CONSOLIDATED WATER CO LTD
Form 10-K
March 16, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended **December 31, 2005**

OR

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

For the transaction period from _____________ to _____________

Commission File Number: **0-25248**

CONSOLIDATED WATER CO. LTD.

(Exact name of Registrant as specified in its charter)

CAYMAN ISLANDS	**N/A**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Regatta Office Park Windward Three, 4th Floor, West Bay Road P.O. Box 1114 GT Grand Cayman, Cayman Islands	**N/A**
(Address of principal executive offices)	(Zip Code)

Registrant s Telephone number, including area code: **(345) 945-4277**
Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, PAR VALUE $.60 (CI$0.50)

(Title of Class)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this 10-K or any amendments to this Form 10-K. [**Not Applicable**]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act. Yes x No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The aggregate market value of common stock held by non-affiliates of the registrant, based on the closing sales price for the registrant s ordinary shares, as reported on the Nasdaq National Market on June 30, 2005, was $149,585,207.

As at June 30, 2005, there were 11,731,488 shares of the registrant s common shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE : None

EXCHANGE RATES

Unless otherwise indicated, all dollar amounts are in United States Dollars and references to $, U.S. , or U.S.$ are to United States Dollars.

The official fixed exchange rate for conversion of CI$ into U.S. $, as determined by the Cayman Islands Monetary Authority, has been fixed since April 1974 at U.S. $1.20 per CI$1.00.

The official fixed exchange rate for conversion of BZE$ into U.S. $, as determined by the Central Bank of Belize, has been fixed since 1976 at U.S.$ 0.50 per BZE$ 1.00.

The official fixed exchange rate for conversion of BAH$ into U.S .$, as determined by the Central Bank of The Bahamas, has been fixed since 1973 at U.S.$ 1.00 per BAH$ 1.00.

The official fixed exchange rate for conversation of BDS$ into U.S. $ as determined by the Central Bank of Barbados has been fixed since 1975 at U.S.$ 0.50 = BDS$ 1.00.

The British Virgin Islands currency is U.S. $.

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Forward-Looking Statements

We discuss in this Annual Report matters which are not historical facts, but which are forward-looking statements. We intend these forward looking statements to qualify for safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, our future plans, objectives, expectations and events, assumptions and estimates about our company and our industry in general.

The forward-looking statements in this Annual Report reflect what we currently anticipate will happen. What actually happens could differ materially from what we currently anticipate will happen. We are not promising to make any public announcement when we think forward looking statements in this Annual Report are no longer accurate whether as a result of new information, what actually happens in the future or for any other reason.

Important matters that may affect what will actually happen include, but are not limited to: tourism and weather conditions in the areas we service; scheduled new construction within our operating areas; the economies of the U.S. and the areas we service; regulatory matters; availability of capital to repay a substantial portion of our bank debt and for expansion of our operations, and other factors described in the Risk Factors section below as well as elsewhere in this Annual Report.

By making these forward-looking statements, the Company undertakes no obligation to update these statements for revisions or changes after the date of this Annual Report.

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PART I

ITEM 1. BUSINESS

Introduction

Our company, Consolidated Water Co. Ltd., was incorporated in 1973 and uses reverse osmosis technology to produce freshwater from seawater. We process and supply water to our customers in the Cayman Islands, Belize, Barbados, The British Virgin Islands and The Commonwealth of The Bahamas. We sell water to a variety of customers, including public utilities, commercial and tourist properties, residential properties and government facilities.

Effective February 1, 2003, we acquired interests in five companies, which operate a total of seven desalination plant facilities.

As a result of our acquisition of DesalCo Limited in 2003, we acquired a 12.7% interest in Waterfields Company Limited. On July 30, 2003, we acquired a further 13.5% of Waterfields Company Limited (Waterfields) and effective August 1, 2003, we acquired an additional 64.7% interest resulting in total controlling interest of 90.9% of Waterfields. As a result of these acquisitions, our daily capacity more than tripled from approximately 2.9 to 10.9 million U.S. gallons per day. Our current capacity is 13.1 million U.S. gallons.

Through these acquisitions, we obtained the exclusive right through October 2009 to distribute the DWEER™ Energy Recovery System for use in reverse osmosis seawater desalination plants in the Caribbean basin. We believe the DWEER ™ System makes us more competitive when bidding for new plant construction projects.

Our strategy is to provide water services in areas where the supply of potable water is scarce. We have focused on the Caribbean basin and adjacent areas as our principal market because these areas have (1) little or no naturally occurring fresh water; (2) limited taxes allowing for higher returns than most highly regulated countries and, (3) a large proportion of tourist properties, which historically have generated higher volume sales than residential properties.

To execute this strategy, we plan to grow our business by:

- continuing to develop our production and distribution infrastructure and providing high quality potable water to our licensed area in the Cayman Islands;

- expanding our existing operations in Belize, Barbados, The British Virgin Islands and The Commonwealth of The Bahamas;

- extending our operations to other markets outside our current areas of operation where there is a need for potable water; and

- broadening our existing and future operations into complimentary services, such as wastewater management.

Our business group structure is defined based on areas of management responsibility, which are (i) the operations to supply water to retail customers, (ii) the operations to supply water to bulk customers,

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and (iii) the provision of engineering and management services. In 2003, we changed the composition of our reportable segments in the financial statements. The operations in the Cayman Islands and The Bahamas that had previously been reported as separate geographical segments are included in our Retail Water segment and the operation in Belize is included in our Bulk Water segment. Our Services segment is a new business segment created as a result of our acquisitions.

Financial Information about Business Segments

Financial information about business segments is included in Note 18 in our consolidated statements set forth in Item 8. Financial Statements and Supplementary Data herein.

Business Combinations

Our consolidated financial statements include the accounts of our wholly-owned subsidiaries Cayman Water Company Limited, Belize Water Limited, Ocean Conversion (Cayman) Limited, DesalCo Limited, DesalCo (Barbados) Ltd., Aquilex, Inc. and our majority owned subsidiary Waterfields Company Limited.

The operating results of Ocean Conversion (Cayman) Limited, DesalCo Limited and DesalCo (Barbados) Ltd. have been included in the consolidated financial statements effective February 1, 2003. The operating results of Waterfields Company Limited have been included in the financial statements effective August 1, 2003. Our investment in Ocean Conversion (BVI) Ltd. is accounted for using the equity method of accounting. All inter-company balances and transactions have been eliminated.

RETAIL WATER OPERATIONS

Our Retail water segment accounted for 51% of our revenues in 2005 (2004: 52%; 2003: 57%) and is comprised of businesses in the Cayman Islands and The Commonwealth of The Bahamas. These businesses produce potable water from seawater and distribute this water to end-users, including residential, commercial and government customers.

Retail Water Operations in the Cayman Islands

In the Cayman Islands, we sell retail water to a variety of residential and commercial customers through our wholly owned subsidiary Cayman Water Company Limited.

Our retail operations in the Cayman Islands currently produce potable water at three reverse osmosis seawater conversion plants in Grand Cayman, namely our Governor s Harbour plant, West Bay plant and Britannia plant. The Britannia plant was destroyed by Hurricane Ivan in September 2004 but was rebuilt and placed back in operation in October 2005.

We own the land where two of our three water plants are located and have entered into a lease which has over 21 years to run on the site where the third plant is located. The current production capacities of our Governor s Harbour plant and West Bay plant are 1.2 million and 710,000 U.S. gallons per day, respectively. The production capacity of the Britannia plant is 750,000 U.S. gallons per day. Since the Governor s Harbour and West Bay plants began production of water, they have consistently been capable of operating at or near their rated capacity.

Feed water for the reverse osmosis units is drawn from deep wells with associated pumps on the properties. Reject water is discharged into brine wells on the properties at a deeper level than the feed water intakes.

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Electricity to our plants is supplied by Caribbean Utilities Co. Ltd., a publicly traded utility company. At all three plant sites from which we supply water to our distribution pipeline, we maintain diesel driven, standby generators with sufficient capacity to operate our distribution pumps and other essential equipment, but not our reverse osmosis desalination equipment, during any temporary interruptions in electricity supply.

Due to the substantial damage incurred as a result of Hurricane Ivan in September 2004 and the costs incurred by Caribbean Utilities Company (CUC) to quickly restore power, CUC imposed a significant electricity rate surcharge which equated to an increase of 4.68% in the basic billing rate on all customers beginning August 1, 2005 and ending on July 31, 2008. We do not expect this event to have a material effect on our financial results of operations.

In the event of an emergency, our distribution system is connected to the George Town, Grand Cayman distribution system of Water Authority-Cayman. In prior years in order to efficiently maintain our equipment, we have purchased water from Water Authority-Cayman for brief periods of time. We have also sold potable water to Water Authority-Cayman. After Hurricane Ivan, we purchased approximately 1.6 million U.S. gallons of water from the Water Authority-Cayman while we were making repairs to our own water production and distribution systems.

Our pipeline system in the Cayman Islands covers the Seven Mile Beach and West Bay areas of Grand Cayman and consists of approximately 68 miles of PVC pipeline. We extend our distribution system periodically as property developments are completed. We have a main pipe loop covering a major part of the Seven Mile Beach area. We place extensions of smaller diameter pipe off our main pipe to service new developments in our service area. This system of building branches from the main pipe keeps construction costs low and allows us to provide service to new areas in a timely manner. During 2004 and 2005, we completed a number of small pipeline extensions into newly developed properties within our distribution system. Developers are responsible for laying the pipeline within their developments at their own cost, but in accordance with our specifications. When a development is completed, the developer then transfers operation and maintenance of the pipeline to us.

We have a comprehensive layout of our pipeline system, which is maintained in a computer-aided design (CAD) system. This system is integrated with digital aerial photographs and a computer generated hydraulic model, which allows us to accurately locate pipes and equipment in need of repair and maintenance. It also helps us to plan extensions and upgrades.

