal Bank of Scotland plc  
Corporate Banking  
5th Floor  
250 Bishopsgate  
London  
United Kingdom  
EC2M 4AA

#### **AUDITOR**

Ernst & Young LLP  
25 Churchill Place  
Canary wharf  
London  
United Kingdom  
E14 5EY

# ARTESIAN FINANCE II PLC

## STRATEGIC REPORT

The “Directors” present their strategic report for Artesian Finance II plc (“the Company”) for the year ended 31 March 2020.

### ACTIVITIES

The Company was incorporated in the United Kingdom and commenced operations on 25 February 2003. It is registered as a public limited company under the Companies Act 2006.

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

### PRINCIPAL ACTIVITY

The Company is authorised to issue loans and bonds up to £500,000,000 (2019: £500,000,000) (“the Bonds”). The Company has no intention to change the business activities. The Bonds are unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest under the terms of a guarantee issued by Assured Guaranty (Europe) Plc (formerly Financial Security Assurance (U.K.) Limited).

### BUSINESS REVIEW

The loan portfolio of the Company consists of two fixed rate and three UK Retail Price Index (“RPI”) linked loans which were funded through the issuance of the fixed rate bonds. Total return swaps were entered into by the Company to exchange RPI linked cash flows it receives on the loans for the fixed coupon amount payable on the Bonds. The total net fair value increase on the bonds, total return swaps and loans is £9,000 (2019: £42,000 decrease). Total assets are the key performance indicator for the Company. The total assets for 2020 are £813,019,000 (2019: £793,167,000).

### PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks facing the Company are liquidity risk, interest rate risk and credit risk. These risks have been monitored on an ongoing basis during the period and the Company has policies in place to mitigate these risks to enable it to continue as a going concern. Refer to note 1 of the Financial Statements for details.

The existence of a new coronavirus (COVID-19) was confirmed in early January 2020. Since then the coronavirus has spread across China and to a significant number of other countries, causing ongoing disruption to businesses and economic activity.

There remains significant uncertainty regarding the developments of the pandemic and the future economic recovery. We have assessed the impact of Covid-19 on the Company’s financial statements. The Company’s assets are comprised of fixed rate and RPI linked loans to UK incorporated water companies, which are collateralised to listed fixed rate bonds. The most likely expected financial impact is in respect of the loans advanced by the Company. This impact is not expected to be significant given that a guarantee is provided by Assured Guaranty (Europe) Plc, which unconditionally and irrevocably guarantees all scheduled payments of principal and interest throughout the life of all related bonds issued.

Further, we have considered the existence of total return swaps and our assessment of financial performance of the underlying water companies and their liquidity position, which has mitigated the uncertainties associated with Covid-19 including the different ways in which this could impact the cash flows, solvency and liquidity position of the Company.

Based on this assessment, the Directors have a reasonable expectation that there is no material impact of Covid-19 on the Company’s financial instruments valuation or liquidity and the Company has adequate resources to continue in operational existence for at least 12 months from the date of approval of these financial statements and have prepared the financial statements on a going concern basis.

We continue to monitor the impact of Covid-19 on the Company.

Notwithstanding the risks and uncertainties above, the financial statements have been prepared on the going concern basis as discussed in Note 1.

**STRATEGIC REPORT (CONTINUED)**

**Credit risk**

The main risk arising from the Company's financial instruments is credit risk. The Company faces the credit risk that the borrowers might not be able to meet their obligations as they fall due. The Company has purchased a guarantee over the principal and the interest due on the bonds from Assured Guaranty (Europe) Plc, who are currently rated by Standard & Poor's at AA.

The maximum exposure to credit risk arising on the Company's financial assets as at the reporting date and prior year end is the Statement of Financial Position amount. No loans are past due or impaired at the year-end or prior year-end.

**Liquidity risk**

Liquidity risk is the risk that the Company is unable to meet its obligations as they fall due.

Funding has been obtained through the issue of bonds.

Liquidity risk is mitigated by both matching the timing of receipts and payments on the loans and derivative with the obligations on the bonds and having in place a guarantee to ensure that its obligations on the bonds can be met.

**Interest rate risk**

Interest rate risk is managed by matching the interest terms of the bonds issued with the loans held. Total return swaps were entered into by the Company to exchange index-linked cash flows it receives on its loan assets for the fixed coupon amount payable on the bonds. The swap counterparties continue to have high credit ratings; therefore no significant interest rate risk issues are noted.

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



Colin Benford  
Director

Date: 23 September 2020

# ARTESIAN FINANCE II PLC

## DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements of the Company for the year ended 31 March 2020.

### RESULTS AND DIVIDENDS

The results for the year and the state of the Company's affairs as at 31 March 2020 are set out in the accompanying financial statements. The Directors do not recommend the payment of a dividend (2019: Nil).

