

CONSOLIDATED WATER CO LTD
Form 10-Q
May 12, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition 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 5, 2014, 14,698,499 shares of the registrant's common stock, with US\$0.60 par value, were outstanding.

TABLE OF CONTENTS

| Description | Page |
|----------------------------------------------------------------------------------------------------------------------------------------|-------------|
| PART I <u>FINANCIAL INFORMATION</u> | 4 |
| Item 1 <u>Financial Statements</u> | 4 |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2014 (Unaudited) and December 31, 2013</u> | 4 |
| <u>Condensed Consolidated Statements of Income (Unaudited) for the Three Months Ended March 31, 2014 and 2013</u> | 5 |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the Three Months Ended March 31, 2014 and 2013</u> | 6 |
| <u>Condensed Consolidated Statements of Cash Flows (Unaudited) for the Three Months Ended March 31, 2014 and 2013</u> | 7 |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | 8 |
| Item 2 <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | 20 |
| Item 3 <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 30 |
| Item 4 <u>Controls and Procedures</u> | 30 |
| PART II <u>OTHER INFORMATION</u> | 30 |
| Item 1A <u>Risk Factors</u> | 30 |
| Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 32 |
| Item 6 <u>Exhibits</u> | 33 |
| <u>SIGNATURES</u> | 34 |

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.

The exchange rate for conversion of Bermuda dollars (BMD\$) into US\$ as determined by the Bermuda Monetary Authority, has been fixed since 1970 at US\$1.00 per BMD\$1.00.

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 pesos into US\$ vary based upon market conditions.

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

| | March 31, 2014 (Unaudited) | December 31, 2013 |
|------------------------------------------------|----------------------------------|----------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$24,693,011 | \$33,626,516 |
| Certificate of deposit | 1,000,000 | - |
| Marketable securities | 8,596,543 | 8,587,475 |
| Accounts receivable, net | 23,815,493 | 18,859,560 |
| Inventory | 1,370,036 | 1,383,135 |
| Prepaid expenses and other current assets | 2,490,098 | 3,435,127 |
| Current portion of loans receivable | 1,644,436 | 1,691,102 |
| Total current assets | 63,609,617 | 67,582,915 |
| Property, plant and equipment, net | | |
| Construction in progress | 57,881,089 | 58,602,886 |
| Inventory, non-current | 1,729,638 | 1,450,417 |
| Loans receivable | 4,243,526 | 4,204,089 |
| Investment in OC-BVI | 6,916,027 | 7,337,177 |
| Intangible assets, net | 5,970,987 | 6,623,448 |
| Goodwill | 1,044,966 | 1,096,488 |
| Investment in land | 3,499,037 | 3,499,037 |
| Other assets | 12,175,566 | 12,175,566 |
| Total assets | 2,683,742 | 2,792,831 |
| | \$ 159,754,195 | \$ 165,364,854 |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Accounts payable and other current liabilities | \$6,768,431 | \$7,157,896 |
| Dividends payable | 1,165,032 | 1,164,026 |
| Current portion of long term debt | - | 5,205,167 |
| Land purchase obligation | 10,050,000 | 10,050,000 |
| Total current liabilities | 17,983,463 | 23,577,089 |
| Other liabilities | 264,827 | 289,392 |
| Total liabilities | 18,248,290 | 23,866,481 |

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Commitments and contingencies

Equity

Consolidated Water Co. Ltd. stockholders' equity

| | | |
|---------------------------------------------------------------------------------------------------------------------------------------------|----------------|----------------|
| Redeemable preferred stock, \$0.60 par value. Authorized 200,000 shares; issued and outstanding 37,408 and 37,408 shares, respectively | 22,445 | 22,445 |
| Class A common stock, \$0.60 par value. Authorized 24,655,000 shares; issued and outstanding 14,698,499 and 14,686,197 shares, respectively | 8,819,099 | 8,811,718 |
| Class B common stock, \$0.60 par value. Authorized 145,000 shares; none issued or outstanding | - | - |
| Additional paid-in capital | 83,607,653 | 83,381,387 |
| Retained earnings | 46,705,864 | 47,155,548 |
| Cumulative translation adjustment | (376,550) | (471,983) |
| Total Consolidated Water Co. Ltd. stockholders' equity | 138,778,511 | 138,899,115 |
| Non-controlling interests | 2,727,394 | 2,599,258 |
| Total equity | 141,505,905 | 141,498,373 |
| Total liabilities and equity | \$ 159,754,195 | \$ 165,364,854 |

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, | |
|---------------------------------------------------------------------------------------------------|------------------------------|--------------|
| | 2014 | 2013 |
| Retail water revenues | \$ 6,112,961 | \$ 6,395,012 |
| Bulk water revenues | 9,959,736 | 9,856,690 |
| Services revenues | 275,913 | 303,495 |
| Total revenues | 16,348,610 | 16,555,197 |
| Cost of retail revenues | 2,931,376 | 2,834,752 |
| Cost of bulk revenues | 7,111,545 | 7,187,413 |
| Cost of services revenues | 335,264 | 312,525 |
| Total cost of revenues | 10,378,185 | 10,334,690 |
| Gross profit | 5,970,425 | 6,220,507 |
| General and administrative expenses | 5,342,633 | 3,568,936 |
| Income from operations | 627,792 | 2,651,571 |
| Other income (expense): | | |
| Interest income | 172,932 | 180,088 |
| Interest expense | (295,737 |) (132,425 |
| Profit sharing income from OC-BVI | 20,250 | 287,459 |
| Equity in earnings of OC-BVI | 54,489 | 787,861 |
| Other | 198,296 | 89,133 |
| Other income (expense), net | 150,230 | 1,212,116 |
| Net income | 778,022 | 3,863,687 |
| Income attributable to non-controlling interests | 123,113 | 121,684 |
| Net income attributable to Consolidated Water Co. Ltd. stockholders | \$ 654,909 | \$ 3,742,003 |
| Basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders | \$ 0.04 | \$ 0.26 |
| Diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders | \$ 0.04 | \$ 0.26 |
| Dividends declared per common share | \$ 0.075 | \$ 0.075 |
| Weighted average number of common shares used in the determination of: | | |
| Basic earnings per share | 14,686,744 | 14,598,096 |
| Diluted earnings per share | 14,766,985 | 14,635,334 |

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, | |
|-------------------------------------------------------------------------------|------------------------------|--------------|
| | 2014 | 2013 |
| Net Income | \$ 778,022 | \$ 3,863,687 |
| Other comprehensive income (loss) | | |
| Foreign currency translation adjustment | 100,456 | (22,703) |
| Total other comprehensive income (loss) | 100,456 | (22,703) |
| Comprehensive income | 878,478 | 3,840,984 |
| Comprehensive income attributable to the non-controlling interest | 128,136 | 120,549 |
| Comprehensive income attributable to Consolidated Water Co. Ltd. stockholders | \$ 750,342 | \$ 3,720,435 |

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, | |
|-------------------------------------------------------------------------------------------|------------------------------|---------------|
| | 2014 | 2013 |
| Net cash provided by (used in) operating activities | \$ (2,126,048) | \$ 3,182,944 |
| Cash flows from investing activities | | |
| Purchase of certificate of deposit | (1,000,000) | - |
| Additions to property, plant and equipment and construction in progress | (661,662) | (1,129,191) |
| Distribution of earnings from OC-BVI | 727,200 | 757,500 |
| Collections on loans receivable | 467,816 | 452,122 |
| Net cash provided by (used in) investing activities | (466,646) | 80,431 |
| Cash flows from financing activities | | |
| Dividends paid | (1,103,587) | (1,096,025) |
| Issuance (repurchase) of redeemable preferred stock, net | - | (4,159) |
| Proceeds received from exercise of stock options | - | 232,734 |
| Principal repayments of long term debt | (5,301,327) | (421,508) |
| Net cash used in financing activities | (6,404,914) | (1,288,958) |
| Effect of exchange rate changes on cash | 64,103 | (5,173) |
| Net increase (decrease) in cash and cash equivalents | (8,933,505) | 1,969,244 |
| Cash and cash equivalents at beginning of period | 33,626,516 | 33,892,655 |
| Cash and cash equivalents at end of period | \$ 24,693,011 | \$ 35,861,899 |
| Interest paid in cash | \$ 110,330 | \$ 104,503 |
| Non-cash investing and financing activities | | |
| Issuance of 12,302 and 11,131, respectively, shares of common stock for services rendered | \$ 173,458 | \$ 82,369 |
| Dividends declared but not paid | \$ 1,105,193 | \$ 1,099,752 |
| Transfers from inventory to property, plant and equipment and construction in progress | \$ 57,543 | \$ 181,875 |

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 fresh water from seawater. The Company processes and supplies water to its customers in the Cayman Islands, Belize, The Bahamas 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 license and supply contracts, which provide for adjustments based upon the movement in the government price indices specified in the licenses 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-Coop”); and (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, 2014.

