CONSOLIDATED WATER CO LTD
Form 10-Q
August 09, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

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	**98-0619652**
(State or other jurisdiction of incorporation or organization)	(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	**N/A**
(Address of principal executive offices)	(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 x 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 x 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 x
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 x

As of August 5, 2016, 14,815,530 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.

Our Netherlands subsidiary conducts business in US$ and euros, our Indonesian subsidiary conducts business in US$ and Indonesian rupiahs, and our 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

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$37,081,272	$44,792,734
Certificate of deposit	-	5,637,538
Restricted cash	-	428,203
Accounts receivable, net	13,717,123	9,529,016
Inventory	1,988,249	1,918,728
Prepaid expenses and other current assets	837,947	1,282,660
Current portion of loans receivable	1,902,490	1,841,851
Costs and estimated earnings in excess of billings	1,066,367	-
Total current assets	56,593,448	65,430,730
Property, plant and equipment, net	54,251,554	53,743,170
Construction in progress	2,163,548	1,928,610
Inventory, non-current	4,508,940	4,558,374
Loans receivable	2,802,365	3,769,016
Investment in OC-BVI	4,678,093	4,548,271
Intangible assets, net	5,993,644	771,811
Goodwill	11,534,248	3,499,037
Land held for development	20,558,424	20,558,424
Other assets	2,717,744	2,767,583
Total assets	$165,802,008	$161,575,026
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and other current liabilities	$4,060,956	$4,829,535
Dividends payable	1,183,134	1,177,246
Note payable to related party	490,000	-
Demand loan payable	-	6,958,328
Billings in excess of costs and estimated earnings	1,469	189,985

Total current liabilities	5,735,559	13,155,094
Deferred tax liability	2,207,636	-
Other liabilities	557,827	224,827
Total liabilities	8,501,022	13,379,921
Commitments and contingencies		
Equity		
Consolidated Water Co. Ltd. stockholders' equity		
Redeemable preferred stock, $0.60 par value. Authorized 200,000 shares; issued and outstanding 45,206 and 38,804 shares, respectively	27,124	23,282
Class A common stock, $0.60 par value. Authorized 24,655,000 shares; issued and outstanding 14,806,040 and 14,781,201 shares, respectively	8,883,624	8,868,721
Class B common stock, $0.60 par value. Authorized 145,000 shares; none issued	-	-
Additional paid-in capital	84,960,531	84,597,349
Retained earnings	54,118,710	52,084,175
Cumulative translation adjustment	(538,907)	(533,365)
Total Consolidated Water Co. Ltd. stockholders' equity	147,451,082	145,040,162
Non-controlling interests	9,849,904	3,154,943
Total equity	157,300,986	148,195,105
Total liabilities and equity	$165,802,008	$161,575,026

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

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CONSOLIDATED WATER CO. LTD.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Retail revenues	$ 6,292,833	$ 6,152,185	$ 12,263,071	$ 12,287,823
Bulk revenues	7,441,061	8,187,273	14,706,354	16,569,589
Services revenues	1,664,741	146,211	2,463,982	294,369
Total revenues	15,398,635	14,485,669	29,433,407	29,151,781
Cost of retail revenues	2,685,316	2,657,698	5,314,990	5,424,561
Cost of bulk revenues	4,813,261	5,649,929	9,423,585	11,115,989
Cost of services revenues	1,307,679	212,748	1,925,422	497,635
Total cost of revenues	8,806,256	8,520,375	16,663,997	17,038,185
Gross profit	6,592,379	5,965,294	12,769,410	12,113,596
General and administrative expenses	4,935,774	3,661,574	9,396,760	7,554,540
Income from operations	1,656,605	2,303,720	3,372,650	4,559,056
Other income (expense):				
Interest income	159,891	258,201	376,726	491,783
Interest expense	(30,323)	(67,929)	(94,369)	(137,461)
Profit sharing income from OC-BVI	14,175	22,275	48,600	48,600
Equity in earnings of OC-BVI	85,858	62,668	131,222	137,823
Impairment of investment in OC-BVI	-	(275,000)	(50,000)	(585,000)
Other	189,236	27,980	396,215	(147,107)
Other income (expense), net	418,837	28,195	808,394	(191,362)
Income before income taxes	2,075,442	2,331,915	4,181,044	4,367,694
Provision for (benefit from) income taxes	(170,393)	-	(243,662)	-
Net income	2,245,835	2,331,915	4,424,706	4,367,694
Income attributable to non-controlling interests	41,502	103,815	165,732	218,333
Net income attributable to Consolidated Water Co. Ltd. stockholders	$ 2,204,333	$ 2,228,100	$ 4,258,974	$ 4,149,361
Basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	$ 0.15	$ 0.15	$ 0.29	$ 0.28
Diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	$ 0.15	$ 0.15	$ 0.29	$ 0.28
Dividends declared per common share	$ 0.075	$ 0.075	$ 0.15	$ 0.15
Weighted average number of common shares used in the determination of:				
Basic earnings per share	14,792,053	14,736,057	14,787,716	14,727,455