### DIRECTORS

The Directors who served throughout the year are as follows:

Colin Benford  
Apex Trust Corporate Limited  
Apex Corporate Services (UK) Limited

None of the Directors has any beneficial interest in the Company (2019: Nil).

### EMPLOYEES

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

### DIRECTORS' INDEMNITIES

Apex Trust Corporate Limited provided third party indemnity provisions for the benefit of Colin Benford during the year. These indemnity provisions remain in force at the date of this report.

### CORPORATE GOVERNANCE

The Board of Directors has overall responsibility for the Company's internal controls systems and risk control which are managed in accordance with the terms of the Bonds issued, as described in the Offering Circular for the Bonds. These are monitored through regular meetings of the Board.

### FUTURE DEVELOPMENTS

The Directors do not anticipate any changes to the present level of activity or the nature of the Company's business in the near future.

### AUDITOR

Ernst & Young LLP has expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

### GOING CONCERN

The Company's business activities, performance and position, as well as principal risks and uncertainties are set out on page 2. In addition, note 1 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

The Company has met its level of expected results for the financial period, and determined that its assets are performing as at the Statement of Financial Position date and therefore does not expect a shortfall in cash receipts from the borrowers. As at the Statement of Financial Position date, the Company has net assets of £1,206,000 (2019: £1,175,000). Currently the long-term assets are funded by long-term fixed rate bonds.

Total return swaps were entered into by the Company to exchange index-linked cash flows it receives on its loan assets for the fixed coupon amount payable on the Bonds. The swap counterparties continue to have high credit ratings; therefore no significant credit issues are noted. In order to protect the Company and the bond holders in the event of a shortfall of funds available to pay amounts on the Bonds, the Company has purchased a guarantee over the principal and the interest due on the bonds from Assured Guaranty (Europe) Plc, who are currently rated by Standard & Poor's at AA.

After making enquiries, and considering the uncertainties set out on page 2, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for at least 12 months from the date of approval of these financial statements. For these reasons, they continue to adopt the going concern basis in preparing the Annual Report and Financial Statements.

**DIRECTORS' REPORT (CONTINUED)**

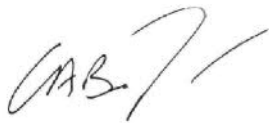
**DISCLOSURE OF INFORMATION TO THE AUDITOR**

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 auditor is 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 auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

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



Colin Benford  
Director

Date: 23 September 2020

**DIRECTORS' RESPONSIBILITIES STATEMENT**

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

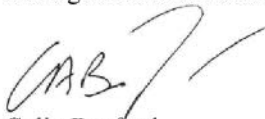
Company law requires the Directors to prepare a Strategic Report, Directors' Report and financial statements for each financial year. Under that law, the Directors have elected to prepare the financial statements in accordance with FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland; and must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs at the end of the year and the profit or loss of the Company for that year. In preparing these financial statements, the Directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- state whether FRS 102 has been followed; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and 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 2006. 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.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

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



Colin Benford

Director

Date: 23 September 2020



# ARTESIAN FINANCE II PLC

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ARTESIAN FINANCE II PLC

### Opinion

We have audited the financial statements of Artesian Finance II Plc ('the Company') for the year ended 31 March 2020 which comprise the Statement of comprehensive income, the Statement of financial position, the Statement of changes in equity, Statement of cash flows, and the related notes 1 to 13, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 31 March 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

### Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"><li>• The calculation of the fair value of loans and bonds is subject to the risk of management override as it includes a high degree of subjectivity in the fair value model and depends on assumptions used by management.</li></ul>
Materiality	<ul style="list-style-type: none"><li>• Overall materiality of £4.07m which represents 0.5% of Total assets.</li></ul>

**Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to those charged with governance
<p><b>The calculation of the fair value of loans and bonds is subject to the risk of management override as it includes a high degree of subjectivity in the fair value model and depends on assumptions used by management.</b></p>		
<p>We consider inappropriate valuation of financial instruments held at fair value and related revenue recognition as a fraud risk. Based on our assessment of the level of management judgement involved in selection of valuation techniques/models and relevant inputs, the following instruments were classified as part of the fraud risk:</p> <ul style="list-style-type: none"> <li>• Loans advanced to water companies (£811m as at 31 March 2020 and £791m as at 31 March 2019)</li> <li>• Bonds issued (£517m as at 31 March 2020 and £498m as at 31 March 2019)</li> <li>• Total return swap derivative financial instruments (net value of £293m as at 31 March 2020 and £292m as at 31 March 2019)</li> </ul> <p>Our assessment of the fraud risk did not change compared to the previous year as there were no significant changes in the Company's activities.</p>	<p>We performed a walkthrough to confirm our understanding of the Company's process and adequacy of controls in the area of relating to financial instruments. We applied a fully substantive approach to our audit due to limited number of transactions performed by the Company in the year ended 31 March 2020.</p> <p>We involved our valuation and modelling specialists to:</p> <ul style="list-style-type: none"> <li>• Independently re-value the loans advanced to water companies using prices of comparable positions and other data points.</li> <li>• Assess the appropriateness of the valuation techniques and significant assumptions used to determine the fair value of bonds issued.</li> <li>• Independently re-value the total return swap derivatives using independent data and taking into account an underlying reference curve in calibrating the bond price (Z-spread).</li> <li>• Perform corroborative calculations to understand the impact on value of certain key assumptions adopted by management</li> </ul>	<p>We are satisfied that the fair value of financial instruments and the recognition of related income is fairly stated, in all material respects, and in accordance with FRS 102.</p>

## **ARTESIAN FINANCE II PLC**

### **An overview of the scope of our audit**

#### **Tailoring the scope**

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

#### **Changes from the prior year**

There were no changes to the scope of our audit compared to the prior year.

#### **Our application of materiality**

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

#### **Materiality**

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the company to be £4.07 million (2019: £3.96 million), which is 0.5% (2019: 0.5%) of Total assets. We believe that the use of total assets is an appropriate basis for the audit materiality as (i) the primary users of the financial statements, i.e., the investors who hold the Bonds issued by the Company, are focused on the valuation of the underlying assets that form the main source for repaying the Bonds issued and (ii) revenue/profit measures are less relevant given the nature of Company's activities (i.e., pass through structure).

During the course of our audit, we reassessed initial materiality and did not apply significant changes to the calculation.

#### **Performance materiality**

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality was 50% (2019: 50%) of our planning materiality, namely £2.0m (2019: £2.0m). We have set performance materiality at this percentage due to the change in the financial reporting framework and change in the finance team responsible for the preparation of the financial statement.

#### **Reporting threshold**

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with those charged with governance that we would report to them all uncorrected audit differences in excess of £203k (2019: £198k), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

## ARTESIAN FINANCE II PLC

### Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

### Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

### Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

### Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

## ARTESIAN FINANCE II PLC

### Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the company and determined that the most significant are:
  - UK Companies Act
  - Tax legislation (governed by HM Revenue and Customs)
- We understood how Artesian Finance II plc is complying with those frameworks by inquiring as to any known instances of non-compliance or suspected non-compliance with laws and regulations.
- We assessed the susceptibility of the company's financial statements to material misstatement, including how fraud might occur by holding discussion with management.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management as well as reviewing correspondence exchanged with the relevant authorities.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

### Other matters we are required to address

- We were appointed by the company on 29 September 2017 to audit the financial statements for the year ending 31 March 2017 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 4 years, covering the years ending 31 March 2017 to 31 March 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit. The audit opinion is consistent with the additional report to those charged with governance.

### Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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.

*Ernst & Young L.L.P.*

**JeanPhilippe Jacques Faillat** (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London  
Date: 24 September 2020

# ARTESIAN FINANCE II PLC

## STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2020

	Note	2020 £'000	2019 £'000
Interest income	3	20,804	20,803
Interest expense		(20,757)	(20,757)
Net interest income		47	46
Operating expenses	4	(75)	(84)
Other operating income		59	59
Change in fair value of loans	11	20,092	21,557
Change in fair value of bonds	11	(19,138)	(1,173)
Change in fair value of swaps	11	(945)	(20,427)
<b>PROFIT/(LOSS) FOR THE YEAR BEFORE TAXATION</b>		40	(22)
Tax charge	6	(9)	(9)
<b>TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR</b>		31	(31)

The accompanying notes from pages 16 to 24 are an integral part of these financial statements.

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

# ARTESIAN FINANCE II PLC

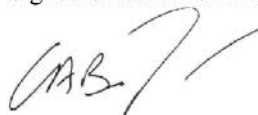
## STATEMENT OF FINANCIAL POSITION As at 31 March 2020