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 pursuant to SEC rules and regulations, although the Company believes that the disclosures made 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, 2013.

Foreign currency:

The Company’s reporting currency is the United States dollar (“US\$”). The functional currency of the Company and its foreign subsidiaries (other than 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, and the Bermuda dollar are fixed to the US\$. CW-Coop 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 pesos into US\$ vary based upon market conditions. Net foreign currency gains arising from transactions conducted in foreign currencies were \$165,854 and \$25,667 for the three months ended March 31, 2014 and 2013, respectively, and are included in “Other income (expense)” in the 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.

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, 2014 and December 31, 2013, the carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, dividends payable and the land purchase obligation approximate their fair values due to the nature of these items and their short term maturities. Management considers that the carrying amounts for loans receivable and long term debt as of March 31, 2014 and December 31, 2013, approximate their fair values as their interest rates approximate market rates for similar instruments.

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 for fair value 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 the fair value hierarchy classification 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, 2014 and December 31, 2013:

| | March 31, 2014 | | | |
|------------------------|----------------|-------------|-------------|-------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Recurring | | | | |
| Certificate of deposit | \$- | \$1,000,000 | \$- | \$1,000,000 |
| Marketable securities | 8,596,543 | - | - | 8,596,543 |
| Total Recurring | \$8,596,543 | \$1,000,000 | \$- | \$9,596,543 |
| Nonrecurring | | | | |
| Investment in OC-BVI | \$- | \$- | \$5,970,987 | \$5,970,987 |

| | December 31, 2013 | | | |
|-----------------------|-------------------|---------|-------------|-------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Recurring | | | | |
| Marketable securities | \$8,587,475 | \$ - | \$- | \$8,587,475 |
| Nonrecurring | | | | |
| Investment in OC-BVI | \$- | \$ - | \$6,623,448 | \$6,623,448 |

The activity for Level 3 investments for the three months ended March 31, 2014 was as follows:

| | |
|---------------------------------------------------|-------------|
| Balance as of December 31, 2013 | \$6,623,448 |
| Profit sharing and equity from earnings of OC-BVI | 74,739 |
| Distribution of earnings from OC-BVI | (727,200) |
| Balance as of March 31, 2014 | \$5,970,987 |

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 West Bay areas of Grand Cayman Island pursuant to an exclusive license granted by the Cayman Islands government. The retail segment also includes a retail water operation under development in Bali, Indonesia to sell water to resort properties. The bulk segment supplies potable water to government utilities in Grand Cayman, the Bahamas and Belize under long-term contracts. The services segment designs, constructs and sells desalination plants, and provides desalination plant management and operating services, to Company subsidiary and affiliated companies as well as third parties. Consistent with prior periods, we record all non-direct general and administrative expenses in our retail business segment and do not allocate any of these non-direct expenses to our other two business segments.

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 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, 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 | 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, net | | | | 150,230 |
| Consolidated net income | | | | 778,022 |
| Income attributable to non-controlling interests | | | | 123,113 |
| | | | | \$654,909 |

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Net income attributable to Consolidated Water Co. Ltd.
stockholders

Depreciation and amortization expenses for the three months ended March 31, 2014 for the retail, bulk and services segments were \$633,273, \$741,063 and \$34,974, respectively.

| | As of March 31, 2014 | | | |
|-----------------------------------|----------------------|--------------|------------|--------------|
| | Retail | Bulk | Services | Total |
| Property plant and equipment, net | \$26,182,394 | \$31,037,689 | \$661,006 | \$57,881,089 |
| Construction in progress | 1,589,932 | 139,706 | - | 1,729,638 |
| Goodwill | 1,170,511 | 2,328,526 | - | 3,499,037 |
| Investment in land | - | - | 12,175,566 | 12,175,566 |
| Total assets | 57,542,305 | 86,054,918 | 16,156,972 | 159,754,195 |

| | Three Months Ended March 31, 2013 | | | |
|------------------------------------------------------------------------|-----------------------------------|-------------|-----------|--------------|
| | Retail | Bulk | Services | Total |
| Revenues | \$6,395,012 | \$9,856,690 | \$303,495 | \$16,555,197 |
| Cost of revenues | 2,834,752 | 7,187,413 | 312,525 | 10,334,690 |
| Gross profit | 3,560,260 | 2,669,277 | (9,030) | 6,220,507 |
| General and administrative expenses | 2,631,510 | 408,247 | 529,179 | 3,568,936 |
| Income (loss) from operations | 928,750 | 2,261,030 | (538,209) | 2,651,571 |
| Other income, net | | | | 1,212,116 |
| Consolidated net income | | | | 3,863,687 |
| Income attributable to non-controlling interests | | | | 121,684 |
| Net income attributable to Consolidated Water Co. Ltd. stockholders | | | | \$3,742,003 |

Depreciation and amortization expenses for the three months ended March 31, 2013 for the retail, bulk and services segments were \$510,640, \$764,516 and \$73,181, respectively.

| | As of December 31, 2013 | | | |
|-----------------------------------|-------------------------|--------------|------------|--------------|
| | Retail | Bulk | Services | Total |
| Property plant and equipment, net | \$26,339,461 | \$31,736,774 | \$526,651 | \$58,602,886 |
| Construction in progress | 1,181,628 | 98,807 | 169,982.00 | 1,450,417 |
| Goodwill | 1,170,511 | 2,328,526 | - | 3,499,037 |
| Investment in land | - | - | 12,175,566 | 12,175,566 |
| Total assets | 65,853,375 | 84,300,971 | 15,210,508 | 165,364,854 |

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 ended March 31, 2014 and 2013.

| | Three Months Ended March 31, | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|--------------|
| | 2014 | 2013 |
| Net income attributable to Consolidated Water Co. Ltd. common stockholders | \$ 654,909 | \$ 3,742,003 |
| Less: preferred stock dividends | (2,806) | (2,232) |
| Net income available to common shares in the determination of basic earnings per common share | \$ 652,103 | \$ 3,739,771 |
| Weighted average number of common shares in the determination of basic earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders | 14,686,744 | 14,598,096 |
| Plus: | | |
| Weighted average number of preferred shares outstanding during the period | 37,408 | 29,879 |
| Potential dilutive effect of unexercised options | 42,833 | 7,359 |
| Weighted average number of shares used for determining diluted earnings per common share attributable to Consolidated Water Co. Ltd. common stockholders | 14,766,985 | 14,635,334 |

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 \$5,970,987 and \$6,623,448 as of March 31, 2014 and December 31, 2013, respectively.

Until 2009, substantially all of the water sold by OC-BVI to the Ministry was initially supplied under a Water Supply Agreement dated May 1990 (the "1990 Agreement") and was produced 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 dispute*"), 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 and the BVI government executed a definitive seven-year contract (the "Bar Bay Agreement") for this plant on March 4, 2010. Under the terms of the Bar Bay Agreement, OC-BVI is required to deliver 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 the 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, 2014 | December 31, 2013 |
|--------------------|-------------------|----------------------|
| Current assets | \$1,913,168 | \$ 3,422,328 |
| Non-current assets | 5,799,522 | 5,923,387 |
| Total assets | \$7,712,690 | \$ 9,345,715 |

| | March 31, 2014 | December 31, 2013 |
|-------------------------|-------------------|----------------------|
| Current liabilities | \$524,813 | \$ 717,887 |
| Non-current liabilities | 1,340,550 | 1,688,850 |
| Total liabilities | \$1,865,363 | \$ 2,406,737 |

| | Three Months Ended March 31, | |
|--------------------------------------------------|------------------------------|----------------|
| | 2014 | 2013 |
| Revenues | \$ 1,175,129 | \$ 1,230,788 |
| Gross Profit | \$ 453,980 | \$ 527,794 |
| Income from operations | \$ 187,303 | \$ 272,605 |
| Other income (expense), net ⁽¹⁾ | \$ (54,954 |) \$ 1,547,456 |
| Net income attributable to controlling interests | \$ 125,176 | \$ 1,809,926 |

(1) Includes income of \$nil and \$2.0 million related to the Court award - Baughers Bay dispute, for the three months ended March 31, 2014 and 2013, respectively.

