

CONSOLIDATED WATER CO LTD  
Form 10-Q  
May 11, 2015

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

**(Mark One)**

**<sup>x</sup> QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended March 31, 2015**

**OR**

**..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For the transaction period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-25248**

**CONSOLIDATED WATER CO. LTD.**

**(Exact name of Registrant as specified in its charter)**

**CAYMAN ISLANDS**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**98-0619652**  
**(I.R.S. Employer Identification No.)**

**Regatta Office Park**  
**Windward Three, 4th Floor, West Bay Road**  
**P.O. Box 1114**  
**Grand Cayman KY1-1102**  
**Cayman Islands**

(Address of principal executive offices)

**N/A**  
(Zip Code)

**(345) 945-4277**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☐ No ☒

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒  
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of May 4, 2015, 14,734,272 shares of the registrant's common stock, with US\$0.60 par value, were outstanding.



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## **NOTE REGARDING CURRENCY AND EXCHANGE RATES**

Unless otherwise indicated, all references to “\$” or “US\$” are to United States dollars.

The exchange rate for conversion of Cayman Island dollars (CI\$) into US\$, as determined by the Cayman Islands Monetary Authority, has been fixed since April 1974 at US\$1.20 per CI\$1.00.

The exchange rate for conversion of Belize dollars (BZE\$) into US\$, as determined by the Central Bank of Belize, has been fixed since 1976 at US \$0.50 per BZE\$1.00.

The exchange rate for conversion of Bahamas dollars (B\$) into US\$, as determined by the Central Bank of The Bahamas, has been fixed since 1973 at US\$1.00 per B\$1.00.

The official currency of the British Virgin Islands is the United States dollar.

Consolidated Water Co. Ltd.’s Netherlands subsidiary conducts business in US\$ and euros, its Indonesian subsidiary conducts business in US\$ dollars and Indonesian rupiahs, and its Mexico subsidiary conducts business in US\$ and Mexican pesos. The exchange rates for conversion of euros, rupiahs and Mexican pesos into US\$ vary based upon market conditions.

**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONSOLIDATED WATER CO. LTD.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2015 (Unaudited)</b>	<b>December 31, 2014</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$36,754,928	\$35,713,689
Certificate of deposit	5,000,000	5,000,000
Restricted cash	442,955	456,083
Accounts receivable, net	12,535,264	11,773,744
Inventory	1,790,103	1,738,382
Prepaid expenses and other current assets	1,530,915	1,961,385
Current portion of loans receivable	1,754,498	1,726,310
Costs and estimated earnings in excess of billings - construction project	869,539	1,090,489
<b>Total current assets</b>	<b>60,678,202</b>	<b>59,460,082</b>
Property, plant and equipment, net	55,064,046	56,396,988
Construction in progress	2,195,456	1,900,016
Inventory, non-current	4,433,571	4,240,977
Loans receivable	5,161,530	5,610,867
Investment in OC-BVI	5,000,083	5,208,603
Intangible assets, net	888,877	927,900
Goodwill	3,499,037	3,499,037
Investment in land	20,558,424	20,558,424
Other assets	2,554,454	2,656,937
<b>Total assets</b>	<b>\$160,033,680</b>	<b>\$160,459,831</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and other current liabilities	\$4,914,993	\$5,962,015
Dividends payable	1,191,703	1,190,325
Demand loan payable	8,500,000	9,000,000
<b>Total current liabilities</b>	<b>14,606,696</b>	<b>16,152,340</b>
Other liabilities	224,827	224,827
<b>Total liabilities</b>	<b>14,831,523</b>	<b>16,377,167</b>
<b>Commitments and contingencies</b>		

**Equity**

Consolidated Water Co. Ltd. stockholders' equity

Redeemable preferred stock, \$0.60 par value. Authorized 200,000 shares; issued and outstanding 36,840 and 36,840 shares, respectively	22,104	22,104
Class A common stock, \$0.60 par value. Authorized 24,655,000 shares; issued and outstanding 14,734,272 and 14,715,899 shares, respectively	8,840,563	8,829,539
Class B common stock, \$0.60 par value. Authorized 145,000 shares; none issued	-	-
Additional paid-in capital	83,994,765	83,779,292
Retained earnings	49,814,648	49,000,621
Cumulative translation adjustment	(516,160 )	(482,388 )
Total Consolidated Water Co. Ltd. stockholders' equity	142,155,920	141,149,168
Non-controlling interests	3,046,237	2,933,496
<b>Total equity</b>	145,202,157	144,082,664
<b>Total liabilities and equity</b>	\$ 160,033,680	\$ 160,459,831