	Note	2020 £'000	2019 £'000
<b>NON-CURRENT ASSETS</b>			
Loans to customers	7	791,954	772,215
<b>CURRENT ASSETS</b>			
Loans to customers	7	18,800	18,447
Cash and cash equivalents		546	518
Derivatives at fair value	11	1,719	1,987
		<u>21,065</u>	<u>20,952</u>
<b>TOTAL ASSETS</b>		<u>813,019</u>	<u>793,167</u>
<b>CURRENT LIABILITIES</b>			
Other payables	8	54	48
Tax liabilities	6	9	9
Bonds issued	9	20,474	20,390
		<u>20,537</u>	<u>20,447</u>
<b>NON-CURRENT LIABILITIES</b>			
Bonds issued	9	496,731	477,677
Derivatives at fair value	11	294,545	293,868
		<u>791,276</u>	<u>771,545</u>
<b>TOTAL LIABILITIES</b>		<u>811,813</u>	<u>791,992</u>
<b>NET ASSETS</b>		<u>1,206</u>	<u>1,175</u>
<b>EQUITY</b>			
Share capital	10	13	13
Retained earnings		1,193	1,162
<b>TOTAL EQUITY</b>		<u>1,206</u>	<u>1,175</u>

The accompanying notes from pages 16 to 24 are an integral part of these financial statements.

These financial statements of Artesian Finance II plc, registration number 4677985, were approved and authorised for issue by the Board of Directors on 23 September 2020.

Signed on behalf of the Board of Directors



Colin Benford  
Director

Date: 23 September 2020

**STATEMENT OF CHANGES IN EQUITY**  
**For the year ended 31 March 2020**

	<b>Share capital</b> <b>£'000</b>	<b>Retained</b> <b>earnings</b> <b>£'000</b>	<b>Total</b> <b>£'000</b>
<b>Balance at 01 April 2018</b>	13	1,193	1,206
Total comprehensive loss for the financial year	-	(31)	(31)
<b>Balance at 31 March 2019</b>	13	1,162	1,175
Total comprehensive income for the financial year	-	31	31
<b>Balance at 31 March 2020</b>	13	1,193	1,206

The accompanying notes from pages 16 to 24 are an integral part of these financial statements.



**STATEMENT OF CASH FLOWS**  
**For the year ended 31 March 2020**

	Note	2020 £'000	2019 £'000
<b>Operating profit/(loss) before taxation</b>		40	(22)
Adjustments for:			
Fair value of swaps	11	(945)	20,427
Fair value of loans	11	20,092	(21,557)
Fair value of bonds	11	(19,138)	1,173
Changes in other payables		(12)	(1)
		<hr/>	<hr/>
<b>Net cash flows from operating activities before tax</b>		37	20
Tax paid		(9)	(9)
		<hr/>	<hr/>
<b>Net cash flows from operating activities after tax</b>		28	11
		<hr/>	<hr/>
<b>Net increase in cash and cash equivalents</b>		28	11
Cash and cash equivalents at the beginning of the year		518	507
		<hr/>	<hr/>
<b>Cash and cash equivalents at the end of the year</b>		546	518
		<hr/>	<hr/>
<b>Supplemental information</b>			
Interest received		20,804	20,803
Interest paid		(20,757)	(20,757)

The accompanying notes from pages 16 to 24 are an integral part of these financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

### 1. ACCOUNTING POLICIES

#### General information

Artesian Finance II plc (“the Company”) is a public company limited by shares incorporated and registered in England in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 1. The nature of the Company’s operations and its principal activities are set out in the Strategic Report.

#### Basis of accounting

The financial statements have been prepared in accordance with Financial Reporting Standard (FRS) applicable in the UK and Republic of Ireland issued by the Financial Reporting Council. The Company has presented its financial statements under Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council. The financial statements have been prepared on a going concern basis as explained below.

#### Going Concern

The existence of a new coronavirus (COVID-19) was confirmed in early January 2020. Since then the coronavirus has spread across China and to a significant number of other countries, causing ongoing disruption to businesses and economic activity.

There remains significant uncertainty regarding the developments of the pandemic and the future economic recovery. We have assessed the impact of Covid-19 on the Company’s financial statements. The Company’s assets are comprised of fixed rate and RPI linked loans to UK incorporated water companies, which are collateralised to listed fixed rate bonds. The most likely expected financial impact is in respect of the loans advanced by the Company. This impact is not expected to be significant given that a guarantee is provided by Assured Guaranty (Europe) Plc, which unconditionally and irrevocably guarantees all scheduled payments of principal and interest throughout the life of all related bonds issued.

Further, we have considered the existence of total return swaps and our assessment of financial performance of the underlying water companies and their liquidity position, which has mitigated the uncertainties associated with Covid-19 including the different ways in which this could impact the cash flows, solvency and liquidity position of the Company.

Based on this assessment, the Directors have a reasonable expectation that there is no material impact of Covid-19 on the Company’s financial instruments valuation or liquidity and the Company has adequate resources to continue in operational existence for at least 12 months from the date of approval of these financial statements and have prepared the financial statements on a going concern basis.