Diluted earnings per share	14,871,119	14,793,298	14,863,791	14,780,269

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

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CONSOLIDATED WATER CO. LTD.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$ 2,245,835	$ 2,331,915	$ 4,424,706	$ 4,367,694
Other comprehensive income (loss)				
Foreign currency translation adjustment	(2,659)	(7,202)	(5,834)	(42,751)
Total other comprehensive income (loss)	(2,659)	(7,202)	(5,834)	(42,751)
Comprehensive income	2,243,176	2,324,713	4,418,872	4,324,943
Comprehensive income attributable to non-controlling interests	41,369	103,454	165,440	216,195
Comprehensive income attributable to Consolidated Water Co. Ltd. stockholders	$ 2,201,807	$ 2,221,259	$ 4,253,432	$ 4,108,748

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

CONSOLIDATED WATER CO. LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30, 2016	2015
Net cash provided by operating activities	$2,695,699	$8,084,316
Cash flows from investing activities		
Purchase of certificate of deposit	-	(5,637,538)
Maturity of certificate of deposit	5,637,538	5,000,000
Additions to property, plant and equipment and construction in progress	(1,356,454)	(1,424,860)
Proceeds from sale of equipment	526,800	10,160
Acquisition of business, net of cash acquired	(7,742,853)	-
Collections on loans receivable	906,012	849,176
Release / (restriction) on cash balance	398,744	(42,090)
Net cash used in investing activities	(1,630,213)	(1,245,152)
Cash flows from financing activities		
Dividends paid to CWCO common shareholders	(2,212,791)	(2,210,203)
Dividends paid to non-controlling interests	(182,663)	(182,663)
Dividends paid to CWCO preferred shareholders	(5,760)	(2,763)
Repurchase of redeemable preferred stock	(9,598)	(2,960)
Proceeds received from exercise of stock options	143,226	210,222
Issuance of note payable to related party	490,000	-
Repayments of demand loan payable	(7,000,000)	(1,000,000)
Net cash used in financing activities	(8,777,586)	(3,188,367)
Effect of exchange rate changes on cash	638	(41,957)
Net increase (decrease) in cash and cash equivalents	(7,711,462)	3,608,840
Cash and cash equivalents at beginning of period	44,792,734	35,713,689
Cash and cash equivalents at end of period	$37,081,272	$39,322,529
Interest paid in cash	$67,689	$76,956
Non-cash investing and financing activities		
Issuance of 8,421 and 8,615, respectively, shares of redeemable preferred stock for services rendered	$106,357	$110,703
Issuance of 9,964 and 0, respectively, shares of common stock for services rendered	$106,415	$-
Conversion (on a one-to-one basis) of 833 and 0, respectively, shares of redeemable preferred stock to common stock	$500	$-
Dividends declared but not paid	$1,113,844	$1,108,963

Transfers from (to) inventory to (from) property, plant and equipment and construction in progress	$134,362	$92,643
Transfers from construction in progress to property, plant and equipment	$1,097,165	$1,419,549

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

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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 and provides water-related products and services to its customers in the Cayman Islands, Belize, The Bahamas, the British Virgin Islands, Indonesia and the United States. 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 manufactures and services a wide range of products and provides design, engineering, management, operating and other services applicable to commercial and municipal water production, supply and treatment, and industrial water and wastewater treatment.

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”), Consolidated Water U.S. Holdings, Inc. (“CW-Holdings”); and (ii) majority-owned subsidiaries Consolidated Water (Bahamas) Ltd. (“CW-Bahamas”), Aerex Industries, Inc. (“Aerex”), 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, 2016.

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, 2015.

Foreign currency: The Company's reporting currency is the United States dollar ("US$"). The functional currency of the Company and its foreign operating subsidiaries (other than NSC and CW-Cooperatief) is the currency for each respective country. The functional currency for NSC is the US$. 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 ($64,113) and ($97,438) for the three months ended June 30, 2016 and 2015, respectively, and $90,296 and ($272,533) for the six months ended June 30, 2016 and 2015, respectively, and are included in "Other income (expense) - Other" 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 and highly liquid deposits at banks with an original maturity of three months or less. Cash and cash equivalents as of June 30, 2016 and December 31, 2015 include $9.0 million and $13.6 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. As of June 30, 2016, the equivalent United States dollar cash balances for deposits held in the Bahamas and Belize were approximately $14.0 million and $4.5 million, 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. Purchase of interest in Aerex Industries, Inc.

On February 11, 2016 (the "Closing Date"), the Company, through its wholly-owned subsidiary, CW-Holdings, entered into a stock purchase agreement (the "Purchase Agreement") with Aerex and Thomas Donnick, Jr. ("Donnick"), Aerex's sole shareholder prior to the Closing Date. Pursuant to the terms of the Purchase Agreement, CW-Holdings purchased a 51% ownership interest in Aerex for an aggregate purchase price of approximately $7.7 million in cash. After giving effect to the transactions contemplated by the Purchase Agreement, CW-Holdings owns 51% of the outstanding capital stock of Aerex and Donnick owns 49% of the outstanding capital stock of Aerex. CW-Holdings also acquired from Donnick an option to compel Donnick to sell, and granted to Donnick an option to require CW-Holdings to purchase, Donnick's 49% ownership interest in Aerex at a price based upon the fair market value of Aerex at the time of the exercise of the option. The options are exercisable on or after the third anniversary of the Closing Date. In connection with the Purchase Agreement, the Company guaranteed the obligations of CW-Holdings with respect to the option granted to Donnick to require CW-Holdings to purchase Donnick's 49% ownership interest in Aerex.