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

**CONSOLIDATED WATER CO. LTD.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(UNAUDITED)**

	Three Months Ended March 31,	
	2015	2014
Retail water revenues	\$6,135,638	\$6,112,961
Bulk water revenues	8,382,316	9,959,736
Services revenues	148,158	275,913
Total revenues	14,666,112	16,348,610
Cost of retail revenues	2,876,788	2,931,376
Cost of bulk revenues	5,449,512	7,111,545
Cost of services revenues	284,887	335,264
Total cost of revenues	8,611,187	10,378,185
Gross profit	6,054,925	5,970,425
General and administrative expenses	3,799,589	5,342,633
Income from operations	2,255,336	627,792
Other income (expense):		
Interest income	233,582	172,932
Interest expense	(69,532 )	(295,737 )
Profit sharing income from OC-BVI	26,325	20,250
Equity in earnings of OC-BVI	75,155	54,489
Impairment of investment in OC-BVI	(310,000 )	-
Other	(175,087 )	198,296
Other income (expense), net	(219,557 )	150,230
Net income	2,035,779	778,022
Income attributable to non-controlling interests	114,518	123,113
Net income attributable to Consolidated Water Co. Ltd. stockholders	\$ 1,921,261	\$654,909
Basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	\$0.13	\$0.04
Diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	\$0.13	\$0.04
Dividends declared per common share	\$0.075	\$0.075
Weighted average number of common shares used in the determination of:		
Basic earnings per share	14,718,757	14,686,744
Diluted earnings per share	14,764,169	14,766,985

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





**CONSOLIDATED WATER CO. LTD.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(UNAUDITED)**

	Three Months Ended March 31,	
	2015	2014
Net income	\$2,035,779	\$778,022
Other comprehensive income (loss)		
Foreign currency translation adjustment	(35,549 )	100,456
Total other comprehensive income (loss)	(35,549 )	100,456
Comprehensive income	2,000,230	878,478
Comprehensive income attributable to non-controlling interests	112,741	128,136
Comprehensive income attributable to Consolidated Water Co. Ltd. stockholders	\$1,887,489	\$750,342

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

**CONSOLIDATED WATER CO. LTD.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	Three Months Ended March 31,	
	2015	2014
Net cash provided by (used in) operating activities	\$2,479,647	\$(2,126,048 )
Cash flows from investing activities		
Additions to property, plant and equipment and construction in progress	(520,756 )	(661,662 )
Proceeds from sale of equipment	600	-
Distribution of earnings from OC-BVI	-	727,200
Collections on loans receivable	421,149	467,816
Net cash provided by (used in) investing activities	(99,007 )	533,354
Cash flows from financing activities		
Dividends paid	(1,105,856 )	(1,103,587 )
Proceeds received from exercise of stock options	145,147	-
Principal repayments of long term debt	-	(5,301,327 )
Repayment of demand loan payable	(500,000 )	-
Net cash provided by (used in) financing activities	(1,460,709 )	(6,404,914 )
Effect of exchange rate changes on cash	121,308	64,103
Net increase (decrease) in cash and cash equivalents	1,041,239	(7,933,505 )
Cash and cash equivalents at beginning of period	35,713,689	33,626,516
Cash and cash equivalents at end of period	\$36,754,928	\$25,693,011
Interest paid in cash	\$39,962	\$110,330
Non-cash investing and financing activities		
Issuance of 0 and 12,302, respectively, shares of common stock for services rendered	\$-	\$173,458
Dividends declared but not paid	\$1,107,834	\$1,105,193
Transfers from (to) inventory to (from) property, plant and equipment and construction in progress	\$(647 )	\$57,543
Transfer from costs and estimated earnings in excess of billings - construction project to accounts receivable	\$239,400	\$-
Transfers from construction in progress to property, plant and equipment	\$95,786	\$329,265
Transfer from construction in progress to costs and estimated earnings in excess of billings - construction project	\$77,841	\$-

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



**CONSOLIDATED WATER CO. LTD.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. Principal activity**

Consolidated Water Co. Ltd., and its subsidiaries (collectively, the “Company”) use reverse osmosis technology to produce potable water from seawater. The Company processes and supplies water to its customers in the Cayman Islands, Belize, The Bahamas, the British Virgin Islands and Indonesia. The Company sells water to a variety of customers, including public utilities, commercial and tourist properties, residential properties and government facilities. The base price of water supplied by the Company, and adjustments thereto, are determined by the terms of a retail license and bulk water supply contracts, which provide for adjustments based upon the movement in the government price indices specified in the license and contracts, as well as monthly adjustments for changes in the cost of energy. The Company also provides engineering and design services for water plant construction, and manages and operates water plants owned by others.

**2. Accounting policies**

**Basis of presentation:** The accompanying condensed consolidated financial statements include the accounts of the Company’s (i) wholly-owned subsidiaries, Aquilex, Inc., Cayman Water Company Limited (“Cayman Water”), Consolidated Water (Belize) Limited (“CW-Belize”), Ocean Conversion (Cayman) Limited (“OC-Cayman”), DesalCo Limited (“DesalCo”), Consolidated Water Cooperatief, U.A. (“CW-Cooperatief”); (ii) majority-owned subsidiaries Consolidated Water (Bahamas) Ltd. (“CW-Bahamas”), Consolidated Water (Asia) Pte. Limited, PT Consolidated Water Bali (“CW-Bali”) and N.S.C. Agua, S.A. de C.V. (“NSC”). The Company’s investment in its affiliate, Ocean Conversion (BVI) Ltd. (“OC-BVI”), is accounted for using the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements are unaudited. These condensed consolidated financial statements reflect all adjustments (which are of a normal recurring nature) that, in the opinion of management, are necessary to fairly present the Company’s financial position, results of operations and cash flows as of and for the periods presented. The results of operations for these interim periods are not necessarily indicative of the operating results for future periods, including the fiscal year ending December 31, 2015.