The Company recognized \$54,489 and \$787,861 in earnings from its equity investment in OC-BVI for the three months ended March 31, 2014 and 2013, respectively. The Company recognized \$20,250 and \$287,459 in profit sharing income from its profit sharing agreement with OC-BVI for the three months ended March 31, 2014 and 2013, respectively.

For the three months ended March 31, 2014 and 2013, the Company recognized approximately \$275,913 and \$258,086, respectively, in revenues from its management services agreement with OC-BVI. The Company's recorded value of this management services agreement, which is reflected as an intangible asset on the Company's condensed consolidated balance sheet, was approximately \$263,000 and \$285,000 as of March 31, 2014 and December 31, 2013, respectively.

Baughers Bay dispute

Under the terms of the 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 (1) 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; (2) 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 (3) 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 been unable to reach agreement on the value of the plant at the date it was transferred to 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 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 fourth quarter of 2013, after reassessing what the Company believes will be the future demand for water in Tortola, British Virgin Islands, and the probable sources the BVI government will utilize to meet this demand, the Company determined it appropriate to modify the projections of cash flows for OC-BVI that it uses to estimate the fair value of its investment in OC-BVI by increasing (from those used in prior years) the probabilities assigned to those scenarios that result in a lower supply of water or revenue stream from the Bar Bay plant. Based on these current estimates of OC-BVI's cash flows and the Company's 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 \$200,000. The resulting carrying value of the Company's investment in OC-BVI of approximately \$6.6 million as of December 31, 2013, and the Company's current carrying value for this investment of approximately \$6.0 million as of March 31, 2014, are based on the assumptions that the BVI government will honor its obligations under the Bar Bay agreement and (on a probability-weighted basis) that the BVI government will exercise its option to extend the Bar Bay agreement for seven years beyond its initial term, which expires in 2017.

The \$6.0 million carrying value of the Company's investment in OC-BVI as of March 31, 2014 exceeds the Company's underlying equity in OC-BVI's net assets by approximately \$2.8 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 and OC-BVI receives (or is determined by the court to not be entitled to receive) the pending Appellate 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 expansion or other 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 in future periods to reduce the carrying value of its investment in OC-BVI to its then current fair value. These impairment losses will, in the aggregate, equal the underlying \$2.8 million in goodwill reflected in the carrying value of the Company's investment in OC-BVI and could have a material adverse effect on the Company's earnings and consolidated statement 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. (“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 previous loan 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 Company believes such a project can be successful due to what the Company anticipates will be a growing need for a new potable water supply for the areas of northern Baja California, Mexico and Southern California, United States. To complete this project, the Company engaged two engineering groups with extensive regional and/or technical experience and conducted an equipment piloting plant and water quality data collection program at the proposed feed water source under a Memorandum of Understanding (the “EPC MOU”) with a global engineering, procurement and construction contractor for large seawater desalination plants. If this project is completed, the Company expects to participate in the operation of the plant and pipeline and also expects to retain a minority ownership position in the project. NSC is presently seeking contracts with proposed customers in Mexico and the United States of America 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, completing the purchases of land required for the project, obtaining approvals and permits from various governmental agencies in Mexico and the United States, 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 entered 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 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 Cooperatief by issuing additional shares of its stock. As a result of this share issuance to Cooperatief, the Company acquired 99.9% of the ownership of NSC. The Option Agreement contained an anti-dilutive 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 purchased the Option Agreement shares in February 2014.

NSC has entered into a purchase contract for 8.1 hectares of land on which the proposed plant would be constructed. In 2012, NSC 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 is required to pay a balance of \$6.98 million on May 15, 2014 to complete the purchase of this land. In 2013, NSC purchased an additional 12 hectares of land, which constitute most of the land required for the project, for \$12 million, of which \$2 million has been paid. The remaining \$10 million balance for this purchase is due on May 15, 2014. The Company has obtained a commitment for new financing to fund NSC’s pending land purchases which are due in May 2014 in the

form of a \$10.0 million demand loan with payments due quarterly under a five year amortization schedule and the remaining principal balance due after two years. This loan will bear interest at LIBOR plus 1.5%.

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 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 developing additional sampling protocols to comply with regulatory requirements in the U.S. and Mexico, and is also coordinating with regulators to assess the need, if any, for further process piloting.

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 United States.

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 without penalty should NSC ultimately not proceed with the project.

Included in the 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 \$1,977,851 and \$479,307 for the three months ended March 31, 2014 and 2013, respectively. The assets and liabilities of NSC included in the consolidated balance sheets amounted to approximately \$14.6 million and \$10.5 million, respectively, as of March 31, 2014 and approximately \$13.7 million and \$10.3 million, respectively, as of December 31, 2013.

The Company has determined that completing NSC's development activities will require significant additional funding. The Company estimates that it will take at least until the first quarter of 2015 for NSC to complete the development activities necessary to commence construction of the plant and pipeline, which include completing the site piloting plant activities, completing the purchase of the land for the plant, securing feed water and power supplies, completing the engineering and feasibility studies, negotiating customer contracts, obtaining the required rights-of-way and regulatory permits and arranging the project financing. However, NSC may ultimately be unable to complete all of the activities necessary to begin construction of the project.

8. Contingencies

Renewal of Retail License

The Company sells water through its retail operations under a license issued in July 1990 by the Cayman Islands government that grants the Company's wholly owned subsidiary Cayman Water the exclusive right to provide water to customers within its licensed service area. Cayman Water's service area is comprised of an area on Grand Cayman that includes the Seven Mile Beach and West Bay areas, two of the three most populated areas in the Cayman Islands. For the three months ended March 31, 2014 and 2013, the Company generated approximately 37% and 39%, respectively, of its consolidated revenues and 55% and 58%, respectively, of its consolidated gross profits from the retail water operations conducted pursuant to our exclusive license. If Cayman Water is not in default of any terms of its terms, this license provides Cayman Water with the right of first refusal to renew the license on terms that are no less favorable than those that the government offers to any third party.

This license was set to expire on July 10, 2010; however, the Company and the Cayman Islands government have agreed in correspondence to extend the license several times in order to provide sufficient time to negotiate the terms of a new license agreement. The most recent extension of the Company's license expires June 30, 2014.

In February 2011, the Water (Production and Supply) Law, 2011 (which replaces the Water (Production and Supply) Law (1996 Revision)) and the Water Authority (Amendment) Law, 2011 (the "New Laws") were published and are now in full force and effect. Under the New Laws, the Water Authority-Cayman ("WAC") would issue any new license which could include a rate of return on invested capital model described below.

The Company has been advised in correspondence from the Cayman Islands government and the WAC that: (i) the WAC is now the principal negotiator, and not the Cayman Islands government, in these license negotiations, and (ii) the WAC has determined that a rate of return on invested capital model ("RCAM") is in the best interest of the public and the Company'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.

In July 2012, in an effort to resolve several issues relating to the 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: (i) a declaration that certain provisions of the Water Authority Law, 2011 and the Water (Production and Supply) Law, 2011, appear to be incompatible and a determination as to how those provisions should be interpreted, (ii) a declaration that the WAC's roles as the principal license negotiator, statutory regulator and our competitor put the WAC in a position of hopeless conflict, and (iii) a declaration that the WAC's decision to replace the rate structure under our current exclusive license with RCAM was predetermined and unreasonable.

Throughout the course of the retail license renewal negotiations, the Company has objected to the use of RCAM on the basis that it believes such a model would not promote the efficient operation of its water utility and could ultimately increase water rates to its customers.

In October 2012, the Company was notified that the Court has agreed to consider the issues raised by the Company in the Application. As a result, the Company, the Cayman Islands government and the WAC would have the opportunity to present their positions to the Court in a trial proceeding. The hearing for this judicial review was held on April 1, 2014, and the Court has not yet rendered its findings.

Prior to the hearing taking place, the parties agreed by consent 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 further representations regarding the model that should be used in the renewed license.

If the Company does not ultimately enter into a new license agreement and no other party is awarded a license, the Company expects to be permitted to continue to supply water to its service area.

It is possible that the Cayman Islands government could offer a third party a license to service some or all of the Company's present service area. In such event, the Company may assume the license offered to the third party by exercising its right of first refusal. However, the terms of any new license agreement may not be as favorable to the Company as the terms under which it is presently operating and could materially reduce the operating income and cash flows that the Company has historically generated from its retail license and could require the Company to record an impairment charge to reduce the \$3,499,037 carrying value of its goodwill. Such impairment charge could have a material adverse impact on the Company's results of operations.

The Company is presently unable to determine what impact the resolution of this matter will have on its cash flows, financial condition or results of operations.