Aerex is an original equipment manufacturer and service provider of a wide range of products and services applicable to municipal water treatment and industrial water and wastewater treatment. Its products include membrane separation equipment, filtration equipment, piping systems, vessels and custom fabricated components. Aerex also offers engineering, design, consulting, inspection, training and equipment maintenance services to its customers. Aerex is an American Society of Mechanical Engineers (ASME) code accredited manufacturer and maintains the ASME U and S and the National Board NB and R Certificates of Authorization. Its corporate offices and manufacturing facilities are located in Fort Pierce, Florida.

In connection with the Purchase Agreement, CW-Holdings, Aerex and Donnick entered into a shareholders agreement pursuant to which CW-Holdings and Donnick agreed to certain rights and obligations with respect to the governance of Aerex. Immediately following the acquisition, Donnick and the Company loaned $490,000 and $510,000, respectively, to Aerex. These loans have a maturity date of August 10, 2016 and bear interest at 1% per annum.

The purchase price for Aerex is summarized as follows:

	February 11, 2016
Cash consideration	

Purchase price (excluding working capital)	$ 7,140,000
Working capital adjustment	605,179
Cash acquired	(2,326)
Total cash consideration	$ 7,742,853

The following table summarizes the estimated fair values of the assets and liabilities assumed at the acquisition date:

	February 11, 2016
Financial assets	$ 456,664
Inventory	70,487
Costs and estimated earnings in excess of billings	784,465
Property, plant and equipment	2,159,401
Identifiable intangible assets	5,900,000
Deferred tax liability	(2,451,298)
Accounts payable and accrued liabilities	(116,893)
Net liability arising from put/call options	(383,000)
Total identifiable net assets	6,419,826
Non-controlling interest in Aerex	(6,712,184)
Goodwill	8,035,211
	$ 7,742,853

The identifiable intangible assets consist of the following items with amortization calculated using a straight line method over the useful life of the asset:

	February 11, 2016	Useful life
Non-compete agreement	$ 400,000	5 years
Trade name	1,400,000	15 years
Certifications/programs	2,000,000	3 years
Customer backlog	100,000	1 year
Customer relationships	2,000,000	4 years
	$ 5,900,000	

The results of operations of Aerex are included in the services segment of the Company's consolidated financial statements from the date of acquisition. The total revenue and net income (loss) included for Aerex in the Company's consolidated results of operations for the three months ended June 30, 2016 were approximately $1.3 million and ($258,000), respectively. The total revenue and net income (loss) included for Aerex in the Company's consolidated results of operations for the period February 11, 2016 to June 30, 2016, were approximately $1.9 million and ($319,000), respectively. General and administrative expenses incurred by the Company for the Aerex acquisition for the three and six months ended June 30, 2016 were approximately $60,000 and $144,000, respectively.

The following pro forma financial information presents the results of operations of the Company for the six months ended June 30, 2016 and 2015, as if the acquisition of Aerex had taken place on January 1, 2015. The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which would have actually occurred had the transaction taken place on January 1, 2015, or of future results of operations:

	Six Months Ended June 30,	
	2016	2015
Revenues	$29,939,124	$42,766,119
Cost of revenues	16,931,414	27,098,193
Gross profit	13,007,710	15,667,926
General and administrative expenses	9,711,477	8,377,414
Income from operations	3,296,233	7,290,512
Other income (expense), net	809,898	(187,688)
Income before income taxes	4,106,131	7,102,824
Provision for (benefit from) income taxes	(316,575)	995,394
Net income	4,422,706	6,107,430
Income attributable to non-controlling interests	190,245	1,205,308
Net income attributable to Consolidated Water Co. Ltd. stockholders	$4,232,461	$4,902,122
	$0.29	$0.33

Basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders		
Diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	$0.28	$0.33
Weighted average number of common shares used in the determination of:		
Basic earnings per share	14,787,716	14,727,455
Diluted earnings per share	14,863,791	14,780,269

4. Fair value measurements

As of June 30, 2016 and December 31, 2015, the carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, the demand loan 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 June 30, 2016 and December 31, 2015 approximate their fair value as the stated interest rates approximate market rates.

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. 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 June 30, 2016 and December 31, 2015:

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Recurring				
Restricted cash	$-	$ -	$-	$-
Certificate of deposit	-	-	-	-
Total recurring	$-	$ -	$-	$-

Nonrecurring				
Investment in OC-BVI	$-	$ -	$4,678,093	$4,678,093
Liabilities				
Recurring				
Net liability arising from put/call options	$-	$ -	$383,000	$383,000

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Recurring				
Restricted cash	$428,203	$-	$-	$428,203
Certificate of deposit	-	5,637,538	-	5,637,538
Total recurring	$428,203	$5,637,538	$-	$6,065,741
Nonrecurring				
Investment in OC-BVI	$-	$-	$4,548,271	$4,548,271

The activity for the Level 3 asset and liability for the six months ended June 30, 2016 was as follows:

Investment in OC-BVI	
Balance as of December 31, 2015	$4,548,271
Profit sharing and equity from earnings of OC-BVI	179,822
Distributions received from OC-BVI	-
Impairment of investment in OC-BVI (See Note 7)	(50,000)
Balance as of June 30, 2016	$4,678,093
Net liability arising from put/call options[1]	
Balance as of December 31, 2015	$-
Net liability arising from put/call options	383,000
Balance as of June 30, 2016	$383,000

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(1) The net liability arising from put/call options is included in the accompanying condensed consolidated balance sheets within other liabilities as of June 30, 2016.