These condensed consolidated financial statements and notes are presented in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”) relating to interim financial statements and in conformity with accounting principles generally accepted in the United States of America (“US GAAP”). Certain information and note disclosures normally included in annual financial statements prepared in accordance with US GAAP have been condensed or omitted in these condensed financial statements pursuant to SEC rules and regulations, although the Company believes that the disclosures made herein are adequate to make the information not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

**Foreign currency:** The Company’s reporting currency is the United States dollar (“US\$”). The functional currency of the Company and its foreign operating subsidiaries (other than its majority-owned subsidiary, NSC) is the currency for each respective country. The functional currency for NSC is the US\$. The exchange rates between the Cayman Islands dollar, the Belize dollar, the Bahamian dollar are fixed to the US\$. CW-Cooperatief conducts business in US\$ and euros, CW-Bali conducts business in US\$ and Indonesian rupiahs, and NSC conducts business in US\$ and Mexican pesos. The exchange rates for conversion of euros, rupiahs and Mexican pesos into US\$ vary based upon market conditions. Net foreign currency gains (losses) arising from transactions conducted in foreign currencies were (\$175,095) and \$161,733 for the three months ended March 31, 2015 and 2014, respectively, and are included in “Other income (expense)” in the accompanying condensed consolidated statements of income.

**Comprehensive income:** Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income (loss) is the total of net income and other comprehensive income (loss) which, for the Company, is comprised entirely of foreign currency translation adjustments related to CW-Bali.

**Cash and cash equivalents:** Cash and cash equivalents consist of demand deposits at banks and highly liquid deposits at banks with an original maturity of three months or less. As of March 31, 2015 and December 31, 2014, this balance includes \$5.1 million and \$3.0 million, respectively, of certificates of deposits with an original maturity of three months or less.

Transfers from the Company’s Bahamas and Belize bank accounts to Company bank accounts in other countries require the approval of the Central Bank of the Bahamas and Belize, respectively.

**Comparative amounts:**

Certain amounts reported in the financial statements issued in prior periods have been reclassified herein to conform to the current period’s presentation. These reclassifications had no effect on consolidated net income.

### 3. Fair value measurements

As of March 31, 2015 and December 31, 2014, the carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, and dividends payable approximate their fair values due to the short term maturities of these instruments. Management considers that the carrying amounts for loans receivable and long term debt as of March 31, 2015 and December 31, 2014 approximate their fair value.

Under US GAAP, fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The US GAAP guidance also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability. The guidance establishes three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. The Company reviews its fair value hierarchy classifications on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy.

The following table presents the Company's fair value hierarchy for assets and liabilities measured at fair value as of March 31, 2015 and December 31, 2014:

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March 31, 2015

	Level 1	Level 2	Level 3	Total
Assets:				
Recurring				
Restricted cash	\$442,955	\$-	\$-	\$442,955
Certificate of deposit	-	5,000,000	-	5,000,000
Total recurring	\$442,955	\$5,000,000	\$-	\$5,442,955
Nonrecurring				
Investment in OC-BVI	\$-	\$-	\$5,000,083	\$5,000,083

December 31, 2014

	Level 1	Level 2	Level 3	Total
Assets:				
Recurring				
Restricted cash	\$456,083	\$-	\$-	\$456,083
Certificate of deposit	-	5,000,000	-	5,000,000
Total recurring	\$456,083	\$5,000,000	\$-	\$5,456,083
Nonrecurring				
Investment in OC-BVI	\$-	\$-	\$5,208,603	\$5,208,603



The activity for Level 3 investments for the three months ended March 31, 2015 was as follows:

Balance as of December 31, 2014	\$5,208,603
Profit sharing and equity from earnings of OC-BVI	101,480
Distributions received from OC-BVI	-
Impairment of investment in OC-BVI (See Note 6)	(310,000 )
Balance as of March 31, 2015	\$5,000,083

#### 4. Segment information

The Company has three reportable segments: retail, bulk and services. The retail segment operates the water utility for the Seven Mile Beach and the West Bay area of Grand Cayman Island pursuant to an exclusive license granted by the Cayman Islands government and also sells water to resort properties in Bali, Indonesia. The bulk segment supplies potable water to government utilities in Grand Cayman, The Bahamas and Belize under long-term contracts. The services segment develops, designs, constructs and sells desalination plants and provides desalination plant management and operating services to affiliated companies. Consistent with prior periods, the Company records all non-direct general and administrative expenses in its retail business segment and does not allocate any of these non-direct expenses to its other two business segments.

The accounting policies of the segments are consistent with those described in Note 2. The Company evaluates each segment's performance based upon its income (loss) from operations. All intercompany transactions are eliminated for segment presentation purposes.