We enter into standard contracts with hotels, condominiums and other properties located in our existing licensed area to provide potable water to such properties. We currently have agreements on differing terms and rates to supply potable water to the 309-room Marriott Hotel, the 343-room Westin Hotel, the 357-room Hyatt Hotel and Britannia Golf Course, and to supply non-potable water to the SafeHaven Golf Course.

In the Seven Mile Beach area, our primary customers are the hotels and condominium complexes that serve the tourist industry. On September 11 and 12, 2004, Hurricane Ivan significantly damaged many of the hotel and condominium properties within our Cayman Islands license area. On August 1, 2005, the Government of the Cayman Islands reported that approximately 40% of Grand Cayman s hotels rooms were fit for occupancy. The Government has reported that room availability has still not been fully restored to pre-Ivan levels at December 31, 2005. In the West Bay area, our primary customers are residential homes.

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Although adversely impacted by Hurricane Ivan, development continues to take place on Grand Cayman, and particularly in our licensed area to accommodate both the growing local population and the tourism market. Because our license requires us to supply water to developments in our licensed area, the planning department of the Cayman Islands government routinely advises us of proposed developments. This advance notice allows us to manage our production capacity to meet anticipated demand. We believe that we have, or have contracted for, a sufficient supply of water to meet the foreseeable future demand.

We bill on a monthly basis based on metered consumption and bills are typically collected within 30 to 35 days after the billing date and receivables not collected within 45 days subject the customer to disconnection from water service. In 2005 and 2004, bad debts represented less than 1% of our total annual sales. Customers who have had their service disconnected must pay re-connection charges.

The following table shows, for each of the five years ended December 31, 2005, our total number of customer connections at the end of each year and metered sales of water for that year:

Thousands of U.S. Gallons

	2005	2004	2003	2002	2001
Number of Customers	3,800	3,600	3,300	3,100	2,999
Metered Sales:					
Commercial	427,439	451,609	429,013	405,545	358,711
Residential	157,924	122,699	107,528	103,661	104,002
Government	8,929	7,584	6,164	13,789	11,425
Total Metered Sales	594,292	581,892	542,705	522,995	474,138

The table above does not precisely represent the actual number of facilities we service. For example, in hotels and condominiums, we may only have a single customer, who is the operator of the hotel or the condominium, but we actually supply water to all of the units within that hotel or condominium development. Of the customers indicated in the table above, 60.9% were residential, 37.9% were hotels, condominiums and other commercial customers and 1.2% were government facilities in the year ended December 31, 2005.

In the past, demand on our pipeline distribution has varied throughout the year. Demand depends upon the number of tourists visiting and the amount of rainfall during any particular time of the year. In general, the majority of tourists come from the United States during the winter months.

Before 1991, any owner of property within our licensed area could install water-making equipment for its own use. Since 1991, that option is only available to private residences, although water plants in existence prior to 1991 can be maintained but not replaced or expanded. When the Marriott Hotel was built in 1990 in our licensed area, the developer installed its own reverse osmosis seawater desalination equipment. The equipment proved unreliable, and on February 4, 1994, we entered into an agreement with the owner of the Marriott Hotel to supply between 60,000 and 180,000 U.S. gallons of water per month at our standard tariff rates. If we are required to supply more than 180,000 U.S. gallons in a month, we will provide the water at our standard tariff rates on a best effort basis. The owner of the hotel has indicated that it may refurbish the reverse osmosis equipment, but we do not believe the hotel has the right to refurbish or replace the plant under Cayman Islands law.

In 1995, we entered into a 10-year agreement with the owner of the Westin Hotel. This agreement requires us to supply up to 1.86 million U.S. gallons per month at a discount to our standard tariff rates, and to supply any additional demand on a best efforts basis. The Westin Hotel maintains storage capacity on-site, assists pressurization with on-site re-pumping facilities, and has provided us with a letter of credit that covered the cost of water supply for 45 days. Since the expiration of this agreement in October 2005, we are supplying the Westin Hotel under the terms and conditions of our short term standard metering agreement.

On February 1, 2002, we entered into an agreement to acquire the Britannia plant and to supply a minimum of 62.0 million U.S. gallons of potable water per year for 25 years on a take or pay basis to Cayman Hotel and Golf, Inc., the owner of the Hyatt Grand Cayman Resort and Britannia golf course. We are required by our government license to meet any water demand from our customer above the 62.0 million U.S. gallons of water supplied per year. A portion of the Hyatt Hotel has been closed since Hurricane Ivan and water demand under this contract has been reduced. Cayman Hotel and Golf, Inc. is invoiced for the monthly minimum balance. This credit resets every twenty-four months and as of December 31, 2005 Cayman Hotel and Golf had a credit of 58.6 million U.S. gallons, which must be used or is lost before May 31, 2006.

Retail Water Operations in the Bahamas

In 2000, we entered into a water supply agreement with South Bimini International Ltd., a company incorporated in The Commonwealth of The Bahamas, and on July 11, 2001 we began to provide potable water from one reverse osmosis seawater conversion plant in South Bimini, The Bahamas capable of producing 115,000 U.S. gallons per day.

Potable water is supplied to Bimini Sands Resort, a marina and condominium development and Bimini Beach Hotel, a 40-room hotel. The developer of the Bimini Sands Resort continues to develop the property, but we are not currently aware of any time schedule by the developer for the completion of the additional condominium units. Under our agreement, South Bimini International Ltd. is committed to pay for a minimum of 3,000 U.S. gallons of water per customer per month (36,000 U.S. gallons per customer per year) on a take or pay basis for the Bimini Sands Resort. The price of water supplied is adjusted for inflation annually based on Bahamian and U.S. government indices, and adjusted monthly for changes in the cost of electricity. During 2005, we supplied South Bimini International Ltd. with 4.8 million U.S. gallons of water. A portion of the hotel was destroyed by a hurricane in the fall of 2005 and may affect total demand.

We believe that water sales in Bimini will continue to be cyclical. We expect that our sales will be higher during the summer months when tourists and fisherman arrive from the United States by boat, and when several large angling tournaments are traditionally held in Bimini. We expect that sales will be lower during winter months when the weather is not conducive to pleasure boat travel from the United States.

We are presently taking steps to transfer and consolidate the Bimini operation to our Bahamian subsidiary, which would standardize our business license and tax status.

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Retail Water Demand and Average Sales Price

The table below lists the total volume of water we supplied on a quarterly basis for the five years ended December 31, 2005 to all of our Retail Water customers:

Thousands of U.S. Gallons

	2005	2004	2003	2002	2001
First Quarter	146,461	176,346	141,575	141,559	119,115
Second Quarter	159,745	175,813	144,134	146,488	129,305
Third Quarter	137,881	123,512	125,510	120,201	119,182
Fourth Quarter	154,972	110,754	134,957	119,231	107,536
Total	599,059	586,425	546,176	527,479	475,138

Our average sales price of potable water sold to our Retail water customers for the three years ended December 31, 2005, 2004 and 2003 are as follows:

	2005	2004	2003
Average Sales Price Per 1,000 U.S. Gallons	$ 22.32	$ 20.62	$ 19.69

BULK WATER OPERATIONS

Our Bulk water segment accounted for 45% of our revenues in 2005 (2004: 44%; 2003: 37%) and is comprised of businesses in the Cayman Islands, Belize, The British Virgin Islands and The Commonwealth of The Bahamas. These businesses produce potable water from seawater and sell this water to governments and private customers

Bulk Water Operations in the Cayman Islands

In the Cayman Islands, we sell bulk water through our wholly owned subsidiary Ocean Conversion (Cayman) Limited. Ocean Conversion (Cayman) Limited provides water on a take or pay basis to the Water Authority-Cayman, a government owned utility and regulatory agency, under various licenses and agreements. The Water Authority-Cayman in turn distributes that water to properties in the parts of Grand Cayman that are outside of our retail licensed area. During 2005, we supplied the Water Authority-Cayman with 878 million U.S. gallons of water.

We operate, but do not own, three additional reverse osmosis seawater conversion plants in Grand Cayman with a total installed capacity of 3.2 million U.S. gallons per day: the Red Gate Road plant with a production capacity of 1.3 million U.S. gallons per day, the Lower Valley plant with a production capacity of 1.1 million U.S. gallons per day and the North Sound plant with a production capacity of 792,000 U.S. gallons per day. Each of these plants was damaged to varying degrees from Hurricane Ivan in September 2004 and was restored to fully operational status and production capacity in the fourth quarter of 2004. The plants that we operate for Water Authority-Cayman are located on land owned by the Cayman Islands government.

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In January 2001, the Company was granted a seven-year water supply license by the government of the Cayman Islands to supply desalinated water from the Red Gate Road plant through December, 2008. Under the terms of this license, Ocean Conversion (Cayman) Limited is obligated to deliver to the Water Authority-Cayman the amount of water it demands or 1.2 million U.S. gallons of water per day on average each month, whichever is less.

In October 2005, the Company was granted a seven-year extension to its water supply license by the government of the Cayman Islands to supply desalinated water from the Lower Valley plant through March, 2013. Under the terms of this license, the Company increased the capacity of the Lower Valley plant to 1.06 million US gallons per day in exchange for certain pricing changes.

In December 2001, the Company was granted a seven-year water supply license, with effect from November 2002, by the government of the Cayman Islands and the Water Authority-Cayman to supply desalinated water from the North Sound plant through November 2009. Under the terms of this license Ocean Conversion (Cayman) Limited is obligated to deliver to the Water Authority-Cayman the amount of water it demands or 713,000 U.S. gallons of water per day on average each month, whichever is less.

Bulk Water Operations in Belize

In Belize, we sell bulk water through our wholly owned subsidiary Belize Water Limited which we acquired on July 21, 2000. Belize Water Limited provides water to Belize Water Services Ltd. (BWSL), which distributes the water through its own pipe line system to residential, commercial and tourist properties in Ambergris Caye, Belize. During 2005, we supplied BWSL with 116.4 million U.S. gallons of water. Potable water is provided from one reverse osmosis seawater conversion plant capable of producing 420,000 U.S. gallons per day. During 2005 we completed the construction of a new water tank.