5. 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 West Bay areas of Grand Cayman Island pursuant to an exclusive license granted by the Cayman Islands government and 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 manufactures and services a wide range of water-related products and provides design, engineering, management, operating and other services applicable to commercial and municipal water production, water supply and treatment, and industrial water and wastewater treatment. The services segment includes the operations of Aerex beginning February 11, 2016. 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 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 water-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 June 30, 2016			
	Retail	Bulk	Services	Total
Revenues	$6,292,833	$7,441,061	$1,664,741	$15,398,635
Cost of revenues	2,685,316	4,813,261	1,307,679	8,806,256
Gross profit	3,607,517	2,627,800	357,062	6,592,379
General and administrative expenses	2,879,405	441,987	1,614,382	4,935,774
Income (loss) from operations	$728,112	$2,185,813	$(1,257,320)	1,656,605
Other income (expense), net				418,837
Income before income taxes				2,075,442
Provision for (benefit from) income taxes				(170,393)
Net income				2,245,835
Income attributable to non-controlling interests				41,502
Net income attributable to Consolidated Water Co. Ltd. stockholders				$2,204,333

Depreciation and amortization expenses for the three months ended June 30, 2016 for the retail, bulk and services segments were $559,369, $841,184 and $522,308, respectively.

	Three Months Ended June 30, 2015			
	Retail	Bulk	Services	Total
Revenues	$6,152,185	$8,187,273	$146,211	$14,485,669
Cost of revenues	2,657,698	5,649,929	212,748	8,520,375
Gross profit (loss)	3,494,487	2,537,344	(66,537)	5,965,294
General and administrative expenses	2,733,877	412,465	515,232	3,661,574
Income (loss) from operations	$760,610	$2,124,879	$(581,769)	2,303,720
Other income (expense), net				28,195
Net income				2,331,915
Income attributable to non-controlling interests				103,815
Net income attributable to Consolidated Water Co. Ltd. stockholders				$2,228,100

Depreciation and amortization expenses for the three months ended June 30, 2015 for the retail, bulk and services segments were $598,079, $792,241 and $22,474, respectively.

	Six Months Ended June 30, 2016			
	Retail	Bulk	Services	Total
Revenues	$12,263,071	$14,706,354	$2,463,982	$29,433,407
Cost of revenues	5,314,990	9,423,585	1,925,422	16,663,997
Gross profit	6,948,081	5,282,769	538,560	12,769,410
General and administrative expenses	5,777,270	877,882	2,741,608	9,396,760
Income (loss) from operations	$1,170,811	$4,404,887	$(2,203,048)	3,372,650
Other income (expense), net				808,394
Income before income taxes				4,181,044
Provision for (benefit from) income taxes				(243,662)
Net income				4,424,706
Income attributable to non-controlling interests				165,732
Net income attributable to Consolidated Water Co. Ltd. stockholders				$4,258,974

Depreciation and amortization expenses for the six months ended June 30, 2016 for the retail, bulk and services segments were $1,147,095, $1,668,573 and $762,015, respectively.

	Six Months Ended June 30, 2015			
	Retail	Bulk	Services	Total
Revenues	$12,287,823	$16,569,589	$294,369	$29,151,781
Cost of revenues	5,424,561	11,115,989	497,635	17,038,185
Gross profit (loss)	6,863,262	5,453,600	(203,266)	12,113,596
General and administrative expenses	5,632,292	829,829	1,092,419	7,554,540
Income (loss) from operations	$1,230,970	$4,623,771	$(1,295,685)	4,559,056
Other income (expense), net				(191,362)
Net income				4,367,694
Income attributable to non-controlling interests				218,333
Net income attributable to Consolidated Water Co. Ltd. stockholders				$4,149,361

Depreciation and amortization expenses for the six months ended June 30, 2015 for the retail, bulk and services segments were $1,204,668, $1,570,418 and $44,948, respectively.

	As of June 30, 2016			
	Retail	Bulk	Services	Total
Accounts receivable, net	$2,898,423	$9,932,093	$886,607	$13,717,123
Property plant and equipment, net	$25,181,966	$26,882,617	$2,186,971	$54,251,554
Construction in progress	$2,028,549	$134,999	$-	$2,163,548
Intangibles, net	$-	$633,056	$5,360,588	$5,993,644
Goodwill	$1,170,511	$2,328,526	$8,035,211	$11,534,248

Land held for development	$-	$-	$20,558,424	$20,558,424
Total assets	$52,576,719	$72,115,646	$41,109,643	$165,802,008

	As of December 31, 2015			
	Retail	Bulk	Services	Total
Accounts receivable, net	$2,261,141	$6,231,626	$1,036,249	$9,529,016
Property plant and equipment, net	$25,204,226	$28,421,906	$117,038	$53,743,170
Construction in progress	$1,860,050	$68,560	$-	$1,928,610
Intangibles, net	$-	$666,152	$105,659	$771,811
Goodwill	$1,170,511	$2,328,526	$-	$3,499,037
Land held for development	$-	$-	$20,558,424	$20,558,424
Total assets	$54,561,577	$83,284,439	$23,729,010	$161,575,026