The Company's segments are strategic business units that are managed separately because, while all segments derive their revenues from desalination-related activities, each segment sells different products and/or services, serves customers with distinctly different needs and generates different gross profit margins.

	Three Months Ended March 31, 2015			
	Retail	Bulk	Services	Total
Revenues	\$6,135,638	\$8,382,316	\$148,158	\$14,666,112
Cost of revenues	2,876,788	5,449,512	284,887	8,611,187
Gross profit (loss)	3,258,850	2,932,804	(136,729)	6,054,925
General and administrative expenses	2,805,038	417,364	577,187	3,799,589
Income (loss) from operations	\$453,812	\$2,515,440	\$(713,916)	2,255,336
Other income (expense), net				(219,557 )
Net income				2,035,779

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Income attributable to non-controlling interests	114,518
Net income attributable to Consolidated Water Co. Ltd. stockholders	\$ 1,921,261

Depreciation and amortization expenses for the three months ended March 31, 2015 for the retail, bulk and services segments were \$606,589, \$778,177 and \$22,474, respectively.

	Three Months Ended March 31, 2014			
	Retail	Bulk	Services	Total
Revenues	\$6,112,961	\$9,959,736	\$275,913	\$16,348,610
Cost of revenues	2,931,376	7,111,545	335,264	10,378,185
Gross profit (loss)	3,181,585	2,848,191	(59,351 )	5,970,425
General and administrative expenses	2,888,229	434,969	2,019,435	5,342,633
Income (loss) from operations	\$293,356	\$2,413,222	\$(2,078,786)	627,792
Other income (expense), net				150,230
Net income				778,022
Income attributable to non-controlling interests				123,113
Net income attributable to Consolidated Water Co. Ltd. stockholders				\$654,909

Depreciation and amortization expenses for the three months ended March 31, 2014 for the retail, bulk and services segments were \$633,273, \$785,901 and \$34,974, respectively.

	As of March 31, 2015			
	Retail	Bulk	Services	Total
Property plant and equipment, net	\$26,366,522	\$28,595,565	\$101,959	\$55,064,046
Construction in progress	1,050,956	1,144,500	-	2,195,456
Goodwill	1,170,511	2,328,526	-	3,499,037
Investment in land	-	-	20,558,424	20,558,424
Total assets	48,515,695	87,791,413	23,726,572	160,033,680

	As of December 31, 2014			
	Retail	Bulk	Services	Total
Property plant and equipment, net	\$26,978,259	\$29,318,534	\$100,195	\$56,396,988
Construction in progress	902,656	997,360	-	1,900,016
Goodwill	1,170,511	2,328,526	-	3,499,037
Investment in land	-	-	20,558,424	20,558,424
Total assets	51,770,206	84,612,482	24,077,143	160,459,831

## 5. Earnings per share

Earnings per share ("EPS") are computed on a basic and diluted basis. Basic EPS is computed by dividing net income (less preferred stock dividends) available to common stockholders by the weighted average number of common shares outstanding during the period. The computation of diluted EPS assumes the issuance of common shares for all potential common shares outstanding during the reporting period and, if dilutive, the effect of stock options as computed under the treasury stock method.

The following summarizes information related to the computation of basic and diluted EPS for the three months ended March 31, 2015 and 2014.

	Three Months Ended March 31,	
	2015	2014
Net income attributable to Consolidated Water Co. Ltd. Common stockholders	\$1,921,261	\$654,909
Less: preferred stock dividends	(2,763 )	(2,806 )
Net income available to common shares in the determination of basic earnings per common share	\$1,918,498	\$652,103
Weighted average number of common shares in the determination of basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	14,718,757	14,686,744
Plus:		

Weighted average number of preferred shares outstanding during the period	36,840	37,408
Potential dilutive effect of unexercised options	8,572	42,833
Weighted average number of shares used for determining diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	14,764,169	14,766,985

## 6. Investment in OC-BVI

The Company owns 50% of the outstanding voting common shares and a 43.5% equity interest in the profits of Ocean Conversion (BVI) Ltd. (“OC-BVI”). The Company also owns certain profit sharing rights in OC-BVI that raise its effective interest in the profits of OC-BVI to approximately 45%. Pursuant to a management services agreement, OC-BVI pays the Company monthly fees for certain engineering and administrative services. OC-BVI’s sole customer is the Ministry of Communications and Works of the Government of the British Virgin Islands (the “Ministry”) to which it sells bulk water.

The Company’s equity investment in OC-BVI amounted to \$5,000,083 and \$5,208,603 as of March 31, 2015 and December 31, 2014, respectively.