On September 17, 2003, we entered into an exclusive 23-year contract with BWSL to supply a minimum of 1.75 million US gallons of water per week, or upon demand up to 2.1 million US gallons per week, on a take or pay basis. This contract terminates on March 23, 2026. BWSL has the option to advise us no later than six months before the termination date that it wishes to renew the contract for a further 25-year period on the same terms and conditions.

On October 3, 2005, a controlling interest in BWSL was sold back to the Government of Belize. This transaction effectively reversed the privatization of BWSL. We do not anticipate that this change in control of our customer will affect our contractual arrangement with BWSL. Prior to this change in control, BWSL requested that we expand the production capacity of our plant by approximately 100,000 US gallons per day and we are presently preparing a design for such expansion and expect to have additional capacity on line in 2006.

We own our production plant in Belize and lease the land on which our plant is located from the Government of Belize at an annual rent of BZE$1.00. The lease commenced on April 27, 1993 and was extended on January 2, 2004 to a period of 33 years.

BWSL distributes our water primarily to residential properties, small hotels, and businesses that serve the tourist market. The base price of water supplied, and adjustments thereto, are determined by the terms of the contracts, which provide for annual adjustments based upon the movement in the government price indices specified in the contract, as well as monthly adjustments for changes in the cost of diesel fuel and electricity. Demand is less cyclical than in our other locations due to a higher proportion of residential to tourist demand.

Feed water for the reverse osmosis units is drawn from deep wells with associated pumps on the property. Reject water is discharged into brine wells on the property at a level below that of the feed water intakes.

Electricity to our plant is supplied by Belize Electricity Limited. At the plant site, we maintain a diesel driven, standby generator with sufficient capacity to operate our essential equipment during any temporary interruption in the electricity supply.

Bulk Water Operations in the British Virgin Islands

In The British Virgin Islands, we sell bulk water through an affiliate, Ocean Conversion (BVI) Ltd. (OCBVI), to the Government of The British Virgin Islands Water and Sewerage Department (BVIW&S), which distributes the water through its own pipeline system to residential, commercial and tourist properties on the islands of Tortola and Jost Van Dyke in the British Virgin Islands. During 2005, OCBVI supplied BVIW&S with 479.0 million U.S. gallons of water.

OCBVI supplies desalinated water produced from its Baughers Bay desalination plant on a month-to-month basis, because the Government did not extend OCBVI s water supply agreement. The Government did not make a terminal payment of $1.42 million to OCBVI, which would have entitled it to take possession of the Baughers Bay plant. On January 28, 2000, the Government advised OCBVI that it considered a water sales arrangement to be in force on a monthly basis until negotiations for a new agreement could be concluded. Negotiations on the terms of a new agreement have not proceeded since our acquisition of interests in OCBVI, so we are presently awaiting an indication from Government that they wish to meet to discuss terms of a new agreement.

The Baughers Bay plant was expanded in December 2003 to a capacity of 1.7 million U.S. gallons per day. The plant is a seawater reverse osmosis plant with an advanced energy recovery system. It generates its own electrical power on site using two large Caterpillar diesel driven generator units. It also purchases electricity from the BVI Electric Co. to power ancillary equipment and provide building lighting.

OCBVI is currently constructing a new reverse osmosis seawater desalination plant in Bar Bay, Tortola with a capacity of 700,000 U.S. gallons per day. The estimated total cost of the plant is $7.0 million and it is expected to be completed in September, 2006.

On February 7, 2003, we completed our purchase of 50% of the issued and outstanding voting stock, certain profit sharing rights and all of the non-voting shares of Ocean Conversion (BVI) Ltd. Also on that date we surrendered 18.2% of our profit sharing rights for 45,000 non-voting shares of Ocean Conversion (BVI) Ltd. On May 9, 2003 we sold all of our non-voting shares of Ocean Conversion (BVI) Ltd. to Sage Water Holdings (BVI) Limited. We now own 50% of the voting shares and 50% of the profit sharing rights of Ocean Conversion (BVI) Ltd. and a 43.5% total interest. Under the Articles of Association of Ocean Conversion (BVI) Ltd., we appoint three of the six directors of the company. Sage Water Holdings (BVI) Limited, which owns the remaining 50% of the issued and outstanding voting shares, is entitled to appoint the remaining three directors. If there is a tied vote on any matter, the President of the Caribbean Water and Wastewater Association will be entitled to appoint a junior director to break the tie.

We provide certain engineering and administrative services to OCBVI for a monthly fee and a bonus arrangement which provides for payment of 4.0% of net operating income of OCBVI.

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We account for our interests in Ocean Conversion (BVI) Ltd. using the equity method of accounting and therefore the operating results of Ocean Conversion (BVI) Ltd. are not consolidated in our financial statements. Income from this investment is included in our Bulk water operations segment.

Bulk Water Operations in The Bahamas

In the Commonwealth of The Bahamas, we sell bulk water through our majority-owned subsidiary, Waterfields Company Limited (WCL), 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. During 2005, WCL supplied WSC with 853.0 million U.S. gallons of water.

As a result of our acquisition of DesalCo Limited on February 7, 2003, we acquired a 12.7% interest in WCL. On July 30, 2003, we acquired a further 13.5% of WCL and effective August 1, 2003, acquired an additional 64.7% interest resulting in total controlling interest of 90.9% of WCL.

We supply bulk water to WSC from our Windsor Plant under the terms of a 15-year water supply agreement dated May 7, 1996. In 2005, we completed an expansion of the plant s capacity from 2.6 to 4.1 million U.S. gallons per day.

We are required to provide WSC with at least 16.8 million US gallons per week of potable water, and WSC has contracted to purchase at least that amount from us on a take-or-pay basis. This water supply agreement expires on the later of March 1, 2013 or after the plant has produced approximately 13.1 billion U.S. gallons of water. At the conclusion of the initial term, WSC has the following options:

- extend the term for an additional five years at a reduced rate specified in the agreement;

- exercise a right of first refusal to purchase any materials, equipment and facilities that WCL intends to remove from the site, and negotiate a purchase price with Waterfields; or

- require WCL to remove all materials, equipment and facilities from the site.

During the past two years, we experienced various equipment failures and operational problems which caused us to incur penalties for not supplying minimum water volumes to WSC. We also incurred penalties for not meeting diesel fuel and electricity efficiencies specified in our water sale agreement with WSC. These penalties totaled $571,349 in 2005 and $313,408 in 2004, respectively. We have undertaken a program to replace certain equipment prone to repetitive failure and to reduce the fouling tendency of the feed water to the plant.

Feed water for the reverse osmosis unit is drawn from deep wells with associated pumps on the property. Reject water is discharged into brine wells on the property at a deeper level than the feed water intakes.

Electricity to our plants is supplied by Bahamas Electricity Corporation. We maintain a standby generator with sufficient capacity to operate essential equipment at our Windsor Plant and are able to produce water with this plant during any temporary interruptions in the electricity supply.

On February 16, 2005, the government of the Commonwealth of The Bahamas announced that the Bahamas government accepted the bid of the Company to build a new seawater desalination plant (the Blue Hills Plant) on the island of New Providence. Although not part of the Blue Hills Plant bid, the Company also expanded its existing seawater desalination plant (the Windsor Plant) on the island of New Providence. On April 11, 2005, the company and WCL accepted the terms set forth in a formal letter of acceptance relating to the construction of the Blue Hills Plant.

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When completed in August, 2006, the Company expects that the Blue Hills Plant will produce 7.2 million U.S. gallons potable water per day and will be its largest seawater conversion facility. The expansion of the Windsor Plant, completed in December 2005, increased the capacity of that operation by approximately 40%. As part of its agreement with WSC, the Company is required to provide engineering services and equipment to reduce the amount of water that is currently lost throughout WSC s pipeline distribution system on New Providence.

In order to finance the construction of the Blue Hills Plant, the expansion of the Windsor Plant and provide the related engineering services described above, our Waterfield s subsidiary sold $10.0 million Series A bonds in June 2005 to Bahamian citizens and permanent resident investors in the Bahamas. In November 2005, our offering of 2,023,850 Bahamian Depository Receipts to similar investors resulted in net proceeds after expenses of approximately $6.8 million.

Bulk Water Demand and Average Sales Price

The table below lists the total volume of water we supplied on a quarterly basis for the four years ended December 31, 2005 to of our Bulk water customers:

	Thousands of U.S. Gallons			
	2005	2004	2003	2002
First Quarter	441,498	438,851	133,682	24,751
Second Quarter	456,625	458,455	208,107	30,206
Third Quarter	442,404	424,665	345,307	30,028
Fourth Quarter	506,892	424,434	414,404	27,552
Total	1,847,419	1,746,405	1,101,500	112,537

Our average sales of potable water sold to our Bulk water customers for the three years ended December 31, 2005, 2004 and 2003 are as follows:

	2005	2004	2003
Average Sales Price Per 1,000 U.S. Gallons	$ 6.35	$ 5.90	$ 6.97

SERVICE OPERATIONS

Our Service segment accounted for 4.0% of revenues in 2005 (2004: 4.0%; 2003: 6.0%).

Engineering and Management Services Operations

We provide management, engineering and construction services for desalination projects and are the exclusive agents for sales of DWEER energy recovery systems for desalination plants in the Caribbean basin until October 2009. DesalCo Limited, which is recognized by suppliers as an original equipment manufacturer of reverse osmosis seawater desalination plants, also functions as the primary purchasing agent for our Company.

In 2003, DWEER Technology Ltd. (DWEER Tech), the owner of the DWEER technology, licensed the worldwide rights to the DWEER technology to Calder AG, a Swiss company. On February 26, 2004 we entered into a new exclusive Caribbean distributorship agreement with Calder AG for the DWEER technology, and amended the terms of our distributorship agreement with DWEER Tech. Our agreements with Calder AG and DWEER Technology Ltd. were amended in 2005 to allow DesalCo Limited to manufacture components for legacy DWEER systems that currently operate in the majority of our desalination facilities.