Windsor Plant Water Supply Agreement

CW-Bahamas provides bulk water to the Water and Sewerage Corporation of The Bahamas ("WSC"), which distributes the water through its own pipeline system to residential, commercial and tourist properties on the Island of New Providence. Pursuant to a water supply agreement, CW-Bahamas was required to provide the WSC with at least 16.8 million gallons per week of potable water from the Windsor plant, and the WSC had contracted to purchase at least that amount from CW-Bahamas on a take-or-pay basis. This water supply agreement expired when CW-Bahamas delivered the total amount of water required under the agreement in July 2013.

At the conclusion of the agreement, the WSC has the option to (i) extend the agreement for an additional five years at a rate to be negotiated; (ii) exercise a right of first refusal to purchase any materials, equipment and facilities that CW-Bahamas intends to remove from the site at a purchase price to be negotiated; or (iii) require CW-Bahamas to remove all materials, equipment and facilities from the site. At the request of the government of The Bahamas, CW-Bahamas continues to operate the Windsor plant to provide the government of The Bahamas with additional time to decide whether or not it will extend CW-Bahamas' water supply agreement for the Windsor plant on a long term basis. The Company is presently unable to determine if CW-Bahamas' water supply agreement for its Windsor plant will be extended or, if extended, on what terms. CW-Bahamas generated approximately \$1.7 million and \$1.8 million in revenues from the operation of this plant during the three months ended March 31, 2014 and 2013, respectively.

CW-Belize

By Statutory Instrument No. 81 of 2009, the Minister of Public Utilities of the government of Belize published an order, the Public Utility Provider Class Declaration Order, 2009 (the "Order"), which as of May 1, 2009 designated CW-Belize as a public utility provider under the laws of Belize. With this designation, the Public Utilities Commission of Belize (the "PUC") has the authority to set the rates charged by CW-Belize and to otherwise regulate its activities. On November 1, 2010, CW-Belize received a formal complaint from the PUC alleging that CW-Belize was operating without a license under the terms of the Water Industry Act. CW-Belize applied for this license in December 2010. On July 29, 2011, the PUC issued the San Pedro Public Water Supply Quality and Security Complaint Order (the "Second Order") which among other things requires that (i) CW-Belize and its customer jointly make a submission to the responsible Minister requesting that the area surrounding CW-Belize's seawater abstraction wells be designated a forest reserve or national park and be designated a Controlled Area under section 58 of the Water Industry Act, (ii) CW-Belize submit an operations manual for CW-Belize's desalination plant to the PUC for approval, (iii) CW-Belize and its customer modify the water supply agreement between the parties to (a) include new water quality parameters included in the Order and (b) cap the current exclusive water supply arrangement in the agreement at a maximum of 450,000 gallons per day, (iv) CW-Belize keep a minimum number of replacement seawater RO membranes in stock at all times and (v) CW-Belize take possession of and reimburse the PUC for certain equipment which the PUC purchased from a third-party in late 2010. CW-Belize has applied for declaratory judgment and has been granted a temporary injunction to stay the enforcement of the Second Order by the PUC until such time as the matter could be heard by the Belize courts. The initial hearing on this matter was conducted on October 30 and 31, 2012 with an additional hearing on November 29, 2012. The ruling on this case is pending. The Company is presently unable to determine what impact the Order and the Second Order will have on its results of operations, financial position or cash flows.

9. Impact of recent accounting pronouncements

In March 2013, the FASB issued ASU 2013-05, *Foreign Currency Matters (Topic 830: Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity)*. This ASU offers guidance on a parent's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendment is effective for annual and interim reporting periods beginning after December 15, 2013. The adoption of ASU 2013-05 did not have an impact on the Company's consolidated financial statements.

10. Subsequent events

The Company's management evaluated subsequent events through the time of the filing of this report on Form 10-Q. Other than as disclosed in these condensed consolidated financial statements, the Company's management is not aware of any significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on its consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including but not limited to, statements regarding our future revenues, future plans, objectives, expectations and events, assumptions and estimates. Forward-looking statements can be identified by use of the words or phrases "will," "will likely result," "are expected to," "will continue," "estimate," "project," "potential," "believe," "anticipate," "expect," "intend," or similar expressions and variations of such words. Statements that are not historical facts are based on our current expectations, beliefs, assumptions, estimates, forecasts and projections for our business and the industry and markets related to our business.

The forward-looking statements contained in this report are not guarantees of future performance and involve certain risks, uncertainties and assumptions which are difficult to predict. Actual outcomes and results may differ materially from what is expressed in such forward-looking statements. Important factors which may affect these actual outcomes and results include, without limitation:

- tourism and weather conditions in the areas we serve;
- the economies of the U.S., the areas, and the governments we serve;
- our relationships with the governments we serve;
- regulatory matters, including resolution of the negotiations for the renewal of our retail license on Grand Cayman;
- our ability to successfully enter new markets, including Mexico and Asia; and
- other factors, including those "Risk Factors" set forth under Part II, Item 1A in this Quarterly Report and in our 2013 Annual Report on Form 10-K.

Each of the forward-looking statements in this Quarterly Report speaks as of its date. We expressly disclaim any obligation or undertaking to update or revise any forward-looking statement contained in this Quarterly Report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based, except as may be required by law.

Unless otherwise indicated, references to "we," "our," "ours" and "us" refer to Consolidated Water Co. Ltd. and its subsidiaries.

Critical Accounting Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Our actual results could differ significantly from such estimates and assumptions.

Certain of our accounting estimates or assumptions constitute “critical accounting estimates” for us because:

- the nature of these estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

- the impact of the estimates and assumptions on financial condition and results of operations is material.

Our critical accounting estimates relate to the valuation of our (i) equity investment in our affiliate, OC-BVI; and (ii) goodwill and intangible assets.

Valuation of Investment in OC-BVI. We account for our 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 our investment in OC-BVI, we estimate 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 us to estimate OC-BVI's cash flows from (i) its water supply agreement with the BVI government for its Bar Bay plant (the "Bar Bay agreement"); and (ii) the pending amount 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.

We estimate 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. We similarly estimate the cash flows OC-BVI will receive from the BVI government for the amount due under the ruling by the Eastern Caribbean Court of Appeals 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 our best estimate of future cash flows, to be derived by OC-BVI from its Bar Bay agreement and the pending 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 us. While we use our 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 our management over time based upon new information or changes in circumstances.

During the fourth quarter of 2013, after reassessing what we believe will be the future demand for water in Tortola, British Virgin Islands, and the probable sources the BVI government will utilize to meet this demand, we determined it appropriate to modify the projections of cash flows for OC-BVI that we use to estimate the fair value of our investment in OC-BVI by increasing (from those used in prior years) the probabilities assigned to those scenarios that result in a lower supply of water or revenue stream from the Bar Bay plant. Based on these current estimates of OC-BVI's cash flows and our resulting estimate of the fair value of our investment in OC-BVI, we determined that the carrying value of our investment in OC-BVI exceeded its fair value and recorded an impairment loss on this investment of \$200,000. The resulting carrying value of our investment in OC-BVI of approximately \$6.6 million as of December 31, 2013, and our current carrying value for this investment of approximately \$6.0 million as of March 31, 2014, are based upon the assumptions that the BVI government will honor its obligations under the Bar Bay agreement and (on a probability-weighted basis) that the BVI government will exercise its option to extend the Bar Bay agreement for seven years beyond its initial term, which expires in 2017.

The \$6.0 million carrying value of our investment in OC-BVI as of March 31, 2014 exceeds our underlying equity in OC-BVI's net assets by approximately \$2.8 million. We account 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 and OC-BVI receives (or is determined by the court 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 expansion or other modification of its Bar Bay agreement that results in a significant increase in the estimated future cash flows from its Bar Bay plant, we will be required to record impairment losses in future periods to reduce the carrying value of our investment in OC-BVI to its then current fair value. These impairment losses will, in the aggregate, equal the underlying \$2.8 million in goodwill reflected in the carrying value of our investment in OC-BVI and could have a material adverse effect on our earnings and consolidated statement of operations.

Goodwill and intangible assets. Goodwill represents the excess cost over the fair value of the assets of an acquired business. Goodwill and intangible assets acquired in a business combination accounted for as a purchase and determined to have an indefinite useful life are not amortized, but are tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values and reviewed periodically for impairment. We evaluate the possible impairment of goodwill annually as part of our reporting process for the fourth quarter of each fiscal year. Management identifies our reporting units and determines the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units. We determine the fair value of each reporting unit and compare the fair value to the carrying amount of the reporting unit. To the extent the carrying amount of the reporting unit exceeds the fair value of the reporting unit, we are required to perform the second step of the impairment test, as this is an indication that the reporting unit goodwill may be impaired. In this step, we compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. If the implied fair value is less than its carrying amount, the impairment loss is recorded.