Until 2009, substantially all of the water sold by OC-BVI to the Ministry was supplied by one desalination plant with a capacity of 1.7 million gallons per day located at Baughers Bay, Tortola (the “Baughers Bay plant”). As discussed later in this Note (see “*Baughers Bay litigation*”), the BVI government assumed the operating responsibilities for the Baughers Bay plant in March 2010. During 2007, OC-BVI completed the construction of a desalination plant with a capacity of 720,000 gallons per day located at Bar Bay, Tortola (the “Bar Bay plant”). OC-BVI began selling water to the Ministry from this plant in January 2009 and on March 4, 2010, OC-BVI and the BVI government executed a seven-year contract for the Bar Bay plant (the “Bar Bay agreement”). Under the terms of the Bar Bay agreement, OC-BVI is required to deliver and the Ministry is required to purchase 600,000 gallons of water per day from the Bar Bay plant. The Bar Bay agreement includes a seven-year extension option exercisable by the BVI government and required OC-BVI to complete a storage reservoir on a BVI government site by no later than March 4, 2011. OC-BVI has not commenced construction of this storage reservoir due to the BVI government’s failure to pay (i) the full amount of invoices for the water provided by the Bar Bay plant on a timely basis; and (ii) the full amount ordered pursuant to a court ruling relating to the Baughers Bay litigation (see discussion that follows).

Summarized financial information of OC-BVI is presented as follows:

	March 31, 2015	December 31, 2014
Current assets	\$3,168,940	\$2,547,542
Non-current assets	5,116,946	5,297,904
Total assets	\$8,285,886	\$7,845,446

	March 31, 2015	December 31, 2014
Current liabilities	\$624,794	\$427,269
Non-current liabilities	1,445,849	1,393,200
Total liabilities	\$2,070,643	\$1,820,469

	Three Months Ended March 31,	
	2015	2014
Revenues	\$1,068,901	\$1,175,129
Cost of revenues	581,644	721,149
Gross profit	487,257	453,980
General and administrative expenses	244,342	266,677
Income (loss) from operations	242,915	187,303
Other income (expense), net	(52,649 )	(54,954 )
Net income	190,266	132,349
Income attributable to non-controlling interests	17,614	7,173
Net income attributable to controlling interests	\$172,652	\$125,176

The Company recognized \$75,155 and \$54,489 in earnings from its equity investment in OC-BVI for the three months ended March 31, 2015 and 2014, respectively. The Company recognized \$26,325 and \$20,250 in profit sharing income from its profit sharing agreement with OC-BVI for the three months ended March 31, 2015 and 2014, respectively.

For the three months ended March 31, 2015 and 2014, the Company recognized \$128,775 and \$275,913, respectively, in revenues from its management services agreement with OC-BVI, which are included in services revenues in the condensed consolidated statements of income. The Company's remaining unamortized balance recorded for this management services agreement, which is reflected as an intangible asset on the condensed consolidated balance sheets, was approximately \$173,000 and \$196,000 as of March 31, 2015 and December 31, 2014, respectively.

*Baughers Bay Litigation*

Under the terms of a water supply agreement dated May 1990 (the “1990 Agreement”) between OC-BVI and the Government of the British Islands (the “BVI Government”), upon the expiration of its initial seven-year term in May 1999, the 1990 Agreement would automatically be extended for another seven-year term unless the BVI government provided notice, at least eight months prior to such expiration, of its decision to purchase the plant from OC-BVI at the agreed upon amount under the 1990 Agreement of approximately \$1.42 million. In correspondence between the parties from late 1998 through early 2000, the BVI government indicated that it intended to purchase the plant but would be amenable to negotiating a new water supply agreement, and that it considered the 1990 Agreement to be in force on a monthly basis until negotiations between the BVI government and OC-BVI were concluded. Occasional discussions were held between the parties since 2000 without resolution of the matter. OC-BVI continued to supply water from the plant and expended approximately \$4.7 million between 1995 and 2003 to significantly expand the production capacity of the plant beyond that contemplated in the 1990 Agreement.

In 2006, the BVI government took the position that the seven-year extension of the 1990 Agreement had been completed and that it was entitled to ownership of the Baughers Bay plant. In response, OC-BVI disputed the BVI government’s contention that the original terms of the 1990 Agreement remained in effect.

During 2007, the BVI government significantly reduced the amount and frequency of its payments for the water being supplied by OC-BVI and filed a lawsuit with the Eastern Caribbean Supreme Court (the “Court”) seeking ownership of the Baughers Bay plant. OC-BVI counterclaimed to the Court that it was entitled to continued possession and operation of the Baughers Bay plant until the BVI government paid OC-BVI approximately \$4.7 million, which OC-BVI believed represented the value of the Baughers Bay plant at its expanded production capacity. OC-BVI subsequently filed claims with the Court seeking payment for water sold and delivered to the BVI government through May 31, 2009 at the contract prices in effect before the BVI government asserted its purported right of ownership of the plant.

The Court ruled on this litigation in 2009, determining that (i) the BVI government was entitled to immediate ownership and possession of the Baughers Bay plant and dismissed OC-BVI’s claim for compensation of approximately \$4.7 million for the expenditures made to expand the production capacity of the plant; (ii) OC-BVI was entitled to full payment of water invoices issued up to December 20, 2007, which had been calculated under the terms of the original 1990 Agreement; and (iii) OC-BVI was entitled to the amount of \$10.4 million for water produced by OC-BVI from the Baughers Bay plant subsequent to December 20, 2007. The BVI government made a payment of \$2.0 million to OC-BVI under the Court order during the fourth quarter of 2009, a second payment of \$2.0 million under the Court order during 2010 and a third payment under the Court order of \$1.0 million in 2011.