6. 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 and six months ended June 30, 2016 and 2015.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income attributable to Consolidated Water Co. Ltd. stockholders	$2,204,333	$2,228,100	$4,258,974	$4,149,361
Less: preferred stock dividends	(3,390)	(3,418)	(6,241)	(6,181)
Net income available to common shares in the determination of basic earnings per common share	$2,200,943	$2,224,682	$4,252,733	$4,143,180
Weighted average number of common shares in the determination of basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	14,792,053	14,736,057	14,787,716	14,727,455
Plus:				
Weighted average number of preferred shares outstanding during the period	39,255	38,459	38,919	37,654
Potential dilutive effect of unexercised options	39,811	18,782	37,156	15,160
Weighted average number of shares used for determining diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders	14,871,119	14,793,298	14,863,791	14,780,269

7. Investment in OC-BVI

The Company owns 50% of the outstanding voting common shares and a 43.53% equity interest in the net income and net losses 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 net income 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 $4,678,093 and $4,548,271 as of June 30, 2016 and December 31, 2015, 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 in March 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 delivers up to 600,000 gallons of water per day to the BVI government 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; (ii) interest income due as a result of late payment of accounts receivable balances; and (iii) the amount for the Baughers Bay plant arising from a court ruling relating to the Baughers Bay litigation (see discussion that follows).

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

	June 30, 2016	December 31, 2015
Current assets	$4,750,135	$ 4,323,792
Non-current assets	4,324,175	4,682,650
Total assets	$9,074,310	$ 9,006,442

	June 30, 2016	December 31, 2015
Current liabilities	$273,997	$ 584,116
Non-current liabilities	1,701,000	1,650,252
Total liabilities	$1,974,997	$ 2,234,368

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	$ 948,189	$ 1,027,352	$ 1,885,073	$ 2,096,253
Cost of revenues	512,699	558,783	997,338	1,140,427
Gross profit	$ 435,490	$ 468,569	887,735	955,826
General and administrative expenses	222,191	261,456	482,733	505,798
Income from operations	$ 213,299	$ 207,113	405,002	450,028
Other income (expense), net	$ (8,913)	$ (44,551)	(77,763)	(97,200)
Net income	204,386	162,562	327,239	352,828
Income attributable to non-controlling interests	7,146	18,598	25,787	36,212
Net income attributable to controlling interests	$ 197,240	$ 143,964	$ 301,452	$ 316,616

The Company recognized $85,858 and $62,668 for the three months ended June 30, 2016 and 2015, respectively, and $131,222 and $137,823 for the six months ended June 30, 2016 and 2015, respectively, in earnings from its investment in OC-BVI. The Company recognized $14,175 and $22,275 for the three months ended June 30, 2016 and 2015, respectively, and $48,600 and $48,600 for the six months ended June 30, 2016 and 2015, respectively, in profit sharing income from its profit sharing agreement with OC-BVI.

For the three months ended June 30, 2016 and 2015, the Company recognized $125,594 and $135,537, respectively, in revenues from its management services agreement with OC-BVI. For the six months ended June 30, 2016 and 2015, the Company recognized $264,350 and $264,312, respectively, in revenues from its management services agreement with OC-BVI. Amounts payable by OC-BVI to the Company were $14,202 and $23,803 as of June 30, 2016 and December 31, 2015, respectively. The Company’s recorded value of this management services agreement, which is reflected as an intangible asset on the Company’s condensed consolidated balance sheets, was $60,588 and $105,659 as of June 30, 2016 and December 31, 2015, 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”) for the Baughers Bay plant 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 after 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.

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During 2007, the BVI government significantly reduced 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; (ii) OC-BVI was not entitled to compensation for the expenditures made to expand the production capacity of the plant; (iii) 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 (iv) 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.

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.

OC-BVI and the BVI government engaged a mutually approved valuation expert to complete a valuation of the Baughers Bay plant at the date it was transferred to the BVI government in accordance with the Appellate Court ruling.

In June 2016, OC-BVI received the final valuation report from the valuation expert, which sets forth a value for the Baughers Bay plant of $13.0 million as of the date OC-BVI transferred possession of the plant to the BVI government. Applying the valuation determined by the valuation expert to the formula set forth by the Appellate Court in its ruling, OC-BVI would be entitled to $11.58 million from the BVI government for the Baughers Bay plant. The BVI government has indicated that it disagrees with the valuation methodology used by the valuation expert and the resulting valuation for the Baughers Bay plant. We cannot presently determine whether the BVI government will attempt to challenge, or the Appellate Court will uphold, the Baughers Bay plant valuation or when, or to what extent, any amount for the value of the Baughers Bay plant will be paid by the BVI government to OC-BVI. Consequently, any amount due for the Baughers Bay plant valuation will not be included in OC-BVI's results of operations until such amount, if any, is paid by the BVI government.

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 due, as required under the final ruling of the Appellate Court for the value of the Baughers Bay plant at the date it was transferred by OC-BVI to the BVI government.

The Company estimates the cash flows OC-BVI will receive from its Bar Bay plant by (i) identifying various possible future scenarios which include the execution of a new agreement for the Bar Bay plant as well as the termination of Bar Bay plant operations upon the expiration of the existing Bar Bay agreement in March 2017; (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 plant and the pending Appellate Court ruling.

The identification of the possible scenarios for the Bar Bay plant 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.

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As of June 30, 2016, 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 did not exceed its fair value. As of March 31, 2016, 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 charge of $50,000 for the three months ended March 31, 2016. The Company recorded impairment charges on its investment in OC-BVI of $310,000 and $275,000 for the three months ended March 31, 2015 and June 30, 2015, respectively.