In July 2005, the Company entered into an Engineering & Consulting Agreement with Industrial Services, Inc. (ISI) and the sole shareholder of ISI, Scott Shumway, pursuant to which both will provide certain industrial project design, engineering and management services as requested. The sole shareholder has unconditionally guaranteed the performance of ISI.

The term of the agreement is approximately 17 months but can be terminated by the Company with 14 days notice in the event of the death or incapacity of Mr. Shumway.

The estimated total aggregate maximum payments over the term of the agreement are approximately $600,000.

In 2005, the Company established a 100% owned U.S. subsidiary, Aquilex, Inc., to provide financial, engineering and supply chain management support services to certain operating segments of the Company.

Service Operations in Barbados

Effective February 1, 2003, we acquired all of the issued and outstanding stock of DesalCo Limited. DesalCo Limited owned all of the issued and outstanding stock of DesalCo (Barbados) Ltd., a Barbados company, which operates a desalination plant for Sandy Lane Properties Ltd. in St. James, Barbados.

Under the terms of a supply and operating agreement with Sandy Lane Properties Ltd., DesalCo Limited constructed and operates a seawater desalination plant which provides irrigation water for several golf courses on the Sandy Lane Resort. Sandy Lane Properties Ltd. owns the plant and property and DesalCo Limited operates the plant under the terms of a five-year operating agreement, which was to expire in January 2006. This agreement was recently extended through January, 2007.

In 2005, 2004 and 2003, the agreement generated revenues of $410,701, $402,631 and $397,929, respectively. DesalCo (Barbados) Ltd. also pays the Company a monthly assignment equal to 8.0% of the gross revenue and certain operating expenses for engineering services.

In October 2005, the Company entered into an agreement with Newwater Incorporated, a Barbados entity partly owned by Zenon Environmental of Canada, to mutually develop business opportunities involving potable and wastewater projects in new and existing markets.

The Government in the Cayman Islands, Customs Duties and Taxes

The Cayman Islands are a British Overseas Territory of the United Kingdom and have had a stable political climate since 1670, when the Treaty of Madrid ceded the Cayman Islands to England. The Queen of England appoints the Governor of the Cayman Islands to make laws with the advice and consent of the legislative assembly. There are 15 elected members of the legislative assembly and three members appointed by the Governor from the Civil Service. The Cabinet is responsible for day-to-day government operations. The Cabinet consists of five ministers who are chosen by the legislative assembly from its 15 popularly elected members, and the three Civil Service members. The Governor has reserved powers and the United Kingdom retains full control over foreign affairs and defense. The Cayman Islands are a common law jurisdiction and have adopted a legal system similar to that of the United Kingdom.

There are no local taxes on profits, income, distributions, capital gains or appreciation in the Cayman Islands. We have exemptions from, or receive concessionaire rates of customs duties on capital expenditures for plant and major consumable spare parts and supplies imported into the Cayman Islands as follows:

we do not pay import duty or taxes on reverse osmosis (RO) membranes, electric pumps and motors and chemicals, but we do pay duty at the rate of 10% of the cost, including insurance and transportation to the Cayman Islands, of other plant and associated materials and equipment to manufacture or supply water in the Seven Mile Beach or West Bay areas; and

Ocean Conversion (Cayman) Limited pays all customs duties up to 10% in respect of materials and supplies imported for the Red Gate plant and is reimbursed amounts in excess of this percentage by Water Authority-Cayman.

A major source of revenue to the Cayman Islands government is a 7.5% or 9.0% stamp tax, depending on location, on the transfer of ownership of land in the Cayman Islands. During the period of November 14, 2001 to date, the stamp tax has been temporarily set at 5.0%. To prevent stamp tax avoidance by transfer of ownership of the shares of a company which owns land in the Cayman Islands (as opposed to transfer of the land itself), The Land Holding Companies (Share Transfer Tax) Law was passed in 1976. The effect of this law is to charge a company, which owns land or an interest in land in the Cayman Islands, a tax based on the value of its land or interest in land attributable to each share transferred. The stamp tax calculation does not take into account the proportion which the value of a company s Cayman land or interest bears to its total assets and whether the intention of the transfer is to transfer ownership or part of a company s entire business or a part of its Cayman land or interest.

Prior to our common shares becoming publicly traded in the United States, we paid this tax on private share transfers. We have never paid the tax on transfers of our publicly traded shares and requested an exemption in 1994. On April 10, 2003, we received notice that the Cayman Islands government had granted an exemption from taxation for all transfers of our shares. We believe it is unlikely that government will seek to collect this tax on transfers of our publicly traded shares during 1994 through April 10, 2003.

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The Government in The Bahamas, Customs Duties, and Taxes

The Commonwealth of The Bahamas is a constitutional parliamentary democracy with the Queen of England as the constitutional head of state. The basis of Bahamian law and legal system is the English common law tradition with a Supreme Court, Court of Appeals, and a Magistrate court.

We have not been granted any tax exemptions for our Bahamian operations. Bahamian companies are subject to an annual business license fee ranging from 1% to 2% of their gross revenues. We did not pay any business license fees to the Bahamian government in respect of our Bimini retail water operations since commencement of operations on July 11, 2001, other than contributions to the National Insurance Board Social Security Fund on behalf of our employees. We estimate our potential tax liability based on our gross revenues earned from commencement of operations to be less than $11,000.

The Government in Belize, Customs Duties and Taxes

Belize (formerly British Honduras) achieved full independence from the United Kingdom in 1981. Today, Belize is a constitutional monarchy with the adoption of a constitution in 1991. Based on the British model with three independent branches, the Queen of England is the constitutional head of state, represented by a Governor General in the government. A Prime Minister and cabinet make up the executive branch, while a 29 member elected House of Representatives and a nine member appointed Senate form a bicameral legislature. The cabinet consists of a prime minister, other ministers and ministers of state who are appointed by the Governor-General on the advice of the Prime Minister, who has the support of the majority party in the House of Representatives. Belize is an English common law jurisdiction with a Supreme Court, Court of Appeals and local Magistrate Courts.

The Government of Belize has exempted Belize Water Limited from certain customs duties and all revenue replacement duties until April 18, 2026, and company taxes until January 28, 2006. Belize levies a gross receipts tax on corporations at a rate varying between 0.75% and 25%, depending on the type of business, and a corporate income tax at a rate of 25% of chargeable income. Gross receipts tax payable amounts are credited towards corporate income tax. The Government of Belize recently increased certain business and personal taxes and created new taxes effective March 1, 2005. We are presently assessing whether these increases will have any impact on our business. Under the old tax structure without our exemption, we believe our business would be subject to a 1.25% gross receipts tax and income tax. Belize levies import duty on most imported items at rates varying between 0% and 45%, with most items attracting a rate of 20%. While the Government of Belize confirmed its commitment in a letter dated June 29, 1992 from the Financial Secretary of Belize to support all future applications for extensions or additional tax exemptions for the life of our water supply contract, future exemptions must be approved by the Belize legislature and we do not have any assurance that we will be granted any further tax exemptions after January 28, 2006.

The Government in the British Virgin Islands, Customs Duties and Taxes

The British Virgin Islands is an Overseas Territory of the United Kingdom that was first settled by the Dutch in 1648 and annexed by the British in 1672. It adopted a constitution in 1977 and is now a constitutional democracy with three branches of government: the Executive Council, the Judiciary and the Legislative Council. Executive authority is vested in the Queen of England, exercised through her representative, the Governor. The Governor has responsibility for the courts, public service, police, and foreign affairs and full policy-making authority. The Governor is not a member of the Executive Council but receives assistance with the day-to-day operations of the government. The Executive Council is made up of various members of the legislature. The Parliament or Legislative Council is made up of thirteen

(13) seats with members elected by popular vote, serving up to but no more than four-year terms. The British Virgin Islands are an English common law jurisdiction with a Supreme Court, Court of Appeals and Magistrates Court.

The British Virgin Islands imposes a corporate income tax at a rate of 15% of net income. However, Ocean Conversion (BVI) Ltd. received an exemption, under the water supply agreement with The British Virgin Islands government, from all taxes, duties, levies and impositions on items, which it imports for the Baughers Bay plant. We expect that this same exemption will apply to the Bar Bay plant when commissioned.

The Government in Barbados, Customs, Duties and Taxes

Barbados is an independent island nation that was initially occupied by the British in 1627. It remained a British colony until 1961 when it was granted internal autonomy. Barbados gained full independence in 1966 but remains a member of the British Commonwealth that appoints the Governor General. The Governor General approves members of the Cabinet on the advice of the prime minister. The parliament consists of the senate whose 21 members are appointed by the Governor General and the assembly whose 30 members are popularly elected to five-year terms. Barbados is an English common law jurisdiction with a Supreme Court.

The net income of DesalCo (Barbados) Ltd. is subject to a 33% Barbados corporate tax, and all dividend payments and supplier payments are subject to a Barbados withholding tax of 15%. DesalCo (Barbados) Ltd. pays for all customs duties due on parts and equipment for the plant since a concession on such duties held by Sandy Lane Properties Ltd. expired in March 2004. Value added taxes are paid by Sandy Lane Properties Ltd. DesalCo (Barbados) Ltd. has made all necessary tax filings and payments.

Government Regulation

In the Cayman Islands, we are regulated by the Water Authority-Cayman on behalf of the Cayman Islands Government and believe that our operations comply with all local laws and regulations.

We believe that our operations in The Bahamas, The British Virgin Islands and Barbados comply with all local laws and regulations, and are reviewing our Bahamian tax status as it relates to our Bimini operation, as discussed above.