OC-BVI filed an appeal with the Eastern Caribbean Court of Appeals (the “Appellate Court”) in October 2009 asking the Appellate Court to review the September 17, 2009 ruling by the Court as it related to OC-BVI’s claim for compensation for expenditures made to expand the production capacity of the Baughers Bay plant. In October 2009, the BVI government also filed an appeal with the Appellate Court requesting the Appellate Court to reduce the \$10.4 million awarded by the Court to OC-BVI for water supplied subsequent to December 20, 2007 to an amount equal to the cost of producing such water.

In March 2010, OC-BVI vacated the Baughers Bay plant and the BVI government assumed direct responsibility for the plant’s operations.

In June 2012, the Appellate Court issued the final ruling with respect to the Baughers Bay litigation. This ruling dismissed the BVI government’s appeal against the previous judgment of the Court awarding \$10.4 million for the water supplied, and also awarded OC-BVI compensation for improvements made to the plant in the amount equal to the difference between (i) the value of the Baughers Bay plant at the date OC-BVI transferred possession of the plant to the BVI government and (ii) \$1.42 million (the purchase price for the Baughers Bay plant under the 1990 Agreement). OC-BVI was also awarded all of its court costs at the trial level and two-thirds of such costs incurred on appeal. Prior to the final ruling, the BVI government had paid only \$5.0 of the original \$10.4 million, and the remaining \$5.4 million amount due had increased to approximately \$6.7 million by the fourth quarter of 2012 due to the court costs awarded by the Appellate Court and the accrued interest due on the aggregate unpaid balance. The BVI government paid OC-BVI \$4.7 million of this amount during the fourth quarter of 2012 and the remaining \$2.0 million in January 2013. These amounts paid by the BVI government were recognized in OC-BVI’s earnings in the periods in which they were received. To date, OC-BVI and the BVI government have not reached an agreement on the

value of the plant at the date it was transferred to the BVI government. However, during the first quarter of 2015, OC-BVI and the BVI government appointed a mutually approved appraiser to complete a valuation of the Baughers Bay plant in accordance with the Appellate Court ruling.

#### *Valuation of Investment in OC-BVI*

The Company accounts for its investment in OC-BVI under the equity method of accounting for investments in common stock. This method requires recognition of a loss on an equity investment that is other than temporary, and indicates that a current fair value of an equity investment that is less than its carrying amount may indicate a loss in the value of the investment.

As a quoted market price for OC-BVI's stock is not available, to test for possible impairment of its investment in OC-BVI, the Company estimates its fair value through the use of the discounted cash flow method, which relies upon projections of OC-BVI's operating results, working capital and capital expenditures. The use of this method requires the Company to estimate OC-BVI's cash flows from (i) the Bar Bay agreement and (ii) the pending amount awarded by the Appellate Court for the value of the Baughers Bay plant previously transferred by OC-BVI to the BVI government.

The Company estimates the cash flows OC-BVI will receive from its Bar Bay agreement by (i) identifying various possible future scenarios for this agreement, which include the cancellation of the agreement after its initial seven-year term, and the exercise by the BVI government of the seven-year extension in the agreement; (ii) estimating the cash flows associated with each possible scenario; and (iii) assigning a probability to each scenario. The Company similarly estimates the cash flows OC-BVI will receive from the BVI government for the amount due under the ruling by the Appellate Court for the value of the Baughers Bay plant at the date it was transferred to the BVI government by assigning probabilities to different valuation scenarios. The resulting probability-weighted sum represents the expected cash flows, and the Company's best estimate of future cash flows, to be derived by OC-BVI from its Bar Bay agreement and the pending Appellate Court award.

The identification of the possible scenarios for the Bar Bay plant agreement and the Baughers Bay plant valuation, the projections of cash flows for each scenario, and the assignment of relative probabilities to each scenario all represent significant estimates made by the Company. While the Company uses its best judgment in identifying these possible scenarios, estimating the expected cash flows for these scenarios and assigning relative probabilities to each scenario, these estimates are by their nature highly subjective and are also subject to material change by the Company's management over time based upon new information or changes in circumstances.



During the three months ended March 31, 2015, after updating its probability-weighted estimates of OC-BVI's future cash flows and its resulting estimate of the fair value of its investment in OC-BVI, the Company determined that the carrying value of its investment in OC-BVI exceeded its fair value and recorded an impairment loss on this investment of \$310,000. The resulting carrying value of the Company's investment in OC-BVI of approximately \$5.0 million as of March 31, 2015 assumes that the BVI government will honor its obligations under the Bar Bay agreement and also assumes (on a probability-weighted basis) that (i) the BVI government will exercise its option to extend the Bar Bay agreement for seven years beyond its initial term, which expires February 2017, and (ii) OC-BVI will receive the pending amount (as estimated by the Company) awarded by the Eastern Caribbean Court of Appeals for the value of the Baughers Bay plant previously transferred by OC-BVI to the BVI government.