The remaining carrying value of the Company's investment in OC-BVI of approximately $4.7 million as of June 30, 2016 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 enter into a new agreement to purchase water from the Bar Bay plant after the current Bar Bay agreement expires in March 2017; and (ii) OC-BVI will receive the pending amount due (as estimated by the Company) as required under the Appellate Court ruling for the value of the Baughers Bay plant previously transferred by OC-BVI to the BVI government.

The $4.7 million carrying value of the Company's investment in OC-BVI as of June 30, 2016 exceeds the Company's underlying equity in OC-BVI's net assets by approximately $850,000. 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 March 2017 expiration date and OC-BVI receives the pending 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, decreases. The Company will be required to record additional impairment charges to reduce the carrying value of its investment in OC-BVI to its then current fair value if OC-BVI does not obtain a new agreement for the Bar Bay plant that generates cash flows sufficient to support the Company's then carrying value of its investment in OC-BVI. These impairment charges may, in the aggregate, equal the underlying $850,000 in goodwill reflected in the carrying value of the Company's investment in OC-BVI. In addition, if OC-BVI does not obtain a new agreement for the Bar Bay plant that generates cash flows sufficient to support OC-BVI's carrying values for its long lived Bar Bay plant assets, OC-BVI will be required to record an impairment charge to reduce the carrying value of its long lived Bar Bay plant assets to their then estimated fair value. The Company's equity in the net earnings or loss of OC-BVI will include 43.53% of any such impairment charge recorded by OC-BVI. Based upon the updating of its probability weighted scenarios for the future cash flows to be derived from its Bar Bay plant, OC-BVI may be required to record impairment charges to reduce carrying value of its Bar Bay plants assets before the expiration of the Bar Bay agreement in March 2017. As of June 30, 2016, the aggregate carrying value of OC-BVI's long lived Bar Bay plant assets was approximately $4.1 million. Future impairment charges for the Company's investment in OC-BVI and the Company's equity in any future losses incurred by OC-BVI could have a material adverse impact on the Company's results of operations.

8. N.S.C. Agua, S.A. de C.V.

In May 2010, the Company acquired, through its wholly-owned Netherlands subsidiary, CW-Cooperatief, a 50% interest in 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 (the "Project") that originally encompassed 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 accompanying pipelines to deliver water to the Mexican potable water system. As discussed in paragraphs that follow, during 2015 the scope of the Project was defined by the State of Baja California (the "State") to consist of a first phase consisting of a 50 million gallons per day plant and a pipeline that connects to the Mexican potable water infrastructure and a second phase consisting of an additional 50 million gallons of production capacity.

Since its inception, 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, and has also acquired the land, performed pilot plant and feed water source testing and evaluated financing alternatives for the Project.

Through a series of transactions completed in 2012-2014, NSC purchased 20.1 hectares of land on which the proposed Project's plant would be constructed for an aggregate price of approximately $20.6 million.

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 2014 as compensation for the operation and maintenance of the pilot plant.

In November 2012, NSC entered into a lease with an effective term of 20-years from the date of full operation of the desalination plant, 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 may be cancelled by NSC should NSC ultimately not proceed with the Project.

In August 2014, the State 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 seeking 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"). 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 (the "APP Proposal") to SIDUE in late March 2015. The new legislation required 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 Project was authorized the State would be required to conduct a public tender for the Project.

In response to its unsolicited APP Proposal, in September 2015 NSC received a letter dated June 30, 2015 from the Director General of the Comisión Estatal de Agua de Baja California ("CEA"), the State agency with responsibility for the Project, stating that (i) the Project is in the public interest with high social benefits and is consistent with the objectives of the State development plan and (ii) that the Project should proceed and the required public tender should be conducted. In November 2015, the State officially commenced the tender for the Project, the scope of which the State defined as a first phase to be operational in 2019 consisting of a 50 million gallons per day plant and a pipeline that connects to the Mexican potable water infrastructure and a second phase to be operational in 2024 consisting of an additional 50 million gallons per day of production capacity. NSC submitted its tender for the Project on the April 21, 2016 tender submission deadline date set by the State.

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. Consequently, NSC's tender to the State for the Project was based upon the following: (i) NSC will sell or otherwise transfer the land and other Project assets to a new company ("Newco") that would build and own the Project; (ii) NSC's potential partners would provide the majority of the equity for the Project and thereby would own the majority interest in Newco; (iii) NSC would maintain a minority ownership position in Newco; and (iv) Newco would enter into a long-term management and technical services contract for the Project with an entity partially owned by NSC or another Company subsidiary.

On June 15, 2016, the State designated the consortium comprised of NSC, NuWater S.A.P.I. de C.V. and Degremont S.A. de C.V. (the "Consortium") as the winner of tender process for the Project and set August 15, 2016 as the deadline for the negotiation of a definitive public-private partnership agreement between the Consortium and the State.

Despite the designation of the Consortium as the winner of the tender process, the Consortium may not be able to finalize and execute an acceptable definitive public-private partnership agreement with the State. The Consortium will be required to obtain debt financing commitments for the Project prior to the execution of the definitive public-private partnership agreement, and such financing may not be available on terms acceptable to the Consortium. Furthermore, even if executed, the definitive public private partnership will not be effective until the following conditions are met:

- the State has established and registered various payment trusts, guaranties and bank credit lines for specific use by the Project;
- CEA has obtained the rights from the relevant federal authority to take and desalinate seawater and distribute it for municipal use;
- various water purchase and sale agreements between CEA, the payment trusts and the Tijuana, Mexico municipal water utility have been executed;
- a permit has been obtained from the relevant federal authority to discharge the residual water from the Project's desalination plant; and
- All financing agreements necessary to provide funding for the Project have been executed.