#### Critical accounting judgements

The preparation of financial statements in conformity with FRS 102 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 the estimation of future cash flows on the Loans to customers and Loan notes issued in order to determine the fair value balance of these instruments.

#### Financial instruments

Financial assets and financial liabilities are recognised in the Company’s Statement of Financial Position when the Company becomes a party to the contractual provisions of the instrument.

The Company’s financial instruments comprise Loans to customers, Bond liabilities, derivative financial instruments, cash and creditors, which arise directly from its operations and are part of its principal activity.

Under FRS 102, in accounting for its financial instruments a reporting entity is required to apply either;

- a) the full provisions of Section 11 “Basis Financial Instruments” and Section 12 “Other Financial Instruments” of FRS 102;
- b) the recognition and measurement provisions of International Accounting Standards 39 “Financial Instruments: Recognition and Measurement” (“IAS 39”) and only the disclosure requirements of Sections 11 and 12 of FRS 102; or
- c) the recognition and measurement provisions of International Financial Reporting Standards (“IFRS”) 9 “Financial Instruments” (“IFRS 9”) and the disclosure requirements of Sections 11 and 12 of FRS 102.

The Company has elected to apply the recognition and measurement provisions of IAS 39 and the disclosure requirements of Sections 11 and 12 of FRS 102.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

### 1. ACCOUNTING POLICIES (CONTINUED)

#### Loans to customers

Loans to customers were designated and are accounted for in these financial statements as financial assets 'at fair value through profit or loss' (FVTPL) with any gain or loss on re-measurement being recognised in the statement of comprehensive income. Loans to customers were designated at FVTPL to significantly reduce a measurement or recognition inconsistency that would otherwise arise. Interest earned on the Loans to customers is included in the interest income line item in the statement of comprehensive income. Fair value is determined in the manner described in Note 11.

#### Bonds issued

The Bonds were designated and are accounted for at FVTPL with any gain or loss on re-measurement being recognised in the statement of comprehensive income. The Bonds were designated at FVTPL to significantly reduce a measurement or recognition inconsistency that would otherwise arise. Interest incurred on the Bonds is included in the interest expense line item in the statement of comprehensive income.

#### Fair valuation

The carrying amounts of all the Company's financial instruments equate to their Fair values. For the fixed rate bonds issued, observed market prices (indicative bid and ask observations) 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 and total return swaps, a spread consistent with that implied on the fixed rate bonds issued has been applied.

#### Derivative Instruments

The Company does not enter into speculative derivative contracts. Derivative financial instruments are recorded at FVTPL, with any gain or loss on re-measurement being recognised in the statement of comprehensive income. The derivative instruments are classified as held for trading.

#### Revenue recognition

Financial assets and financial liabilities are recorded at fair value. Changes in fair value are recognised in profit or loss separately from interest income and expense.

#### Segmental analysis

The Directors have determined that the Company has only one reportable operating segment as all the investment income arises in the United Kingdom.

#### Taxation

The Company has elected to be taxed under the 'permanent' tax regime, for securitisation companies (contained in Statutory Instrument 2006/3296), under which the Company is taxed broadly by reference to its net cash flows during the period and not by reference to its accounting profit.

#### Derecognition

The Company derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognised as a separate asset or liability. The Company derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

#### Key sources of estimation uncertainty

The estimates and associated assumptions including credit risk 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

**NOTES TO THE FINANCIAL STATEMENTS**

**For the year ended 31 March 2020**

**1. ACCOUNTING POLICIES (CONTINUED)**

**Key sources of estimation uncertainty (continued)**

making judgements on carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these 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.

**Netting / Offsetting Assessment**

Netting / Offsetting assessment has been performed according to FRS 102. A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when and only when, an entity:

- currently has a legally enforceable right to set off the recognised amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

The Company does not meet any of the criteria mentioned above and therefore, the financial statements have not been presented on a net basis.

**2. DIRECTORS AND EMPLOYEES**

None of the Directors received any emoluments for their services to the Company during the year (2019: nil).

None of the Directors have any interests in the Company as at year end (2019: nil).

None of the Directors had any material interest in any contract of significance in relation to the business of the Company (2019: none).

The Company does not have any employees (2019: none).

**3. INTEREST INCOME**

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Interest income on loans	18,770	18,374
Interest received on swaps	2,034	2,429
	<u>20,804</u>	<u>20,803</u>

**4. OPERATING EXPENSES**

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Administrative expenses incurred	<u>75</u>	<u>84</u>

**5. REMUNERATION OF AUDITOR**

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
<b>Amounts paid or payable to auditor:</b>		
Audit of the Company's accounts:		
Charge for the year*	<u>32</u>	<u>32</u>

\* Audit fees disclosed are exclusive of VAT.