For each of the years in the three-year period ended December 31, 2013, we estimated the fair value of our reporting units by applying the discounted cash flow method, the subject company stock price method, the guideline public company method, the mergers and acquisitions method and, on an exception basis and where necessary and appropriate, the net asset value method.

The discounted cash flow method relied upon seven-year discrete projections of operating results, working capital and capital expenditures, along with a terminal value subsequent to the discrete period. These seven-year projections were based upon historical and anticipated future results, general economic and market conditions, and considered the impact of planned business and operational strategies. The discount rates for the calculations represented the estimated cost of capital for market participants at the time of each analysis. In preparing these seven-year projections for our retail unit we (i) identified possible outcomes of our on-going negotiations with the Cayman Islands government for the renewal of our retail license; (ii) estimated the cash flows associated with each possible outcome; and (iii) assigned a probability to each outcome and associated estimated cash flows. The weighted average estimated cash flows were then summed to determine the overall fair value of the retail unit under this method. The possible outcomes used for the discounted cash flow method for the retail unit included the implementation of a rate of return on invested capital model, the methodology proposed by Cayman Islands government representatives for the new retail license.

We also estimated the fair value of each of our reporting units for each of the years in the three-year period ended December 31, 2013 through reference to the quoted market prices for our Company and guideline companies and the market multiples implied by guideline merger and acquisition transactions. For the year ended December 31, 2012, we also relied upon net asset values to estimate the fair value of our services unit.

We weighted the fair values estimated for each of our reporting units under each method and summed such weighted fair values to estimate the overall fair value for each reporting unit. We changed the relative weightings for 2013 from those used for 2012 to increase the weightings applied to those methods that resulted in more conservative estimates of fair value. The respective weightings we applied to each method for the years ended December 31, 2013 and 2012 are as follows:

| Method | 2013 | | | 2012 | | |
|-----------------------------|--------|-------|----------|--------|-------|----------|
| | Retail | Bulk | Services | Retail | Bulk | Services |
| Discounted cash flow | 50 % | 50 % | - | 20 % | 30 % | - |
| Subject company stock price | 30 % | 30 % | - | 60 % | 50 % | 10 % |
| Guideline public company | 10 % | 10 % | - | 10 % | 10 % | - |
| Mergers and acquisitions | 10 % | 10 % | - | 10 % | 10 % | - |
| Net asset value | - | - | - | - | - | 90 % |
| | 100 % | 100 % | - | 100 % | 100 % | 100 % |

The fair values we estimated for our retail, bulk and services units exceeded their carrying amounts for the year ended December 31, 2011. The fair values we estimated for our retail and bulk units exceeded their carrying amounts by 39% and 6%, respectively, for the year ended December 31, 2012. The fair value we estimated for our services unit for the year ended December 31, 2012 was 10% less than its carrying amount. As a result of this estimate and our subsequent step 2 analysis of the implied fair value of the goodwill recorded for our services unit, we recorded an impairment charge for the services unit goodwill of \$88,717 for the year ended December 31, 2012. The fair values we estimated for our retail and bulk units exceeded their carrying amounts by 47% and 23%, respectively, for the year ended December 31, 2013.

We also performed an analysis reconciling the conclusions of value for our reporting units to our market capitalization at October 1, 2013. This reconciliation did not result in an implied control premium for our Company.

RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included under Part I, Item 1 of this Quarterly Report and our consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for our fiscal year ended December 31, 2013 (“2013 Form 10-K”) and the information set forth under Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2013 Form 10-K.

Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013

Consolidated Results

Net income attributable to our common stockholders for the three months ended March 31, 2014 was \$654,909 (\$0.04 per share on a fully-diluted basis), as compared to \$3,742,003 (\$0.26 per share on a fully-diluted basis) for the three months ended March 31, 2013.

Total revenues for the three months ended March 31, 2014 decreased to \$16,348,610 from the \$16,555,197 in revenues generated for the three months ended March 31, 2013, due to a decrease in revenues for the retail segment. Gross profit for the three months ended March 31, 2014 was \$5,970,425 or 37% of total revenues, as compared to \$6,220,507, or 38% of total revenues, for the three months ended March 31, 2013, as gross profit for the bulk segment increased while gross profit for the retail and services segments decreased. For further discussion of revenues and gross profit for the three months ended March 31, 2014, see the “Results by Segment” analysis that follows.

General and administrative (“G&A”) expenses on a consolidated basis were \$5,342,633 and \$3,568,936 for the three months ended March 31, 2014 and 2013, respectively. For 2014 as compared to 2013, project development expenses incurred by our Mexico subsidiary, N.S.C. Agua, S.A. de C.V., (“NSC”) increased by approximately \$1.5 million, professional fees increased by \$120,000, employee costs were approximately \$124,000 higher due to base salary increases, and an increase of \$27,000 in information technology expenses.

Interest income remained relatively consistent at \$172,932 for the three months ended March 31, 2014 as compared to \$180,088 for the three months ended March 31, 2013.

Interest expense for the three months ended March 31, 2014 and 2013 was \$295,737 and \$132,425, respectively. The increase in interest expense for 2014 reflects the prepayment premium paid for the early redemption on February 17, 2014 of the remaining outstanding balance on our bonds payable and the amortization of the related bond discount and deferred issuance costs.

We recognized earnings and profit sharing on our investment in OC-BVI for the three months ended March 31, 2014 and 2013, of \$74,739 and \$1,075,320, respectively. The additional earnings and profit sharing we recognized in 2013 from this equity investment resulted from the payment by the British Virgin Islands government to OC-BVI in January 2013 of the remaining \$2.0 million of the amount awarded to OC-BVI as a result of the Baughers Bay litigation. See further discussion of this litigation at Note 6 of the Notes to Condensed Consolidated Financial Statements included at “ITEM 1. FINANCIAL STATEMENTS” of this Quarterly Report.

Results by Segment

Retail Segment:

The retail segment contributed \$293,356 and \$928,750 to our income from operations for the three months ended March 31, 2014 and 2013, respectively.

Revenues generated by our retail water operations were \$6,112,961 and \$6,395,012 for the three months ended March 31, 2014 and 2013, respectively. The decrease in retail revenues from 2013 to 2014 resulted from a decrease in the total gallons of water sold by the retail segment of approximately 4%. This decrease in volume of gallons sold reflects lower purchases by several of our larger retail customers. Based upon our discussions with these customers, we understand that part of the decrease in the water volumes they purchased resulted from their adoption of water conservation measures. The decrease in the volume of gallons sold from 2013 to 2014 also reflects rainfall on Grand

Cayman that was twelve times greater during the three months ended March 31, 2014 as compared to the three months ended March 31, 2013.

Retail segment gross profit was \$3,181,585 (52% of revenues) and \$3,560,260 (56% of revenues) for the three months ended March 31, 2014 and 2013, respectively. The decrease in retail gross profit was primarily due to the decrease in revenues from 2013 to 2014 as the majority of our retail segment's cost of revenues are relatively fixed in nature.

Consistent with prior periods, we record all non-direct G&A expenses in our retail business segment and do not allocate any of these non-direct costs to our other two business segments. Retail segment G&A expenses for the three months ended March 31, 2014 and 2013 were \$2,888,229 and \$2,631,510, respectively. G&A expenses increased from 2013 to 2014 primarily due to an increase of \$118,000 in employee costs due to base salary increases and an increase of \$113,000 in legal fees related to the negotiations for the renewal of our retail license.

During the latter half of 2012, we commenced, through our subsidiary, PT Consolidated Water Bali, the construction of a seawater reverse osmosis (“SWRO”) plant in Nusa Dua, one of the primary tourist areas of Bali, Indonesia. We believe the water demands of the tourist resorts in Nusa Dua will soon exceed the water supplies that can be provided to the area by the local public water utility, and that other areas of Bali will also eventually experience fresh water shortages. However, as SWRO has not been employed to any meaningful extent in Bali, we concluded that to obtain customers in Bali we must first demonstrate the viability of SWRO as well as our capabilities and expertise. Consequently, we elected to construct this plant before obtaining commitments for most of its production. We believe sufficient demand exists in Nusa Dua to enable us to sell all of the plant’s capacity, although we cannot assure that we will be able to do so. The capital investment for this plant is estimated at approximately \$5 million, which will fund production, reservoir storage, and distribution capacity of approximately 750,000 gallons per day. As of March 31, 2014, capitalized costs for this plant reflected on our consolidated balance sheet were approximately \$3.4 million. The revenues we generated from this plant amounted to approximately \$23,000 for the three months ended March 31, 2014.