Market and Service Area

Although we currently operate in the Cayman Islands, Belize, Barbados, The British Virgin Islands and The Bahamas, we believe that our potential market consists of any location where there is a need for potable water. The desalination of seawater, either through distillation or reverse osmosis, is the most widely used process for producing fresh water in areas with an insufficient natural supply. We believe our experience in the development and operation of distillation and reverse osmosis desalination plants as well as our exclusive rights in the Caribbean to the DWEER energy recovery system provides us with a significant opportunity to successfully expand our operations beyond the markets in which we currently operate.

Prior to our acquisition of Ocean Conversion (Cayman) Limited in February 2003, the market that we serviced under our exclusive license in the Cayman Islands consisted of Seven Mile Beach and West Bay, Grand Cayman, two of the three most populated areas in the Cayman Islands. The Cayman Islands Government, through Water Authority-Cayman, supplies water to parts of Grand Cayman, which are not within our licensed area, as well as to Little Cayman and Cayman Brac. We operate all the reverse osmosis desalination plants of Water Authority-Cayman on Grand Cayman and supply water under licenses and supply agreements held by Ocean Conversion (Cayman) Limited with Water-Authority Cayman.

According to the most recent information published by the Economics and Statistics Office of the Cayman Islands Government, the population of the Cayman Islands was estimated in July 2004 to be approximately 43,000. According to the figures published by the Department of Tourism Statistics Information Center, during the year ended December 31, 2005 tourist air arrivals decreased by 35.4% and tourists cruise ship arrivals increased 6.2% over the same period in 2004.

The decline in air travel in 2005 was primarily due to Hurricane Ivan, which impacted the tourist industry throughout 2005. Total visitors for the year increased only slightly to 1.5 million from 1.4 million over the same period in 2004. We believe that our water sales in the Cayman Islands are more positively impacted by tourists that arrive by air than by those arriving by cruise ship, since cruise ship tourists generally only remain on island for one day or less.

Tourist air arrivals increased 110.0% and cruise ship arrivals increased 23.8% in January 2006 compared to the same period in 2005. At this time we are not able to determine whether this positive trend will continue through 2006.

In December 2005, the 360-room Ritz Carlton Hotel, condominiums and golf course development began operations. The developer of this project has revised an anticipated full completion date to May 2006 because of the disruption caused by Hurricane Ivan in 2004. The development is required to purchase potable water from us for the hotel and condominiums under the terms of our exclusive license agreement, but not for its golf course. We have service agreements in place with the resort.

During 2002, the government of the Cayman Islands amended the Development and Planning Law to permit construction of buildings up to seven stories in certain zones within our license area, including commercial and hotel zones. Previously, buildings in these zones were only permitted to be built to five stories. We believe that this change in the law will facilitate the development of certain properties within our license area that may have otherwise not developed under the old height restriction, and it has already facilitated the re-development of three existing properties, which have been demolished and are being re-built as multi-story structures.

Our current operations in Belize are located on Ambergris Caye, which consists of residential, commercial and tourist properties in the town of San Pedro. This town is located on the southern end of Ambergris Caye. Ambergris Caye is one of many islands located east of the Belize mainland and off the southeastern tip of the Yucatan Peninsula. Ambergris Caye is approximately 25 miles long and, according to the Belize National Population Census 2000, has a population of about 4,500 residents, which has increased approximately 144% over the past ten years. We provide bulk potable water to Belize Water Services Limited, which distributes this water to this market. Belize Water Services Limited (BWSL) currently has no other source of potable water on Ambergris Caye. Our contract with BWSL makes us their exclusive producer of desalinated water on Ambergris Caye though 2026.

A 185 mile long barrier reef, which is the largest barrier reef in the Western Hemisphere, is situated just offshore of Ambergris Caye. This natural attraction is becoming a choice destination for scuba divers and tourists. According to information published by the Belize Trade and Investment Development Service, tourism is Belize s second largest source of foreign income, next to agriculture.

Our current operations in the Bahamas are located on South Bimini Island and in Nassau on New Providence. The Bimini Islands consist of North Bimini and South Bimini, and are two of 700 islands which comprise the Bahamas. The Bimini Islands are located approximately 50 miles east of Ft. Lauderdale, Florida and are a premier destination for sport fishing enthusiasts. The population of the Bimini Islands is approximately 1,600 persons and the islands have about 200 hotel and guest rooms available for tourists. The total land area of the Bimini Islands is approximately 9 square miles.

New Providence, Lyford Caye and Paradise Island, connected by several bridges, are located approximately 150 miles east southeast of the Bimini Islands. With an area of 151 square miles and a population of approximately 211,000, Nassau is the political capital and the commercial hub of the Bahamas. As the largest city with its famed Cable Beach, it accounts for more than two-thirds of the 4.0 million tourists who visit the Bahamas annually. New Providence is presently experiencing intermittent to severe water shortages and imports about one-half of its water from Andros Island, which lies 35 miles west of New Providence.

The Company expects that the Blue Hills Plant will produce 7.2 million U.S. gallons potable water per day when completed in August, 2006 and it will be the Company s largest seawater conversion facility. The expansion of the Windsor Plant, completed in December 2005, increased the capacity of that operation by approximately 40%, to 3.6 million U.S. gallons of potable water per day.

The British Virgin Islands are an Overseas Territory of the United Kingdom and are situated east of Puerto Rico. They consist of 16 inhabited and more than 20 uninhabited islands, of which Tortola is the largest and most populated island. The islands are the center for many large yacht-chartering businesses.

Barbados, located northeast of Venezuela between the Caribbean Sea and the North Atlantic Ocean, is an independent sovereign nation member of the British Commonwealth. It has a population of approximately 277,000 and was traditionally known for its cultivation of sugar cane. More recently, the economy has diversified to include tourism and light manufacturing.

Growth Strategy

Our strategy is to provide water services in areas where the supply of potable water is scarce. We have focused on the Caribbean basin and adjacent areas as our principal market because these areas have: little or no naturally occurring fresh water; limited local regulations and taxes allow for higher returns than most highly regulated countries; and a large proportion of tourist properties, which historically have generated higher volume sales than residential properties.

Our growth strategy is as follows:

- We intend to continue to develop our production and distribution infrastructure and provide high quality potable water to our licensed area in the Cayman Islands. We have increased our share of the potable water market in the Cayman Islands as a result of our purchase of the Britannia plant and acquisition of Ocean Conversion (Cayman). We also intend to explore the feasibility of either acquiring or obtaining the license from the Cayman Islands government to operate Water Authority-Cayman, which supplies water to parts of Grand Cayman and Cayman Brac and has the right to supply water in Little Cayman.

- We intend to expand our existing operations in the Cayman Islands, Belize, Barbados, The British Virgin Islands and the Commonwealth of The Bahamas. For example, through negotiations with Belize Water Services Limited, we have extended the term of our agreement to 23 years and increased the guaranteed minimum quantities supplied. We intend to seek new water supply agreements for other areas in Belize. Similarly, as the development of resort properties in Bimini continues, we expect to sell more water to additional customers

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further utilizing our current plant until the installation of a larger plant becomes necessary. In the British Virgin Islands, we expanded the capacity of our existing plant on the island of Tortola from 1.2 million to 1.7 million U.S. gallons per day in December 2003, and we are constructing a second plant, the Bar Bay plant, with a capacity of 700,000 U.S. gallons per day on the island.

We intend to expand our operations to other markets outside of our current areas of operation where there is need for potable water. In addition to our acquisitions, we are currently involved in preliminary discussions to operate water-making plants and to supply water in other new markets and may pursue these opportunities either on our own or through joint ventures and strategic alliances, such as the agreement with Newwater Incorporated previously described. So far, we have focused on various locations throughout the Caribbean basin and Central America.

We intend to broaden our existing and future operations into complementary services. Prior to the installation of a central wastewater system by the Cayman Islands government, we provided wastewater services on Grand Cayman. We may reenter this field in the Cayman Islands and intend to provide such services outside of the Cayman Islands.

Reverse Osmosis Technology

The conversion of saltwater to potable water is called desalination. There are two primary forms of desalination: distillation and reverse osmosis. Both methods are used throughout the world and technologies are improving to lower the costs of production. Reverse osmosis is a separation process in which the water from a pressurized saline solution is separated from the dissolved material by passing it over a semi-permeable membrane. An energy source is needed to pressurize the saline (or feed) water for pretreatment, which consists of fine filtration and the addition of precipitation inhibitors. Pre-treatment removes suspended solids, prevents salt precipitation and keeps the membranes free of microorganisms. Next, a high-pressure pump enables the water to actually pass through the membrane, while salts are rejected. The feed water is pumped into a closed vessel where it is pressurized against the membrane. As a portion of the feed water passes through the membrane, the remaining feed water increases in salt content. This remaining feed water is discharged without passing through the membrane. As the discharged feed water leaves the pressure vessel, its energy is captured by an energy recovery device which is used to pressurize incoming feed water. The final step is post-treatment, which consists of stabilizing the water, removing undesirable dissolved gases and adjusting the pH and chlorination to prepare it for distribution.

We use reverse osmosis technology to convert seawater to potable water. We believe that this technology is the most effective and efficient conversion process for our market. However, we are always seeking ways to maximize efficiencies in our current processes and to investigate new more efficient processes to convert seawater to potable water. The equipment at our plants is among the most energy efficient available and we monitor and maintain our equipment in an efficient manner. As a result of our years of experience in seawater desalination, we believe that we have an expertise in the development and operation of desalination plants which is easily transferable to locations outside of our current operating areas.

In addition, DesalCo Limited is the exclusive distributor in the Caribbean basin for the DWEER system produced by DWEER Technology Limited for use in reverse osmosis seawater desalination plants through October, 2009. An advanced energy recovery system, the DWEER system is utilized to efficiently recover energy from the high-pressure brine that is the by-product of the reverse osmosis desalination process. Unlike pump/turbine systems used in many desalination plants around the world, the DWEER system recovers nearly 100% of the energy contained in the reject water (or brine) from the reverse osmosis process. As a result, the DWEER energy recovery system for reverse osmosis seawater desalination plants is one of the most energy efficient systems of its kind. The DWEER system is used on most of our all desalination plants designed by us since 1990.