**NOTES TO THE FINANCIAL STATEMENTS**

**For the year ended 31 March 2020**

**6. TAXATION**

a) Tax on profits/(losses)

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Current taxation:		
Charge for the year	9	9
Tax charge for the year	<u>9</u>	<u>9</u>

b) Reconciliation of the total tax charge

The actual tax (credit)/charge differs from the expected tax (credit)/charge computed by applying the standard rate of UK corporation tax of 19% (2019: 19%) as follows:

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Profit/(loss) before tax	<u>40</u>	<u>(22)</u>
Expected tax charge/(credit)	8	(4)
Effects of:		
Adjustment under s14(4) SI 2006/3296	(8)	4
Adjustment under s14(1)(a)(ii) SI 2006/3296	9	9
Total tax charge for the year	<u>9</u>	<u>9</u>

The Company is taxed in accordance with Statutory Instrument No. 3296 'The Taxation of Securitisation Companies Regulations 2006' which requires that tax is charged on the cash profit retained by the issuer. No other amounts are taxable. There is no deferred tax recognised or unrecognised.

**7. LOANS TO CUSTOMERS**

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Loans to customers – fixed rate	86,047	82,863
Loans to customers – RPI indexed	724,707	707,799
	<u>810,754</u>	<u>790,662</u>
Loans falling due within one year	18,800	18,447
Loans falling due after more than one year	791,954	772,215
	<u>810,754</u>	<u>790,662</u>

The loan portfolio at year end has nominal values amounting to £321,500,000 (2019: £321,500,000) and comprises of five loans to four water companies. Three of them have RPI index-linked principal and interest rate characteristics while the remaining two have two fixed rates of interest (see Note 11). The loans are due to mature on 30 September 2033, but the borrowers have the right to make voluntary prepayments if they give no less than 45 days' written notice in accordance with the loan agreement.

**8. OTHER PAYABLES**

	<b>2020</b>	<b>2019</b>
	<b>£'000</b>	<b>£'000</b>
Other payables	<u>54</u>	<u>48</u>

## ARTESIAN FINANCE II PLC

### NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

#### 9. BONDS ISSUED

	2020 £'000	2019 £'000
Fixed rate bonds	(517,205)	(498,067)
Amounts falling due within one year	(20,474)	(20,390)
Amounts falling due after more than one year	(496,731)	(477,677)
	<u>(517,205)</u>	<u>(498,067)</u>

The Company has issued fixed rate bonds which are listed on the London Stock Exchange with a nominal value of £345,950,000 under the Company's £500,000,000 bond issuance programme. The Bonds bear interest of 6% with a legal maturity date of 30 September 2033. The Bonds can be redeemed early under certain conditions described in the Offering Circular.

In order to protect the Company and the bond holders in the event of a shortfall of funds available to pay amounts on the Bonds, the Company has entered into a guarantee agreement for which borrowers make the payments of premium to an insurer. The guarantee is provided by Assured Guaranty (Europe) Plc, who are rated by S&P at AA, which unconditionally and irrevocably guarantees all scheduled payments of principal and interest throughout the life of all related bonds issued.

#### 10. SHARE CAPITAL

	2020 £'000	2019 £'000
<b>Authorised</b>		
50,000 (2019: 50,000) ordinary shares of £1 each	<u>50</u>	<u>50</u>
<b>Called up, allotted and partly paid</b>		
50,000 (2019: 50,000) ordinary shares partly paid up at 25p each	<u>13</u>	<u>13</u>

49,999 shares of the Company are held by Apex Trust Nominees No. 1 Limited as trustee on behalf of a Charitable Trust and 1 share by Apex Corporate Trustees (UK) Limited as trustee on behalf of a Charitable Trust. These shares were issued on 1 March 2003 for a cash consideration of 25p each.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

11. FINANCIAL INSTRUMENTS

The Company's financial instruments principally comprise Loans advanced to water companies, Bonds issued, total return swap contracts, cash 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.

**Capital risk management**

The Company manages its capital to enable it to continue as a going concern.

The capital structure of the Company primarily comprises issued bonds. Other sources of funding consist of equity attributable to equity holders of the parent, comprising issued share capital and retained earnings.

The Company is not subject to any externally imposed capital requirements.

**Credit risk**

The main risk arising from the Company's financial instruments is credit risk. The Company faces the credit risk that customers might not be able to meet their obligations as they fall due. While the Loans are secured by a fixed and floating charge over customers' assets and their immediate holding companies, the Company considered the customers' ability to service the Loans to be the principal factor in assessing the credit risk and the decision to lend. With respect to the five loans to UK water board companies, the Directors conclude that there are no past due receivable balances at year-end (2019: £nil). The water companies are rated BAA1 by rating agencies as disclosed in their latest financial statements, except for South West Water which does not provide the rating. However, the Company performed the assessment based on the latest financial statements and concluded the credit quality is similar to other water companies.