If the Consortium is ultimately unable to proceed with the Project, the land NSC has purchased may lose its strategic importance as the site for the Project and consequently may decline in value. If the Consortium does not proceed with the Project, NSC may ultimately be unable to sell this land for an amount equal to or in excess of its current carrying value of approximately $20.6 million and any loss on sale of the land, or impairment charge NSC may be required to record as a result of a decrease in the fair value of the land, could have a material adverse impact on the Company's results of operations.

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 $875,000 and $475,000 for the three months ended June 30, 2016 and 2015, respectively, and $1,642,000 and $1,012,000 for the six months ended June 30, 2016 and 2015, respectively. The assets and liabilities of NSC included in the Company's consolidated balance sheets amounted to approximately $22.0 million and $357,000, respectively, as of June 30, 2016 and approximately $22.0 million and $488,000 respectively, as of December 31, 2015.

NSC Litigation

Immediately following CW-Cooperatief's acquisition of its initial 50% ownership in NSC, the remaining 50% ownership interest in NSC was held by an unrelated company, Norte Sur Agua, S. de R.L. de C.V. ("NSA"). NSA subsequently transferred ownership of half of its shares in NSC to EWG Water LLC ("EWG") and the other half of its shares in NSC to Alejandro de la Vega (the "individual shareholder"). 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 NSC owned by the individual shareholder, 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 individual 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 the individual shareholder to purchase the Option Agreement shares in February 2014.

In October 2015, the Company learned that EWG had filed a lawsuit against the individual shareholder, NSC, NSA, CW-Cooperatief, Ricardo del Monte Nunez, Carlos Eduardo Ahumada Arruit, Luis de Angitia Becerra, and the Public Registry of Commerce of Tijuana, Baja California in the Civil Court located in Tecate, Baja California, Mexico.

In this lawsuit, EWG is challenging the capital investment transactions that increased the Company's ownership interest in NSC to 99.9%. EWG requested that the court, as a preliminary matter: (a) suspend the effectiveness of the challenged transactions; (b) order public officials in Mexico to record the pendency of the lawsuit in the public records; and (c) appoint an inspector for NSA and NSC to oversee its commercial activities. The court granted, ex-parte, the preliminary relief sought by EWG, which resulted in the placement of inscriptions for the lawsuit on NSC's public records.

EWG is also seeking an order directing: (i) NSA, NSC and CW-Cooperatief to refrain from carrying out any transactions with respect to the Project; and (ii) NSA, NSC and CW-Cooperatief, and the partners thereof, to refrain from transferring any interests in NSA, NSC and CW-Cooperatief.

On April 5, 2016, NSC filed a motion for reconsideration with the Tecate, Mexico Court asking, among other things, that the Court; (i) reverse its order to record the pendency of the lawsuit in the public records, (ii) cancel the appointment of the inspector, and (iii) allow NSC to provide a counter-guarantee to suspend the effects of the Court's order regarding the challenged transactions. On April 26, 2016, the Tecate, Mexico Court issued an interlocutory judgment (i) ordering the cancellation of the inscriptions on NSC's public records and (ii) rejecting NSC's motion for cancellation of the appointment of the inspector. The Court’s decision regarding NSC’s request to provide a counter-guarantee is pending.

On May 17, 2016, the Company filed a claim with the Third District Court in Matters of Amparo and Federal Trials in the City of Tijuana, Baja California (the “Amparo Court”) challenging the Tecate, Mexico Court ex-parte order which appointed an inspector over NSC’s commercial activities. On July 29, 2016, the Amparo Court found that such appointment is unconstitutional and reversed the Tecate, Mexico Court’s appointment of an inspector.

On April 26, 2016, NSC filed a full answer to EWG’s claims rejecting every claim made by EWG. The Court’s response on this matter is pending.

The Company believes that the claims made by EWG are baseless and without merit, will vigorously defend NSC and CW-Cooperatief in this litigation, and will seek dismissal of the orders entered by the court and all claims against NSC and CW-Cooperatief. Furthermore, in November 2015, NSC and CW-Cooperatief filed a complaint in the United States District Court, Southern District of New York against EWG and its managing Partner based upon the Company’s conclusion that lawsuit filed by EWG in Mexico directly breaches a contract dated April 12, 2012 between NSC and CW-Cooperatief and EWG. The Company is vigorously pursuing its claims and seeking relief pursuant to this complaint. The Company incurred legal fees in connection with this litigation of approximately $143,000 and $339,000 for the three and six months ended June 30, 2016.

The Company cannot presently determine the outcome of this litigation. However, such litigation could adversely impact the Company’s efforts to complete the Project.

Mexico Tax Authority

The Mexico tax authority, the Servicio de Administracion Tributaria (“SAT”), assessed NSC for taxes relating to payments to foreign vendors on which the SAT contended should have been subject to income tax withholdings during NSC’s 2011 tax year. As of December 31, 2015, the assessment and related penalties, surcharges, inflation adjustments and late fees totaled 7,367,875 Mexican pesos. Such assessments were equivalent to approximately $428,203 as of December 31, 2015 based upon the exchange rate between the United States dollars and the Mexican peso.