Bulk Segment:

The bulk segment contributed \$2,413,222 and \$2,261,030 to our income from operations for the three months ended March 31, 2014 and 2013, respectively.

Bulk segment revenues remained relatively consistent at \$9,959,736 and \$9,856,690 for the three months ended March 31, 2014 and 2013, respectively.

Bulk segment gross profit was \$2,848,191 (29% of revenues) and \$2,669,277 (27% of revenues) for the three months ended March 31, 2014 and 2013, respectively. The improvement in gross profit dollars and in gross profit as a percentage of sales from 2013 to 2014 reflects improved margins for our Cayman bulk operations.

Bulk segment G&A expenses were relatively consistent at \$434,969 and \$408,247 for the three months ended March 31, 2014 and 2013, respectively.

We supplied the aggregate amount of water contracted by the Water & Sewerage Corporation of The Bahamas (“WSC”) under the water supply agreement for our Windsor plant in July 2013, at which time such agreement expired. However, we are presently continuing to supply water to the WSC from this plant. See further discussion of the Windsor plant at “Material Commitments, Expenditures and Contingencies.”

Services Segment:

The services segment incurred losses from operations of (\$2,078,786) and (\$538,209) for the three months ended March 31, 2014 and 2013, respectively. We expect our services segment to continue to incur losses from operations while we continue to fund the project development activities of NSC and/or until such time as we obtain significant new management services or plant construction contracts with external customers.

Services segment revenues were \$275,913 and \$303,495 for the three months ended March 31, 2014 and 2013, respectively. Services revenues decreased from 2013 to 2014 due to a non-recurring sale of chemicals and materials to an unrelated company in 2013.

Our services segment generated a negative gross profit of (\$59,351) and (\$9,030) for the three months ended March 31, 2014 and 2013, respectively. The reduction in gross profit for 2014 reflects higher engineering expenses and greater employee costs.

G&A expenses for the services segment were \$2,019,435 and \$529,179 for the three months ended March 31, 2014 and 2013, respectively. The increase in G&A expenses for 2014 as compared to 2013 reflects an increase of approximately \$1.5 million in the project development activities of NSC attributable to a \$1.0 million payment on an option agreement to purchase the shares in NSC held by one of its shareholders and a \$350,000 payment made to reimburse a construction contractor for pilot testing and water monitoring activities conducted by the contractor on behalf of NSC. Such reimbursement was required due to NSC’s decision not to extend a memorandum of understanding with this contractor. See further discussion of these two payments at Item 1 – Notes to Condensed Consolidated Financial Statements – Note 7.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity Position

Our projected liquidity requirements for the remainder of 2014 include capital expenditures for our existing operations of approximately \$5.1 million, approximately \$17.0 million to purchase the land site for NSC's project and approximately \$6.7 million for NSC's project development activities. Our liquidity requirements for 2014 may also include quarterly dividends, if such dividends are declared by our Board. Our dividend payments amounted to approximately \$4.4 million for the year ended December 31, 2013 and approximately \$1.1 million for the three months ended March 31, 2014.

We have obtained a commitment for new financing to fund NSC's pending land purchases which are due in May 2014 in the form of a \$10.0 million demand loan with payments due quarterly under a five year amortization schedule and the remaining principal balance due after two years. This loan will bear interest at LIBOR plus 1.5%.

As of March 31, 2014, we had cash of approximately \$24.7 million and working capital of approximately \$45.6 million and during the second quarter, the Bahamas government paid us \$11.0 million on the Water and Sewerage Corporation's delinquent accounts receivable balances. We are not presently aware of anything that would lead us to believe that we will not have sufficient liquidity to meet our needs for 2014 and thereafter. However, our available cash and working capital balances as of March 31, 2014 could decline over the course of 2014 as we continue, as we presently anticipate, funding the project development activities of NSC.

Borrowings Outstanding

As of December 31, 2013, our borrowings outstanding with an aggregate unamortized balance of \$5,205,167 consisted entirely of bonds payable bearing interest at a contractual rate of 5.95%. These bonds were issued in August 2006 in the principal amount of \$15,771,997 in a private offering. We received net proceeds (excluding issuance costs and after the offering discount) from this issuance of \$14,445,720. These bonds were repayable in quarterly principal and interest installments of \$526,010, and were scheduled to mature in 2016. We had the right to redeem these bonds in full at any time after August 4, 2009 at a premium of 1.5% of the outstanding principal and accrued interest on the bonds on the date of redemption. We exercised this right in February 2014 and redeemed these bonds.

Material Commitments, Expenditures and Contingencies

Renewal of Retail License

We sell water through our retail operations under a license issued in July 1990 by the Cayman Islands government that grants Cayman Water the exclusive right to provide 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, we have the exclusive right to produce potable water and distribute it by pipeline to our 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 March 31, 2014 and 2013 we generated approximately 37% and 39%, respectively, of our consolidated revenues and 55% and 58%, respectively, of our consolidated gross profits from the retail water operations conducted pursuant to our exclusive license. If we are not in default of any of its terms, this license provides us with the right of first refusal to renew the license on terms that are no less favorable than those that the government offers to any third party.

Under our license, we pay a royalty to the government of 7.5% of our gross retail water sales revenues (excluding energy adjustments). The selling prices of water sold to our 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 (“WAC”), on behalf of the government, reviews and confirms the calculations of the price adjustments for inflation and electricity costs. If we want to adjust our prices for any reason other than inflation or electricity costs, we have to request prior approval of the Cabinet of the Cayman Islands government. Disputes regarding price adjustments are referred to arbitration. Our last price increase, requested in June 1985, was granted in full.

This license was set to expire on July 10, 2010; however, we and the Cayman Islands government have extended the license several times in order to provide sufficient time to negotiate the terms of a new license agreement. The most recent extension of our license expires June 30, 2014.

In February 2011, the Water (Production and Supply) Law, 2011 (which replaces the Water (Production and Supply) Law (1996 Revision)) and the Water Authority (Amendment) Law, 2011 (the “New Laws”) were published and are now in full force and effect. Under the New Laws, the WAC would issue any new license which could include a rate of return on invested capital model described below.

We have been advised in correspondence from the Cayman Islands government and the WAC that: (i) the WAC is now the principal negotiator, and not the Cayman Islands government, in these license negotiations, and (ii) the WAC

has determined that a rate of return on invested capital model (“RCAM”) is in the best interest of the public and the Company’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. We have advised the Cayman Islands government that we disagree with its position on these two issues.

In July 2012, in an effort to resolve several issues relating to our retail license renewal negotiations, we filed an Application for Leave to Apply for Judicial Review (the “Application”) with the Grand Court of the Cayman Islands (the “Court”), seeking: (i) a declaration that certain provisions of the Water Authority (Amendment) Law, 2011 and the Water (Production and Supply) Law, 2011, appear to be incompatible and a determination as to how those provisions should be interpreted, (ii) a declaration that the WAC’s roles as the principal license negotiator, statutory regulator and our competitor put the WAC in a position of hopeless conflict, and (iii) a declaration that the WAC’s decision to replace the rate structure under our current exclusive license with RCAM was predetermined and unreasonable.

Throughout the course of the license renewal negotiations, we have objected to the use of RCAM on the basis that we believe such a model would not promote the efficient operation of our water utility and could ultimately increase water rates to our customers.

In October 2012, we were notified that the Court agreed to consider the issues outlined in the Application. As a result, our Company, the Cayman Islands government and the WAC would have the opportunity to present their positions to the Court in a trial proceeding. The hearing for this judicial review was held on April 1, 2014, and the Court has not yet rendered its findings.

Prior to the hearing taking place, the parties agreed by consent that the Court should solely be concerned with the interpretation of the statutory provisions. As part of this agreement, the WAC agreed to consider our further representations regarding the model that should be used in the renewed license.

In August 2013, we met with representatives of the Cayman Islands government and the WAC to discuss the status of our license negotiations. As a result of this meeting, all parties agreed to await the outcome of the pending judicial review before recommencing any meaningful negotiations on the license. Subsequently our water utility license on Grand Cayman was extended until June 30, 2014 to allow additional time for the judicial review proceedings to conclude.

If we do not ultimately enter into a new license agreement and no other party is awarded a license, we expect to be permitted to continue to supply water to our service area.