In order to protect the Company and the bond holders in the event of a shortfall of funds available to pay amounts on the Bonds, the Company has entered into a guarantee agreement for which borrowers make the payments of premium to an insurer. The guarantee is provided by Assured Guaranty (Europe) Plc, who are rated by S&P at AA, which unconditionally and irrevocably guarantees all scheduled payments of principal and interest throughout the life of all related bonds issued.

In addition, the Company faces credit risk on the swap counterparties' obligations under the agreement. The swap counterparties JP Morgan and Belfius Bank SA (formerly known as Dexia Bank SA) have high credit ratings by S&P, and the Directors and management will continue to monitor this exposure.

The fixed and floating charge over the customers' assets, and their immediate holding companies, make up the primary collateral for the Loans.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is the Statement of Financial Position amount of Loans to customers of £810,754,000 (2019: £790,662,000).

And the maximum exposure on total return swaps, at the reporting date is £1,719,000 of derivative assets. The Statement of Financial Position amount of net swaps is £292,826,000 (2019: £291,881,000). This year's amount of swaps consists of £1,719,000 of derivatives assets and £294,544,000 of derivatives liabilities.

The changes in fair value of the designated Loans and Bonds attributable to changes in credit risk have been calculated as a difference between their fair value determined as described in Note 1 and present value of future expected cash flows discounted using 6 month GBP Libor zero coupon curve.

**Financial assets at fair value through profit or loss**

	2020 £'000	2019 £'000
Cumulative change in fair value of the loans attributable to changes in credit risk	(86,329)	(74,011)
Change during the year in fair value of the loans attributable to changes in credit risk	(12,318)	(2,034)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

11. FINANCIAL INSTRUMENTS (CONTINUED)

Financial liabilities at fair value through profit or loss

	2020 £'000	2019 £'000
Cumulative change in fair value of the fixed rate bonds attributable to changes in credit risk	48,816	40,858
Change during the year in fair value of the fixed rate bonds attributable to changes in credit risk	7,959	323

Liquidity risk

Funding for purchase of the loan portfolio was obtained through issuance of fixed rate bonds to the market. The Company has entered into total return swaps to hedge the difference between amounts received on the loans to customers and amounts payable on the Bonds. 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 bondholders.

The Company has in place a guarantee to ensure that sufficient liquidity is maintained to meet the obligations on the Bonds. As such if the Company faces a shortfall in cash resources to pay interest or principal on the notes, the bondholders would receive the required amount from the guarantor.

The table below reflects the undiscounted contractual cash flows of financial liabilities at the Statement of Financial Position date.

As at 31 March 2020	Carrying amount £'000	Contractual cash flows £'000	<1 month £'000	1-3 months £'000	3 months-1 year £'000	1-5 years £'000	5 years and over £'000
<b>Non-derivative financial Liabilities</b>							
Bonds issued	(517,205)	(626,170)	-	-	(20,757)	(83,028)	(522,385)
Other creditors	(54)	(54)	-	(16)	(38)	-	-
Current tax liabilities	(9)	(9)	-	-	(9)	-	-
	<u>(517,268)</u>	<u>(626,233)</u>	<u>-</u>	<u>(16)</u>	<u>(20,804)</u>	<u>(83,028)</u>	<u>(522,385)</u>
<b>Derivative financial liabilities</b>							
Total return swaps (net)	(292,826)	(374,325)	-	-	1,742	2,188	(378,255)
Total	<u>(810,094)</u>	<u>(1,000,558)</u>	<u>-</u>	<u>(16)</u>	<u>(19,062)</u>	<u>(80,840)</u>	<u>(900,640)</u>
<b>As at 31 March 2019</b>							
	Carrying amount £'000	Contractual cash flows £'000	<1 month £'000	1-3 months £'000	3 months-1 year £'000	1-5 years £'000	5 years and over £'000
<b>Non-derivative financial Liabilities</b>							
Bonds issued	(498,067)	(646,927)	-	-	(20,757)	(83,028)	(543,142)
Other creditors	(48)	(48)	(48)	-	-	-	-
Current tax liabilities	(9)	(9)	-	-	(9)	-	-
	<u>(498,124)</u>	<u>(646,984)</u>	<u>(48)</u>	<u>-</u>	<u>(20,766)</u>	<u>(83,028)</u>	<u>(543,142)</u>
<b>Derivative financial liabilities</b>							
Total return swaps (net)	(291,881)	(410,710)	-	-	2,022	3,039	(415,771)
Total	<u>(790,005)</u>	<u>(1,057,694)</u>	<u>(48)</u>	<u>-</u>	<u>(18,744)</u>	<u>(79,989)</u>	<u>(958,913)</u>



NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2020

11. FINANCIAL INSTRUMENTS (CONTINUED)

**Liquidity risk (continued)**

The table below reflects the discounted contractual cash flows of financial derivatives at the Statement of Financial Position date.