NSC retained the assistance of Mexican tax advisers in this matter, as it believed the assumptions and related work performed by the SAT did not support their tax assessment. As a result, NSC elected to contest this assessment in Mexico federal tax court. NSC was required to provide an irrevocable letter of credit which amounted to 7,367,875 Mexican pesos as of December 31, 2015 as collateral in connection with this tax case. The restricted cash balance of $428,203 included in the accompanying consolidated balance sheet as of December 31, 2015 represented the US dollar equivalent of Mexican pesos on deposit with a bank to secure payment of this irrevocable letter of credit.

In November 2014, NSC received a favorable judgment from the tax court. Based on this outcome, the SAT filed an appeal shortly thereafter to contest the judgment. On February 15, 2016, NSC received a favorable judgment from the appellate tax court and shortly thereafter obtained the release of the Mexican pesos cash balance that had been restricted and pledged as collateral as of December 31, 2015 for the irrevocable letter of credit.

9. Contingencies

Retail License

The Company sells water through its retail operations under a license issued in July 1990 by the Cayman Islands government that grants Cayman Water the exclusive right to provide potable water to customers within its licensed service area. As discussed below, this license was set to expire in July 2010 but has since been extended while negotiations for a new license take place. Pursuant to the license, Cayman Water has the exclusive right to produce potable water and distribute it by pipeline to its licensed service area, which consists of two of the three most populated areas of Grand Cayman, the Seven Mile Beach and West Bay areas. For the three months ended June 30, 2016 and 2015, the Company generated approximately 41%, and 42%, respectively, of its consolidated revenues and 56% and 60%, respectively, of its consolidated gross profit from the retail water operations conducted pursuant to Cayman Water’s exclusive license. For the six months ended June 30, 2016 and 2015, the Company generated approximately 42% and 42%, respectively, of its consolidated revenues and 56% and 58%, respectively, of its consolidated gross profit from the retail water operations conducted pursuant to Cayman Water’s exclusive license.

Under the license, Cayman Water pays a royalty to the government of 7.5% of its gross retail water sales revenues (excluding energy cost adjustments). The selling prices of water sold to its customers are determined by the license and vary depending upon the type and location of the customer and the monthly volume of water purchased. The license provides for an automatic adjustment for inflation or deflation on an annual basis, subject to temporary limited exceptions, and an automatic adjustment for the cost of electricity on a monthly basis. The Water Authority Cayman (the “WAC”), on behalf of the government, reviews and confirms the calculations of the price adjustments for inflation and electricity costs. If Cayman Water wants to adjust its prices for any reason other than inflation or electricity costs, Cayman Water has to request prior approval of the Cabinet of the Cayman Islands government. Disputes regarding price adjustments would be referred to arbitration.

The license was scheduled to expire in July 2010 but has been extended several times by the Cayman Islands government in order to provide the parties with additional time to negotiate the terms of a new license agreement. The most recent extension of the license expired on June 30, 2016. The Company continues to provide water subsequent to June 30, 2016 under a further extension of the license that the Company believes will be forthcoming.

The Cayman Islands government could ultimately offer a third party a license to service some or all of Cayman Water's present service area. However, as set forth in the existing license, "*the Governor hereby agrees that upon the expiry of the term of this Licence or any extension thereof, he will not grant a licence or franchise to any other person or company for the processing, distribution, sale and supply of water within the Licence Area without having first offered such a licence or franchise to the Company on terms no less favourable than the terms offered to such other person or company.*"

In February 2011, the Water (Production and Supply) Law, 2011 and the Water Authority (Amendment) Law, 2011 (the "New Laws") were published and enacted. Under the New Laws, the WAC will issue any new license, and such new license could include a rate of return on invested capital model, as discussed in the following paragraph.

Following the enactment of the New Laws, the Company was advised in correspondence from the Cayman Islands government and the WAC that: (i) the WAC, and not the Cayman Islands government, is the principal negotiator in these license negotiations; and (ii) the WAC has determined that a rate of return on invested capital model ("RCAM") for the retail license is in the best interest of the public and Cayman Water's customers. RCAM is the rate model currently utilized in the electricity transmission and distribution license granted by the Cayman Islands government to the Caribbean Utilities Company, Ltd. The Company responded to the Cayman Islands government that it disagreed with the government's position on these two matters and negotiations for a new license temporarily ceased.

In July 2012, in an effort to resolve several issues relating to its retail license renewal negotiations, the Company filed an Application for Leave to Apply for Judicial Review (the "Application") with the Grand Court of the Cayman Islands (the "Court"), seeking declarations that: (i) certain provisions of the New Laws appear to be incompatible and a determination as to how those provisions should be interpreted; (ii) the WAC's roles as the principal license negotiator, statutory regulator and the Company's competitor put the WAC in a position of hopeless conflict; and (iii) the WAC's decision to replace the rate structure under the Company's current exclusive license with RCAM was predetermined and unreasonable. In October 2012 the Company was notified that the Court agreed to consider the issues raised in the Application.

The hearing for this judicial review was held on April 1, 2014. Prior to the commencement of the hearing, the parties agreed that the Court should solely be concerned with the interpretation of the statutory provisions. As part of this agreement, the WAC agreed to consider the Company's submissions on the RCAM model and/or alternative models of pricing. In June 2014, the Court determined that: (i) the renewal of the license does not require a public bidding process; and (ii) the WAC is the proper entity to negotiate with the Company for the renewal of the license.