Raw Materials and Sources of Supply

All materials, parts and supplies essential to our business operations can normally be obtained from multiple sources, except for the DWEER energy recovery devices which are exclusively manufactured by Calder AG, a Swiss company, and which we use at all of our plants with the exception of the Belize and Britannia plants. We do not manufacture any parts or components for equipment essential to our business. Our access to seawater for processing into potable water is granted through our licenses and contracts with governments of the various jurisdictions in which we have our operations.

Licenses, Franchises and Concessions

Our exclusive operational license was issued to us by the Cayman Islands government under The Water (Production and Supply) Law of 1979. Unless renewed, the license terminates on July 11, 2010.

Two years prior to the expiration of the license, we have the right to negotiate with the government to extend the license for an additional term. Unless we are in default under the license, the government may not grant a license to any other party without first offering the license to us on terms that are no less favorable than those which the government offers to a third party.

We must provide, within our licensed area, any requested piped water service that, in the opinion of the Cabinet of the Cayman Islands government, is commercially feasible. Where supply is not considered commercially feasible, we may require the potential customer to contribute toward the capital costs of pipe-laying. We then repay these contributions to the customer, without interest, by way of a 10% discount on future billings for water sales until this advance in aid of construction has been repaid. We have been installing additional pipeline when we consider it to be commercially feasible, and the Cayman Islands government has never objected to our determination regarding commercial feasibility.

Under our exclusive license, we pay a royalty to the government of 7.5% of our gross water sales revenue. Other than the selling prices provided in our agreements with the Westin Hotel, the Hyatt Hotel and Britannia Golf Course and SafeHaven Golf Course, the selling price of water under the license varies 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, on behalf of the government, reviews and approves 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. If the parties fail to agree, the matter is referred to arbitration. The last such price increase that we requested was granted in full in June 1985.

Seasonal Variations in Our Business

Our water sales in the Cayman Islands, Belize and Bimini are affected by demand but not significantly. We normally sell more water during the first and second quarters when greater numbers of tourists are present. Demand can be affected by both the weather and the tourist season. We sell less water during the third and fourth quarters, which normally experience higher rainfall amounts than other times of the year. We do not believe that our operations in Nassau and Tortola will be subject to significant seasonal variations in demand. Our operation in Barbados has been subject to significant demand variations since Sandy Lane finished the grow-in of the grass on their three golf courses in early 2003.

Competition

We do not compete with utilities within our licensed area in the Cayman Islands. Although we have been granted an exclusive license for our present service area, our ability to expand our service area is limited at the discretion of the government. At the present time, we are the only non-municipal public water utility on Grand Cayman. The Cayman Islands government, through Water Authority-Cayman, supplies water to parts of Grand Cayman which are not within our licensed area.

On Ambergris Caye in Belize, our water supply contract with Belize Water Services Limited is exclusive, and Belize Water Services Limited can no longer seek contracts with other water suppliers, or produce water themselves, to meet their future needs in San Pedro, Ambergris Caye, Belize.

On South Bimini Island in the Bahamas, we supply water to a private developer and do not have competitors. AquaDesign, an Ionics Inc. company, operates a seawater desalination plant on North Bimini Island. We competed with companies such as AquaDesign/Ionics, Enerserve/Vivendi, IDE, Pridesa, Inima and Biwater for the new contract with the Bahamian government to build and operate a seawater desalination plant at Blue Hills, New Providence, Bahamas.

In the British Virgin Islands, AquaDesign operates seawater desalination plants in West End and Sea Cows Bay, Tortola, and on Virgin Gorda and generally bids against OCBVI for projects. There are currently water shortages in certain areas of Tortola, particularly on the eastern end of the island, and we believe that additional desalination plants will be required to alleviate these shortages.

DesalCo (Barbados) Ltd. operates a seawater desalination plant which provides irrigation water for several golf courses on the Sandy Lane Resort in St. James, Barbados. Ionics Inc. competed with us for this operating agreement. We expect that Ionics and other companies of comparable size and financial resources will compete with us for future agreements with the Sandy Lane Resort as well as any other agreements which we may seek in Barbados.

To implement our growth strategy outside our existing operating areas, we will have to compete with the same companies we competed with for the Blue Hills project in Nassau, Bahamas such as AquaDesign/Ionics, Enerserve/Vivendi, IDE, Pridesa, Inima and Biwater. These companies currently operate in areas in which we would like to expand our operations. These companies already maintain worldwide operations and have greater financial, managerial and other resources than our company. We believe that our low overhead costs, knowledge of local markets and conditions, exclusive rights in the Caribbean to the DWEER energy recovery system and our efficient manner of operating desalinated water production and distribution equipment will provide us competitive advantage on projects in the Caribbean basin and surrounding areas.

Environmental Matters

With respect to our Cayman Islands operations, although not required by local government regulations, we operate our water plants in accordance with guidelines of the Cayman Islands Department of Environment. We are licensed by the government to discharge concentrated seawater, which is a byproduct of our desalination process, into deep disposal wells.

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Our Cayman Islands license requires that our potable water quality meet the World Health Organization s Guidelines for Drinking Water Quality and contain less than 200 mg/l of total dissolved solids. We completed upgrades to our Governor s Harbour, West Bay and Britannia plants before October 1, 2003, and we meet all of the water quality requirements in our Cayman license. In addition, noise levels at our plants cannot exceed the standards established by the U.S. Occupational Safety and Health Act.

With respect to our Belize, Bahamas and British Virgin Islands operations, we are required by our water supply contracts to take all reasonable measures to prevent pollution of the environment. We are licensed by the Belize and Bahamian governments to discharge concentrated seawater, which is a byproduct of our desalination process, into deep disposal wells, and by British Virgin Islands government to discharge concentrated seawater into the sea. We operate our plants in a manner so as to minimize the emission of hydrogen sulfide gas into the environment. We are not aware of any existing or pending environmental legislation, which may affect our operations in Belize, the Bahamas and the British Virgin Islands. To date we have not received any complaints from any regulatory authorities regarding hydrogen sulfide gas emission, nor any other matter relating to operations.

To the best of our knowledge, there is no existing or pending environmental legislation which may affect our operations in Barbados.

Employees

We employ 62 persons in the Cayman Islands and ten in the United States. The eight executive management personnel have an average of 15 years experience with the Company or in a directly related position while 11 employees function in administrative and clerical positions. The remaining employees are engaged in engineering, purchasing, plant maintenance and operations, pipe laying and repair, leak detection, new customer connections, meter reading and laboratory analysis of water quality.

We employ six persons in Belize to manage and operate our plant. Waterfields Company Limited presently employs 22 persons in The Bahamas. We employ four persons in Barbados to operate the water plant for Sandy Lane Properties and we manage the eight employees of Ocean Conversion (BVI) Ltd. in the British Virgin Islands. None of our employees is a party to a collective bargaining agreement. We consider our relationship with our employees to be good.

The total of 112 employees have, on average, worked with us for seven years, with two employees having worked with us over 20 years.

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ITEM 1A. RISK FACTORS

We have described below some risks which may materially and adversely affect our business, financial condition or results of operations.

Our exclusive license for our service area in the Cayman Islands may not be renewed in the future and requires that we obtain prior approval for any rate increase for reasons other than inflation.

In the Cayman Islands, we presently operate as a public water utility under an exclusive license originally issued to us in December 1979 by the government of the Cayman Islands. Our existing license expires on July 11, 2010. If we are not in default of any terms of the license, we have a right of first refusal to renew the license on terms that are no less favorable than those that the government offers to a third party. Nevertheless, we cannot assure you that the government will renew our license or that we will be able to negotiate a new license on satisfactory terms. We would retain ownership of our production infrastructure and substantially our entire distribution infrastructure if our license were not renewed.

Under our existing license, we must obtain prior approval from the Cayman Islands government to increase our rates for any reason other than inflation. Our ability to raise our rates is limited by this requirement, including potential delays and costs involved in obtaining government approval for a rate increase. Failure to obtain adequate rate increases could have an adverse effect on our results of operations.

We rely on water supply and/or service agreements with our customers in the Cayman Islands, Belize, The Bahamas and Barbados which, upon their expiration, may not be renewed or may be renegotiated on less favorable terms to us.

We presently operate as bulk water suppliers under water sales agreements in the Cayman Islands with our customer the Water Authority-Cayman, in Belize with our customer, Belize Water Services Limited, and in The Bahamas with our customers, the Water & Sewerage Corporation and South Bimini International Ltd. We presently operate a plant in Barbados under a service agreement for our customer Sandy Lane Properties Ltd. Upon expiration, these agreements may not be renewed or may be renewed on less favorable terms.

The British Virgin Islands Water and Sewerage Department has taken the position that our water supply agreement is operating on a month-to-month basis.

We have accepted the position of The British Virgin Islands Water and Sewerage Department that Ocean Conversion (BVI) Ltd. s existing water supply arrangement is in force on a month-to-month basis until negotiations for a definitive agreement are finalized. In May 1999, The British Virgin Islands government did not make a required buyout payment of $1.42 million for the Baughers Bay plant and has taken the position that the water supply agreement continues on a month-to-month basis. Thus, it is possible, but we believe it unlikely, that the government could cease purchasing water at any time. While Ocean Conversion (BVI) Ltd. has made attempts in the past to negotiate a new water supply agreement, there is no guarantee such agreement will be obtained, or if obtained, would be on terms favorable to Ocean Conversion (BVI) Ltd. Cessation of the government water purchases, or failure to negotiate a new agreement on terms favorable to us, could have an adverse effect on our results of operations. For the year ended December 31, 2005, gross revenue of our affiliate Ocean Conversion (BVI) Ltd. was $7,715,827. Our equity investment in Ocean Conversion (BVI) Ltd., as at December 31, 2005, was $11,305,281. In the event that the government ceased purchasing water from the Baughers Bay plant, or we negotiated a

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new contract with the government on less favorable terms than the existing supply arrangement, we would be required to evaluate this investment for impairment. In the event that we determined that this investment was impaired, we could incur significant expense to write off part or all of this investment, which would reduce our earnings during the period in which the investment was determined to be impaired.