	2020 £'000	2019 £'000
Total return swaps	(292,826)	(291,881)
Amounts falling due within one year	1,719	1,987
Amounts falling due after more than one year	(294,545)	(293,868)

**Interest rate risk**

The Company finances its operations through the issue of bonds at a fixed rate of 6.00% per annum (p.a.). The loan to Bristol Water plc carries a fixed rate of interest of 6.01% p.a. The loans to Southern Water Services Limited, Bournemouth Water Limited and South East Water Limited (formerly known as Mid Kent Water Limited) carry a fixed rate of interest of 4.076% p.a., 3.083% p.a. and 2.801% p.a. respectively, adjusted for the UK RPI indexation on a semi-annual basis. However, the Company has entered into total return swaps in which the Company exchanges the indexation-linked interest it receives on the loans for the fixed coupon amount payable on the Bonds; hence no significant net interest rate risk exists. As such, no sensitivity analysis has been presented. The loans and bonds mature on 30 September 2033.

**Foreign exchange risk**

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

**Fair values of financial assets and financial liabilities**

The carrying amounts of all the Company's financial instruments equate to their fair values. Fair values have been determined using the methods described in Note 1.

	Opening fair value £'000	Cash Movement £'000	Movement in fair value £'000	Closing fair value £'000
Cash and cash equivalents	518	28	-	546
Loans to customers – fixed rate	82,863	-	3,184	86,047
Loans to customers – RPI indexed	707,799	-	16,908	724,707
Fixed rate bonds	(498,067)	-	(19,138)	(517,205)
Total return swaps	(291,881)	-	(945)	(292,826)
	<u>1,232</u>	<u>28</u>	<u>9</u>	<u>1,269</u>

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
- c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

There have been no transfers between Level 1 and 2 during the year.

**NOTES TO THE FINANCIAL STATEMENTS**

**For the year ended 31 March 2020**

**11. FINANCIAL INSTRUMENTS (CONTINUED)**

**Fair values of financial assets and financial liabilities (continued)**

**As at 31 March 2020**

	<b>Total £'000</b>	<b>Level 1 £'000</b>	<b>Level 2 £'000</b>	<b>Level 3 £'000</b>
<b>Financial assets</b>				
Loans to customers – fixed rate	86,047	-	86,047	-
Loans to customers – RPI indexed	724,707	-	724,707	-
Total return swaps	1,719	-	1,719	-
	<u>812,473</u>	<u>-</u>	<u>812,473</u>	<u>-</u>
<b>Financial liabilities</b>				
Fixed rate bonds	517,206	-	517,206	-
Total return swaps	294,544	-	294,544	-
	<u>811,750</u>	<u>-</u>	<u>811,750</u>	<u>-</u>

**As at 31 March 2019**

	<b>Total £'000</b>	<b>Level 1 £'000</b>	<b>Level 2 £'000</b>	<b>Level 3 £'000</b>
<b>Financial assets</b>				
Loans to customers – fixed rate	82,863	-	82,863	-
Loans to customers – RPI indexed	707,799	-	707,799	-
Total return swaps	1,987	-	1,987	-
	<u>792,649</u>	<u>-</u>	<u>792,649</u>	<u>-</u>
<b>Financial liabilities</b>				
Fixed rate bonds	498,067	-	498,067	-
Total return swaps	293,868	-	293,868	-
	<u>791,935</u>	<u>-</u>	<u>791,935</u>	<u>-</u>

**12. RELATED PARTY TRANSACTIONS**

Apex Trust Corporate Limited is the corporate service provider for the Company. During the year, fees incurred for these services were £15,010 (2019: £15,144). The Company enters into transactions with the service provider on an arms' length basis, they include the payment of taxes including UK corporation tax and Value Added Tax.

**13. ULTIMATE PARENT AND CONTROLLING PARTY**

The management determined that the Company has no ultimate controlling party. As described in Note 10, the shares of the Company are held by Apex Trust Nominees No. 1 Limited and Apex Corporate Trustees (UK) Limited as trustees under the terms of a trust declared ultimately for charitable purposes.

**14. SUBSEQUENT EVENTS**

There have been no subsequent events post the Statement of Financial Position date.