It is possible that the Cayman Islands government could offer a third party a license to service some or all of our present service area. In such event, we may assume the license offered to the third party by exercising our right of first refusal. However, the terms of any new license agreement may not be as favorable to us as the terms under which we are presently operating and could materially reduce the operating income and cash flows that we have historically generated from our retail license and could require us to record an impairment loss to reduce the \$3,499,037 carrying value of our goodwill. Such impairment loss could be material to our results of operations.

Under the New Laws, the Governor in Cabinet sets the rates and rate adjustment mechanisms for water and sewerage services of the WAC. On October 30, 2012 by order of Cabinet, the regulations which govern the base water and sewerage rates charged by the WAC were amended to include an annual inflation adjustment mechanism which is functionally the same as the inflation adjustment mechanism included in our extended license agreement. In addition, the rates charged by the WAC for sewerage services now include a monthly energy adjustment charge which allows the WAC to increase or decrease their sewerage charges to reflect monthly changes in energy costs. This new energy adjustment charge is also functionally similar to the energy adjustment charge contained in our extended license agreement. Finally, WAC's base water and sewerage rates were immediately increased by an average of 9.2% in November 2012. We believe that as a result of these fundamental changes, the WAC's rate structure is now consistent with the rate structure of our extended license agreement. In our opinion, such changes are inconsistent with the WAC's previous assertion that a rate of return on invested capital model is in the best interests of the public.

NSC Agua

In May 2010, we acquired, through our wholly-owned Netherlands subsidiary, Consolidated Water Cooperatief, U.A., ("Cooperatief") a 50% interest in N.S.C. Agua, S.A. de C.V., ("NSC") a development stage Mexican company. We have since purchased, through the conversion of a loan we made to NSC, sufficient shares to raise our 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. We believe such a project can be successful due to what we anticipate will be a growing need for a new potable water supply for the areas of northern Baja California, Mexico and Southern California, United States. To complete this project, NSC engaged two engineering groups with extensive regional and/or technical experience and conducted an equipment piloting plant and water quality data collection program at the proposed feed water source under a Memorandum of Understanding (the "EPC MOU") with a global engineering, procurement and construction contractor for large seawater desalination plants. If this project is completed, we expect to participate in the operation of the plant and pipeline and also expect to retain a minority ownership position in the project. NSC is presently seeking contracts with proposed customers in Mexico and the United States of America 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, completing the purchases of land required for the project, obtaining approvals and permits from various governmental agencies in Mexico and the United States, 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, we entered into an agreement (the “Option Agreement”) that provided us 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 Cooperatief by issuing additional shares of its stock. As a result of this share issuance to Cooperatief, we acquired 99.9% of the ownership of NSC. The Option Agreement contained an anti-dilutive provision that required us 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) we did not exercise our share purchase option by February 7, 2014. We exercised our option and purchased the Option Agreement shares in February 2014.

NSC has entered into a purchase contract for 8.1 hectares of land on which the proposed plant would be constructed. In 2012, NSC 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 is required to pay a balance of \$6.98 million on May 15, 2014 to complete the purchase of this land. In 2013, NSC purchased an additional 12 hectares of land, which constitute most of the land required for the project, for \$12 million, of which \$2 million has been paid. The remaining \$10 million balance for this purchase is due on May 15, 2014.

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 has 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 developing additional sampling protocols to comply with regulatory requirements in the U.S. and Mexico, and is also coordinating with regulators to assess the need, if any, for further process piloting.

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 United States.

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.

We include the accounts of NSC in our consolidated financial statements. Included in our 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 \$1,977,851 and \$479,307 for the three months ended March 31, 2014 and 2013, respectively. The assets and liabilities of NSC included in the consolidated balance sheets amounted to approximately \$14.6 million and \$10.5 million, respectively, as of March 31, 2014 and approximately \$13.7 million and \$10.3 million, respectively, as of December 31, 2013.

Significant additional funding will be required to complete NSC's development activities. Presently, we estimate we will expend approximately \$23.7 million in the remainder of 2014 on behalf of NSC, consisting of approximately \$17.0 million to purchase the land (a portion or all of which may be financed) and \$6.7 million in other project development expenses.

We also expect to incur project development costs on behalf of NSC after 2014 as we estimate that it will take at least until the first quarter of 2015 for NSC to complete all of the development activities necessary to commence construction of the plant and pipeline, which include completing the site piloting plant activities, completing the purchase of the land for the plant, securing feed water and power supplies, completing the engineering and feasibility studies, negotiating customer contracts, obtaining the required rights-of-way and regulatory permits and arranging the project financing. However, NSC may ultimately be unable to complete all of the activities necessary to begin construction of the project.

CW-Belize

By Statutory Instrument No. 81 of 2009, the Minister of Public Utilities of the government of Belize published an order, the Public Utility Provider Class Declaration Order, 2009 (the "Order"), which as of May 1, 2009 designated CW-Belize as a public utility provider under the laws of Belize. With this designation, the Public Utilities Commission of Belize (the "PUC") has the authority to set the rates charged by CW-Belize and to otherwise regulate its activities. On November 1, 2010, CW-Belize received a formal complaint from the PUC alleging that CW-Belize was operating without a license under the terms of the Water Industry Act. CW-Belize applied for this license in December 2010. On July 29, 2011, the PUC issued the San Pedro Public Water Supply Quality and Security Complaint Order (the "Second Order") which among other things requires that (i) CW-Belize and its customer jointly make a submission to the responsible Minister requesting that the area surrounding CW-Belize's seawater abstraction wells be designated a forest reserve or national park and be designated a Controlled Area under section 58 of the Water Industry Act, (ii) CW-Belize submit an operations manual for CW-Belize's desalination plant to the PUC for approval, (iii) CW-Belize and its customer modify the water supply agreement between the parties to (a) include new water quality parameters included in the Order and (b) cap the current exclusive water supply arrangement in the agreement at a maximum of 450,000 gallons per day, (iv) CW-Belize keep a minimum number of replacement seawater RO membranes in stock at all times and (v) CW-Belize take possession of and reimburse the PUC for certain equipment which the PUC purchased from a third-party in late 2010. CW-Belize has applied for declaratory judgment and has been granted a temporary injunction to stay the enforcement of the Second Order by the PUC until such time as the matter could be

heard by the Belize courts. The initial hearing on this matter was conducted on October 30 and 31, 2012 with an additional hearing on November 29, 2012. The ruling on this case is pending. We are presently unable to determine what impact the outcome of this matter will have on our results of operations, financial position or cash flows.

Transfers of U.S. dollars from CW-Belize to our other subsidiaries require authorization in advance from the Central Bank of Belize.

Windsor plant

Our subsidiary CW-Bahamas provides bulk water to the Water and Sewerage Corporation of The Bahamas (“WSC”), which distributes the water through its own pipeline system to residential, commercial and tourist properties on the Island of New Providence. Pursuant to a water supply agreement, we are required to provide the WSC with at least 16.8 million gallons per week of potable water from our Windsor plant, and the WSC has contracted to purchase at least that amount from us on a take-or-pay basis. This water supply agreement expired when we delivered the total amount of water required under the agreement in July 2013.

At the conclusion of the agreement, the WSC has the option to (i) extend the agreement for an additional five years at a rate to be negotiated; (ii) exercise a right of first refusal to purchase any materials, equipment and facilities that CW-Bahamas intends to remove from the site at a purchase price to be negotiated; or (iii) require CW-Bahamas to remove all materials, equipment and facilities from the site. At the request of the government of The Bahamas, we continue to operate the Windsor plant to provide the government of The Bahamas with additional time to decide whether or not it will extend CW-Bahamas' water supply agreement for the Windsor plant on a long term basis. We are presently unable to determine if CW-Bahamas' water supply agreement for its Windsor plant will be extended or, if extended, on what terms. CW-Bahamas generated approximately \$1.7 million and \$1.8 million in revenues from the operation of this plant during the three months ended March 31, 2014 and 2013, respectively.

Dividends

On January 31, 2014, we paid a dividend of \$0.075 to shareholders of record on January 1, 2014. On February 18, 2014, our Board declared a dividend of \$0.075 payable on April 30, 2014 to shareholders of record on April 1, 2014.

We have paid dividends to owners of our common shares and redeemable preference shares since we began declaring dividends in 1985. Our payment of any future cash dividends will depend upon our earnings, financial condition, cash flows, capital requirements and other factors our Board deems relevant in determining the amount and timing of such dividends.