Our business is affected by tourism, weather, the economies of the locations where we provide service and the U.S. and European economies.

Tourist arrivals and weather within our operating areas affect the demand for our water to a greater extent in the Cayman Islands and in Belize than in The Bahamas, The British Virgin Islands and Barbados. In the Cayman Islands and Belize, the highest demand is normally in the first two quarters of each calendar year. The lowest demand for water occurs in the third quarter of each calendar year. A significant percentage of tourists visiting the Cayman Islands and Belize come from the U.S. or certain European countries. In addition, development activity in our service areas in the Cayman Islands is significantly impacted by the U.S. economy. Accordingly, a significant downturn in tourist arrivals to the Cayman Islands or in the U.S. or European economies for any reason would be detrimental to our revenues and operating results. Additional terrorist activities in the United States, Europe or in areas served by us or extended hostilities in the Middle East would likely have a material adverse effect on our business and results of operations.

We may have difficulty accomplishing our growth strategy within and outside of our current operating areas.

Even though we have an exclusive license for our present operating area in the Cayman Islands and supply agreements in the Cayman Islands, The Bahamas, The British Virgin Islands, Barbados and Belize, our ability to expand our operating areas is often subject to the approval of the respective governments in each location.

Further, part of our long-term growth strategy is to expand our water supply and distribution operations to other locations. Our expansion into new locations depends on our ability to obtain necessary permits, licenses and approvals to operate in new territories. We may not obtain these necessary permits, licenses and approvals in a timely and cost efficient manner, or at all.

Our expansion to territories outside of our current operating areas includes significant risks, including, but not limited to, the following:

- regulatory risks, including government relations difficulties, local regulations and currency controls;

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risks related to operating in foreign countries, including political instability, reliance on local economies, environmental or geographical problems, shortages of materials, immigration restrictions and limited skilled labor;

risks related to development of new operations, including assessing the demand for water, engineering difficulties and inability to begin operations as scheduled; and

risks relating to greater competition in these new territories, including the ability of our competitors to gain or retain market share by reducing prices.

Even if our expansion plans are successful, we may have difficulty managing our growth. We cannot assure you that any new operations outside of our current operating areas will attain or maintain profitability or that the results from these new operations will not negatively affect our overall profitability.

The Windsor Contract may not be renewed in the future.

The Windsor Contract expires on or near to March 2013 or after Waterfields has supplied 13.1 billion U.S. gallons to WSC. The Company cannot assure that WSC will renew the contract or that it will be able to negotiate a new contract on satisfactory terms. The Company would retain ownership of the production infrastructure if the Windsor Contract were not renewed. From time to time and since October 2004, the Company has been unable to deliver the required water volumes to WSC from the Windsor Plant because of mechanical equipment problems and fouling of the reverse osmosis membrane elements. As a result of this fouling, the Company has been subject to water rate adjustments that have reduced sales, and may or may not be technically in default of the Windsor Contract. The Company has implemented an extensive program to test and understand the cause of the membrane fouling which has increased and abated several times since the Windsor Plant was commissioned in December 1996. The Company has also undertaken to expand the capacity of the Windsor Plant in order to replace the production capacity that has been lost because of membrane fouling. WSC has not notified the Company that it is in breach of the terms of the Windsor Contract.

The Blue Hills Plant is larger than any other single desalination plant that we have built previously and revenue from this plant is substantially derived from fixed unit prices.

Because of the size of the Blue Hills project, there were inherent uncertainties in the cost estimates to construct this facility and construction and/or operating cost overruns could materially affect the return on our investment. Additionally, the terms of the contract required us to guarantee the price of desalinated water on a per unit basis, subject to certain annual inflation adjustments, and assume the risk that the costs associated with producing this water may be greater than anticipated. The profitability of this project is therefore dependent on our ability to estimate accurately the costs of constructing as well as operating the plant. These costs were and can in the future be affected by a variety of factors, such as changes in the costs of materials and services or the delivery of such services since we submitted our bid in March 2004, lower than anticipated production efficiencies and hydro-geological conditions at the plant site differing materially from what was evaluated at the time we bid on the contract. If we did not estimate accurately the costs of this project or its operating costs, it may have a lower margin than expected, which could adversely affect our results of operations or financial condition.

On March 10, 2005, Biwater International Limited, a corporation which was unsuccessful in its bid for the construction of the Blue Hills Plant, and Biwater Bahamas Limited (BBL) filed an application with the Supreme Court of The Commonwealth of The Bahamas for judicial review of WSC s award for the construction of the Blue Hills Plant to the Company. The unsuccessful bidder and BBL are

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seeking an order from the court rescinding the award to the Company of the Blue Hills Plant construction project and an order awarding the project to the unsuccessful bidder. In the alternative, the unsuccessful bidder and BBL are seeking an order from the court awarding compensatory and exemplary damages to them. The Company is not a party to this action.

The Company is currently performing its obligations under the Blue Hills contract and expects to complete the project in August, 2006. WSC has entered into an agreement to indemnify the Company against all expenses and losses incurred by the Company, including loss of profits, which the Company may incur if the court were to award the Blue Hills Project construction project to Biwater International Limited

We do not own a majority interest in Ocean Conversion (BVI) Ltd.

We own 50% of the voting shares of Ocean Conversion (BVI) Ltd., which allows us to appoint three of the six directors of that company. Sage Water Holdings (BVI) Limited, which owns the remaining 50% of the voting shares, is entitled to appoint the remaining three directors. If there is a tied vote of the directors on any matter, the president of the Caribbean Water and Wastewater Association is entitled to appoint a temporary director to break the tie. As a result, we share the management of Ocean Conversion (BVI) Ltd. with Sage Water Holdings (BVI) Limited. Although we also provide management and engineering services to Ocean Conversion (BVI) Ltd., we do not fully control the operations, as our total ownership interest is 43.5%.

Our operations could be harmed by hurricanes.

Another significant hurricane such as Ivan, which affected our Cayman Islands operations in September 2004, could cause major damage to our equipment and properties and the properties of our customers, including the large tourist properties in our areas of operation. This would result in decreased revenues and profits from water sales until our damaged equipment and properties are repaired and our customers and the tourism industry returned to the status quo before the hurricane. We insure all of our assets except for our feed wells and, in the Cayman Islands our underground water distribution system.

Also, another significant hurricane such as Katrina, which affected an area in geographic proximity to several of our operations and significant suppliers, could disrupt our supply chain and/or the related delivery of components necessary to our operations, resulting in an adverse impact on our results of operations and financial condition.

Contamination to our processed water may cause disruption in our services and adversely affect our revenues.

Naturally occurring or man-made compounds and events may contaminate our processed water. In the event that a portion of our processed water is contaminated, we may have to interrupt the supply of water until we are able to install treatment equipment or substitute the flow of water from an uncontaminated water production source. In addition, we may incur significant costs in order to treat a contaminated source of plant feed water through expansion of our current treatment facilities, or development of new treatment methods. Our inability to substitute processed water from an uncontaminated water source, or to adequately treat the contaminated plant feed water in a cost-effective manner may have an adverse effect on our revenues.

In addition, in the wake of the September 11, 2001 terrorist attacks in New York, Washington, D.C. and Pennsylvania, we have taken steps to heighten employee awareness of threats to our water supply. While we are not aware of any specific threats to our facilities, operations or supplies, we have and will continue to take security precautions to protect our facilities, operations and supplies. It is possible, however, that we would not be in a position to control the outcome or the costs of such events should they occur, which could have an adverse effect on the results of our operations.

Potential government actions and regulations could negatively affect us.

Any government that regulates our operations may issue legislation or adopt new regulations, including but not limited to:

- restricting foreign ownership of our Company;
- providing for the expropriation of our assets by the government;
- providing for nationalization of public utilities by the government;
- providing for different water quality standards;
- unilateral changes to or renegotiations of our exclusive licenses; or
- causing currency exchange fluctuations or devaluation s or changes in tax laws.

We rely on the efforts of several key employees.

Our success depends upon the abilities of our executive officers. In particular, the loss of the services of Jeffrey Parker, our Chairman of the Board, or Fredrick W. McTaggart, our President and Chief Executive Officer could be detrimental to our operations and our continued success. Although Messrs. Parker and McTaggart have entered into three-year employment agreements, which may be extended every year for an additional one-year term, we cannot guarantee that Mr. Parker or Mr. McTaggart will continue to work for us during the term of their agreements. In addition to Messrs. Parker and McTaggart, our Senior Vice President and our Vice Presidents have entered into non-compete agreements.

We are exposed to credit risk.

We are not exposed to significant credit risk on retail customer accounts in the Cayman Islands and Bimini, Bahamas, as our policy is to cease supply of water to customers whose accounts are more than 45 days overdue. Our exposure to credit risk is from our bulk water sales customers in Belize, The Bahamas, The British Virgin Islands, Barbados and the Cayman Islands and our outstanding affiliate loan balance with OCBVI. In addition, the balance of our loan receivable is with one bulk water customer, Water Authority-Cayman.

We are exposed to interest rate risk in several countries.

As of December 31, 2005, we had loans outstanding totaling $12,850,542, all of which bear interest at various lending rates such as LIBOR, Cayman Island s Prime Rate or The Bahamas Prime Lending Rate. We are subject to interest rate risk to the extent that any of these rates change.

Provisions in our Articles of Association and an Option Deed adopted by our Board of Directors may discourage a change in control of our Company.

Our Articles of Association include provisions which may discourage or prevent a change in control of our Company. For instance, our Board of Directors consists of three groups. Each group serves a staggered term of three years before the Directors in the group are up for re-election.