The \$5.0 million carrying value of the Company's investment in OC-BVI as of March 31, 2015 exceeds the Company's underlying equity in OC-BVI's net assets by approximately \$1.6 million. The Company accounts for this excess as goodwill. The BVI government is OC-BVI's sole customer and substantially all of OC-BVI's revenues are generated from its Bar Bay plant. As the Bar Bay agreement matures to its February 2017 expiration date, and OC-BVI receives (or is determined by the valuation expert to not be entitled to receive) the pending court award amount assumed due for the value of the Baughers Bay plant, OC-BVI's expected future cash flows, and therefore its fair value computed under the discounted cash flow method, will decrease. Unless OC-BVI obtains an extension or modification of its Bar Bay agreement that results in a significant increase in the estimated future cash flows from its Bar Bay plant, the Company will be required to record impairment losses during the remainder of 2015 and in 2016 to reduce the carrying value of its investment in OC-BVI to its then current fair value. These impairment losses will, in the aggregate, at least equal the underlying \$1.6 million in goodwill reflected in the carrying value of the Company's investment in OC-BVI. The losses the Company records for its investment in OC-BVI in the future will exceed this \$1.6 million if OC-BVI ultimately ceases operations at its Bar Bay plant, as OC-BVI will be required to record an impairment loss to reduce the carrying value of its Bar Bay plant to its then estimated fair value. OC-BVI's aggregate carrying value of the assets that comprise its Bar Bay plant was approximately \$4.9 million as of March 31, 2015. Future impairment losses for the Company's investment in OC-BVI and the Company's equity in any future operating losses incurred by OC-BVI could have a material adverse impact on the Company's consolidated results of operations.

## **7. N.S.C. Agua, S.A. de C.V.**

In May 2010, the Company acquired, through its wholly-owned Netherlands subsidiary, Consolidated Water Cooperatief, U.A., ("CW-Cooperatief") a 50% interest in N.S.C. Agua, S.A. de C.V. ("NSC"), a development stage Mexican company. The Company has since purchased, through the conversion of a loan it made to NSC, sufficient shares to raise its ownership interest in NSC to 99.9%. NSC was formed to pursue a project encompassing the construction, operation and minority ownership of a 100 million gallon per day seawater reverse osmosis desalination plant to be located in northern Baja California, Mexico and an accompanying pipeline to deliver water to the Mexican potable water infrastructure and the U.S. border (the "Project"). The Company believes the Project can be successful due to what it believes is a growing need for a new potable water supply for the areas of northern Baja California, Mexico and Southern California, U.S.

NSC has engaged engineering groups with extensive regional and/or technical experience to prepare preliminary designs and cost estimates for the desalination plant and the proposed pipeline and prepare the environmental impact studies for local, state and federal regulatory agencies. NSC is presently seeking contracts with proposed customers in Mexico and the U.S. for the sale of the desalinated water from the Project. NSC will be required to accomplish various additional steps before it can commence construction of the plant and pipeline including, but not limited to, obtaining approvals and permits from various governmental agencies in Mexico, securing contracts with its proposed customers to sell water in sufficient quantities and at prices that make the Project financially viable, and obtaining equity and debt financing for the Project. NSC's potential customers will also be required to obtain various governmental permits and approvals in order to purchase water from NSC.

In February 2012, the Company paid \$300,000 to enter into an agreement (the "Option Agreement") that provided it with an option, exercisable through February 7, 2014, to purchase the shares of one of the other shareholders of NSC, along with an immediate power of attorney to vote those shares, for \$1.0 million. Such shares constituted 25% of the ownership of NSC as of February 2012. In May 2013, NSC repaid a \$5.7 million loan payable to CW-Cooperatief by issuing additional shares of its stock. As a result of this share issuance to CW-Cooperatief, the Company acquired 99.9% of the ownership of NSC. The Option Agreement contained an anti-dilution provision that required the Company to issue new shares in NSC of an amount sufficient to maintain the other shareholder's 25% ownership interest in NSC if (i) any new shares of NSC were issued subsequent to the execution of the Option Agreement and (ii) the Company did not exercise its share purchase option by February 7, 2014. The Company exercised its option and paid the \$1.0 million to purchase the Option Agreement shares in February 2014.

NSC entered into a purchase contract for 8.1 hectares of land on which the proposed plant would be constructed and in 2012 obtained an extension of this purchase contract through May 15, 2014 in exchange for prepayments of (i) \$500,000 paid at signing of the extension and (ii) a further \$500,000 paid in May 2013. NSC paid \$7.4 million in May 2014 to complete this land purchase. In 2013, NSC purchased an additional 12 hectares of land for the project for \$12 million, of which \$2 million was paid. NSC paid the remaining \$10 million balance for this land purchase on May 15, 2014. The Company obtained new financing in May 2014 to assist in the funding of NSC's land purchases in the form of a \$10.0 million loan which is payable on demand by the lender. The loan terms require principal and interest payments to be made quarterly under a five year amortization schedule and payment of the remaining principal balance after two years, if the loan is not called before that time. This loan bears interest at LIBOR plus 1.5% and is secured by substantially all of the Company's assets in the Cayman Islands.