Dividend Reinvestment and Common Stock Purchase Plan

This program is available to our shareholders, who may reinvest all or a portion of their common cash dividends into shares of common stock at prevailing market prices and may also invest optional cash payments to purchase additional shares at prevailing market prices as part of this program.

Impact of Inflation

Under the terms of our Cayman Islands license and our water sales agreements in Belize, Bahamas and the British Virgin Islands, our water rates are automatically adjusted for inflation on an annual basis, subject to temporary exceptions. We, therefore, believe that the impact of inflation on our gross profit, measured in consistent dollars, will not be material. However, significant increases in items such as fuel and energy costs could create additional credit risks for us, as our customers' ability to pay our invoices could be adversely affected by such increases.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our exposure to market risk from December 31, 2013 to the end of the period covered by this report.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management has evaluated, with the participation of its principal executive officer and principal financial and accounting officer, the effectiveness of its disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, our principal executive officer and principal financial and accounting officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

Changes in Internal Controls

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of such internal control that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1A. RISK FACTORS

Our business faces significant risks. These risks include those disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 as supplemented by the additional risk factors included below. If any of the events or circumstances described in the referenced risks actually occurs, our business, financial condition or results of operations could be materially adversely affected and such events or circumstances could cause our

actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. These risks should be read in conjunction with the other information set forth in this Quarterly Report as well as in our Annual Report on Form 10-K for the year ended December 31, 2013 and in our other periodic reports on Form 10-Q and Form 8-K.

Our exclusive license to provide water to retail customers in the Cayman Islands may not be renewed in the future.

In the Cayman Islands, we provide water to retail customers under a license issued to us in July 1990 by the Cayman Islands government that grants us the exclusive right to provide water to retail customers within our licensed service area. Our service area is comprised of an area on Grand Cayman that includes the Seven Mile Beach and West Bay areas, two of the three most populated areas in the Cayman Islands. For the three months ended March 31, 2014 and 2013 we generated approximately 37% and 39%, respectively, of our consolidated revenues and 55% and 58%, respectively, of our consolidated gross profits from the retail water operations conducted pursuant to our exclusive license. If we are not in default of any of its terms, the license provides us with the right of first refusal to renew the license on terms that are no less favorable than those that the government offers to any third party.

This license was set to expire on July 10, 2010; however, we and the Cayman Islands government have extended the license several times in order to provide sufficient time to negotiate the terms of a new license agreement. The most recent extension of our license expires June 30, 2014.

In February 2011, the Water (Production and Supply) Law, 2011 (which replaces the Water (Production and Supply) Law (1996 Revision)) and the Water Authority (Amendment) Law, 2011 (the “New Laws”) were published and are now in full force and effect. Under the New Laws, the Water Authority-Cayman (“WAC”) would issue any new license which could include a rate of return on invested capital model described below.

We have been advised in correspondence from the Cayman Islands government and the WAC that: (i) the WAC is now the principal negotiator, and not the Cayman Islands government, in these license negotiations, and (ii) the WAC has determined that a rate of return on invested capital model (“RCAM”) is in the best interest of the public and the Company’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. We have advised the Cayman Islands government that we do not agree with its position on the two issues.

In July 2012, in an effort to resolve several issues relating to our retail license renewal negotiations, we filed an Application for Leave to Apply for Judicial Review (the "Application") with the Grand Court of the Cayman Islands (the "Court"), seeking: (i) a declaration that certain provisions of the Water Authority Law, 2011 and the Water (Production and Supply) Law, 2011, appear to be incompatible and a determination as to how those provisions should be interpreted, (ii) a declaration that the WAC's roles as the principal license negotiator, statutory regulator and our competitor put the WAC in a position of hopeless conflict, and (iii) a declaration that the WAC's decision to replace the rate structure under our current exclusive license with RCAM was predetermined and unreasonable.

Throughout the course of the retail license renewal negotiations, we have objected to the use of RCAM on the basis that we believe such a model would not promote the efficient operation of our water utility and could ultimately increase water rates to our customers.

In October 2012, we were notified that the Court agreed to consider the issues outlined in the Application. As a result, our Company, the Cayman Islands government and the WAC would have the opportunity to present their positions to the Court in a trial proceeding. The hearing for this judicial review was held on April 1, 2014, and the Court has not yet rendered its findings.

Prior to the hearing taking place, the parties agreed by consent that the Court should solely be concerned with the interpretation of the statutory provisions. As part of this agreement, WAC agreed to consider our further representations regarding the model that should be used in the renewed license.

In August 2013, we met with representatives of the Cayman Islands government and the WAC to discuss the status of our license negotiations. As a result of this meeting, all parties agreed to await the outcome of the pending judicial review before recommencing any meaningful negotiations on the license. Subsequently our water utility license on Grand Cayman was extended until June 30, 2014 to allow additional time for the judicial review proceedings to conclude.

If we do not ultimately enter into a new license agreement and no other party is awarded a license, we expect to be permitted to continue to supply water to our service area.

The Cayman Islands government could offer a third party a license to service some or all of our present service area. In such event, we may assume the license offered to the third party by exercising our right of first refusal. However, the terms of any new license agreement may not be as favorable to us as the terms under which we are presently operating and could materially reduce the operating income and cash flows that we have historically generated from our retail license and could require us to record an impairment loss to reduce the \$3,499,037 carrying value of our goodwill. Such impairment loss could be material to our results of operations.

We have spent approximately \$15.6 million to fund the development costs for a possible project in Mexico and expect to expend significant additional funds in the future to continue to pursue this project. However, we may not be successful in completing this project.

We own (through our wholly-owned Netherlands subsidiary, Consolidated Water Cooperatief, U.A.) a 99.9% interest in N.S.C. Agua, S.A. de C.V., (“NSC”), a development stage Mexico company 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 system and the U.S. border. If this project is completed, we expect to participate in the operation of the plant and pipeline and also expect to retain a minority ownership position in the project. NSC has conducted an equipment piloting plant and water quality data collection program at the proposed feed water source and is presently seeking contracts with customers in Mexico and the United States of American for the sale of 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, completing the purchases of land required for the project, obtaining approvals and permits from various governmental agencies in Mexico and the United States, 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. As of March 31, 2014, we have spent approximately \$15.6 million on this project.

During the three months ended March 31, 2014 we (i) exercised an option to purchase the shares of one of the other shareholders of NSC for \$1.0 million, increasing our ownership in NSC to 99.9%; and (ii) decided not to extend a Memorandum of Understanding with one of our contractors, electing instead to reimburse this contractor \$350,000 for work performed in connection with our pilot plant and water data collection program.

NSC has entered into a purchase contract for 8.1 hectares of land on which the proposed plant would be constructed. In 2012, NSC 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 is required to pay a balance of \$6.98 million on May 15, 2014 to complete the purchase of this land. In 2013, NSC purchased an additional 12 hectares of land, which constitute most of the land required for the project, for \$12 million, of which \$2 million has been paid. The remaining \$10 million balance for this purchase is due on May 15, 2014.

We have determined that completing NSC’s development activities will require significant additional funding beyond the share purchase option and pilot plant expenses incurred during the three months ended March 31, 2014 and the remaining approximately \$17.0 million due to purchase the land for the project site. We expect to incur significant development expenses in 2014 and 2015 for this project. We estimate that it will take at least until the first quarter of 2015 for NSC to complete the development activities necessary to commence construction of the plant and pipeline, which include completing the site piloting plant activities, completing the purchase of the land for the plant, securing feed water and power supplies, completing the engineering and feasibility studies, negotiating customer contracts, obtaining the required rights-of-way and regulatory permits and arranging the project financing. However, NSC may

ultimately be unable to complete all of the activities necessary to begin construction of the project.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On March 28, 2014, we issued 12,302 common shares to one of our executive officers as part of his 2013 compensation pursuant to the terms of his executive employment agreement. The issuance of the shares was exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, because the executive officer has knowledge of all material information relating to us.

ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description |
|---------------------------|-------------------------------------------------------------------|
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.1 | Section 1350 Certification of Chief Executive Officer |
| 32.2 | Section 1350 Certification of Chief Financial Officer |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Schema |
| 101.CAL | XBRL Taxonomy Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Definition Linkbase |
| 101.LAB | XBRL Taxonomy Label Linkbase |
| 101.PRE | XBRL Taxonomy Presentation Linkbase |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CONSOLIDATED WATER CO. LTD.

By: /s/ Frederick W. McTaggart
Frederick W. McTaggart
Chief Executive Officer
(Principal Executive Officer)

By: /s/ David W. Sasnett
David W. Sasnett
Executive Vice President & Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: May 12, 2014