In 2012 and 2013, NSC conducted an equipment piloting plant and water data collection program at the proposed feed water source for the Project under a Memorandum of Understanding (the “EPC MOU”) with a global engineering, procurement and construction contractor for large seawater desalination plants. Under the EPC MOU, the contractor installed and operated an equipment piloting plant and collected water quality data from the proposed feed water source site in Rosarito Beach, Baja California, Mexico. The EPC MOU required that NSC negotiate exclusively with the contractor for the construction of the 100 million gallon per day seawater reverse osmosis desalination plant, and further required payment by NSC to the contractor of up to \$500,000 as compensation for the operation and maintenance of the equipment piloting plant should NSC not award the engineering, procurement and construction contract for the Project to the contractor. This first phase of the pilot plant testing program was completed in October 2013. NSC decided not to extend the EPC MOU beyond its February 2014 expiration date and NSC paid the contractor \$350,000 during the three months ended March 31, 2014 as compensation for the operation and maintenance of the pilot plant.

NSC is currently conducting additional source water sampling protocols to comply with regulatory requirements in the U.S. and Mexico, and is also coordinating with regulators.

In November 2012, NSC signed a letter of intent with Otay Water District in Southern California to deliver no less than 20 million and up to 40 million gallons of water per day from the plant to the Otay Water District at the border between Mexico and the U.S. On November 25, 2013, Otay Water District submitted an application to the Department of State of the United States of America for a Presidential Permit authorizing the construction, connection, operation and importation of desalinated seawater at the international boundary between the United States and Mexico in San Diego County, California. The Company understands that this application is currently being reviewed by the relevant authorities.

NSC has entered into a 20-year lease, effective November 2012, with the Comisión Federal de Electricidad for approximately 5,000 square meters of land on which it plans to construct the water intake and discharge works for the plant. The amounts due on this lease are payable in Mexican pesos at an amount that is currently equivalent to approximately \$20,000 per month. This lease is cancellable should NSC ultimately not proceed with the Project.

In August 2014, the State of Baja California enacted new legislation to regulate Public-Private Association projects which involve the type of long-term contract between a public sector authority and a private party that NSC is required to obtain to complete the Project. Pursuant to this new legislation, on January 4, 2015, NSC submitted an expression of interest for its project to the Secretary of Infrastructure and Urban Development of the State of Baja California (“SIDUE”). On January 23, 2015, SIDUE accepted NSC’s expression of interest and requested that NSC submit a detailed proposal for the Project that complies with requirements of the new legislation. NSC submitted this detailed proposal to SIDUE in late March 2015. The new legislation requires that such proposal be evaluated by SIDUE and submitted to the Public-Private Association Projects State Committee (the “APP Committee”) for review and authorization. If the APP Committee grants its authorization, the State of Baja California is required to conduct a public tender for the Project. The Company presently cannot determine if the APP Committee will grant its

authorization or, if a public tender process is commenced, when such process will be completed or whether NSC will be awarded the Project.

The Company has acknowledged since the inception of the Project that, due to the amount of capital the Project requires, NSC will ultimately need an equity partner or partners for the Project. During the fourth quarter of 2014, the Company concluded that its chances of successfully completing the Project under the new Public-Private Association legislation would be greatly enhanced through the addition of an equity partner for NSC with substantial financial resources and a history of successful capital project investments in Mexico. In February 2015, NSC entered into a Letter of Intent (LOI) with such a potential partner. The terms of this LOI will be binding if and only if NSC and its potential partner are ultimately awarded the Project by early February 2016. Pursuant to the LOI, (i) NSC has agreed to sell the land and other Project assets to a new company ("Newco") that will build and own the Project; (ii) NSC's potential partner will provide the majority of the equity for the Project and thereby will own the majority interest in Newco; (iii) NSC will maintain a minority ownership position in Newco; and (iv) Newco will enter into a long-term management and technical services contract with NSC for the Project.

On February 20, 2015, NSC received notification from the regulatory authorities in Mexico that its federal environmental impact assessment and mitigation plan for the Project's proposed desalination plant was approved.

Included in the Company's consolidated results of operations are general and administrative expenses from NSC, consisting of organizational, legal, accounting, engineering, consulting and other costs relating to NSC's project development activities. Such expenses amounted to approximately \$561,000 and \$2.0 million for the three months ended March 31, 2015 and 2014, respectively. The assets and liabilities of NSC included in the Company's consolidated balance sheets amounted to approximately \$22.0 million and \$270,000, respectively, as of March 31, 2015 and approximately \$22.0 million and \$214,000, respectively, as of December 31, 2014.

The Company expects to incur additional project development costs on behalf of NSC in 2015.

Despite the expenditures made and the activities completed to date, the Company may ultimately be unsuccessful in its efforts to complete the Project.