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We have also adopted an Option Deed, which is similar to a poison pill. The Option Deed will discourage a change in control of our Company by causing substantial dilution to a person or group who attempts to acquire our Company on terms not approved by the Board of Directors. The Option Deed will expire on July 31, 2007.

As a result of these provisions, which discourage or prevent an unfriendly or unapproved change in control of our Company, our shareholders may not have an opportunity to sell their common stock at a higher market price, which, at least temporarily, typically accompanies attempts to acquire control of a company through a tender offer, open market purchase or otherwise.

There may be a risk of variation in currency exchange rates.

Although we report our results in United States dollars, the majority of our revenue is earned in other currencies. All of the currencies in our operating areas have been fixed to the United States dollar for over 20 years and we do not employ a hedging strategy against exchange rate risk associated with our reporting in United States dollars. If any of these fixed exchange rates becomes a floating exchange rate our results of operations could be adversely affected.

Service of process and enforcement of legal proceedings commenced against us in the United States may be difficult to obtain.

Service of process on our Company and our directors and officers, twelve out of sixteen of whom reside outside the United States, may be difficult to obtain within the United States. Also, since substantially all of our assets are currently located outside the United States, any judgment obtained in the United States against us may not be collectible.

There is no reciprocal statutory enforcement of foreign judgments between the United States and the Cayman Islands, so foreign judgments originating from the United States are not directly enforceable in the Cayman Islands. A prevailing party in a United States proceeding against us or our officers or directors would have to initiate a new proceeding in the Cayman Islands using the United States judgment as evidence of the party s claim. A prevailing party could rely on the summary judgment procedures available in the Cayman Islands, subject to available defenses in the Cayman Islands courts, including, but not limited to, the lack of competent jurisdiction in the United States courts, lack of due service of process in the United States proceeding and the possibility that enforcement or recognition of the United States judgment would be contrary to the public policy of the Cayman Islands.

Depending on the nature of damages awarded, civil liabilities under the Securities Act of 1933 or the Securities Exchange Act of 1934 for original actions instituted outside the Cayman Islands may or may not be enforceable. For example, a United States judgment awarding remedies unobtainable in any legal action in the courts of the Cayman Islands (for example, treble damages, which would probably be regarded as penalties), would not likely be enforceable under any circumstances.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Cayman Island Properties

Governor s Harbour Plant

We own our Governor s Harbour plant and the 8,745 square feet of buildings, which contain the water treatment facility, and operate and maintain the plant through our wholly-owned subsidiary Ocean Conversion (Cayman) Limited. The plant is located on 3.2 acres, including 485 feet of waterfront. The current water production capacity of our Governor s Harbour plant is 1.2 million U.S. gallons per day. On this site we also have three 1.0 million U.S. gallon potable water storage tanks, which were constructed in 2003 to replace our previous 2.0 million U.S. gallon fabric-lined storage tanks. The property surrounding the facility has yet to be fully developed, although these areas are being developed for residential and tourist accommodations.

West Bay Plant

We own, operate and maintain our West Bay plant in Grand Cayman, which is located on 6.1 acres in West Bay. The plant began operating on June 1, 1995 and was expanded in February 1998 and again in February 2000. On this site, we have a 2,600 square foot building which houses our water production facilities, a 2,400 square foot building which houses the potable water distribution pumps, a water quality testing laboratory, office space and water storage capacity consisting of three 1.0 million U.S. gallon potable water tanks. The current capacity of our West Bay plant is 710,000 U.S. gallons per day.

Britannia Plant

On February 1, 2002, we purchased the Britannia seawater desalination plant in Grand Cayman, which consists of four seawater reverse osmosis production units with a combined nominal production capacity of 440,000 U.S. gallons of water per day, an 840,000 U.S. gallon bolted steel water tank, potable water high service pumps, and various ancillary equipment to support the operation. We have entered into a lease of the 0.73 acre site and steel frame building, which houses the plant, from Cayman Hotel and Golf Inc., for a term of 25 years at an annual rent of $1.00. In September, 2004 the seawater reverse osmosis production units and potable water high service pumps were destroyed by Hurricane Ivan. The depreciated value of this equipment was written off in 2004 and the full cost of replacement was funded from the proceeds of an insurance settlement. The production capacity of the plant has been expanded to 750,000 U.S. gallons per day and was re-commissioned in October, 2005.

Distribution System

We own our Seven Mile Beach and West Bay potable water distribution systems in Grand Cayman. The combined systems consist of polyvinyl chloride and polyethylene water pipes, valves, curb stops, meter boxes, and water meters installed in accordance to accepted engineering standards in the United States of America.

Leased Properties

In addition to the properties where our water plants are located, we lease approximately 5,451 square feet of office space at the Regatta Business Park, West Bay Road, Grand Cayman, Cayman Islands. The term of the lease is three years from April 1, 2005 and upon expiration may be renewed at our option for a further three-year period.

Ocean Conversion (Cayman) Limited Properties

Following completion of our acquisition of all of the outstanding stock of each of DesalCo Limited and Ocean Conversion (Cayman) Limited, we assumed operational control over four water production plants in the Cayman Islands, one of which we already owned, but had contracted with Ocean Conversion (Cayman) Limited to operate until December 2004.

Red Gate Road Plant

Under the terms of the water production and supply license between Ocean Conversion (Cayman) Limited and the government of the Cayman Islands, Ocean Conversion (Cayman) Limited is allowed to use the property on which the plant is located to produce approximately 1.3 million U.S. gallons of desalinated water per day for sale to the Water Authority-Cayman. Ocean Conversion (Cayman) Limited owns all of the buildings, equipment feed water wells and brine disposal wells with the exception of the piping from the wells to the plant (including feed water and brine disposal) and the main electrical service disconnect, both of which are owned by Water Authority-Cayman. The property on which the plant is located is also owned by Water Authority-Cayman. The plant was originally powered only by electricity, but was upgraded in 1994 to include diesel driven high-pressure pumps. Upon expiration of the water production and supply license on November 30, 2008, Water Authority-Cayman will take possession of the plant for no consideration. This license was extended in November 2001 for a period of seven years and no further extension options are included in the present license.

Lower Valley Plant

Ocean Conversion (Cayman) Limited provided the plant and equipment to Water Authority-Cayman under a seven-year vendor-financed sale and operating agreement. Ocean Conversion (Cayman) Limited operates the electrically-powered 850,000 U.S. gallons per day rated plant and supplied approximately 792,000 U.S. gallons of desalinated water per day to Water Authority-Cayman.

In 2005 Water Authority-Cayman accepted our proposal to increase the capacity of the Lower Valley plant to 1.06 million U.S. gallons per day in exchange for a seven-year extension of the license.

Ocean Conversion (Cayman) Limited leases the property on which the plant is located from Water Authority-Cayman for a minimal annual rent for the duration for the sale and operating agreement, which originally was set to expire on March 9, 2006, but was extended with the seven-year extension of the license. Responsibility for operation of the plant passes to Water Authority-Cayman upon expiration of the lease-purchase and operating agreement.

North Sound Plant

Construction of this plant was completed in November 2002. Ocean Conversion (Cayman) Limited provided the plant and equipment to Water Authority-Cayman under a seven-year vendor-financed sale and operating agreement. Ocean Conversion (Cayman) Limited operates the electrically powered plant and supplies approximately 792,000 U.S. gallons of desalinated water per day to Water Authority-Cayman. Ocean Conversion (Cayman) Limited leases the property on which the plant is located from Water Authority-Cayman for a minimal annual rent, for the duration of the sale and operating agreement. Responsibility for operation of the plant passes to Water Authority-Cayman upon expiration of the sale and operating agreement on November 28, 2009.

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Belize Properties

We own our San Pedro water production facility in Ambergris Caye, Belize. The plant consists of a one story concrete block building, which contains a seawater RO water production plant with a production capacity of 420,000 US gallons per day. We lease from the Government of Belize at an annual rent of BZ$1.00, land on which our plant is located. The lease commenced on April 27, 1993 and expires in 2026.

Bahamas Properties

We own the water production facility in South Bimini. The plant consists of two 40 foot long standard refrigerated shipping containers, which contains a seawater reverse osmosis production plant with a rated capacity of 115,000 U.S. gallons per day, a 250,000 US gallon bolted steel potable water tank, a high service pump skid and an office trailer. The facility is located on a parcel of land owned by South Bimini International Ltd., and we are allowed, under the terms of our agreement, to utilize the land for the term of the agreement without charge.

We own the water production facility in Nassau, New Providence, with a production capacity is 2.6 million U.S. gallons per day. The plant is powered by a combination of diesel engine-driven high-pressure pumps, and electrical power purchased from the Bahamas Electricity Corporation to power all other loads in the plant. The plant is contained within a 13,000-sq. ft. concrete and steel building that also contains a warehouse, workshop and offices. It is located on land owned by the Water and Sewerage Corporation of The Bahamas and our fifteen-year water sales agreement gives us a license to use the land throughout the term of that agreement.

U.S. Property

On July 25, 2005, the Company guaranteed the financial obligations of a five year lease for about 7,200 square feet for Aquilex, Inc., a wholly owned subsidiary of the Company incorporated in the United States for the purpose of providing financial, engineering and supply chain management support services to operating segments of the Company.

ITEM 3. LEGAL PROCEEDINGS

We are not currently a party to any ongoing or pending legal proceeding which, in the opinion of management, is likely to have a material adverse effect on the financial conditions, results of operations or liquidity of the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted during the fourth quarter of the fiscal year covered by this Annual Report to a vote of security holders, through the solicitation of proxies or otherwise.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our Class A common stock is listed on the Nasdaq National Market and trades under the symbol CWCO .. Listed below, for each quarter of the last two fiscal years, are the high and low closing bid prices for the common stock on the Nasdaq National Market.

	High	Low
First Quarter 2005	$ 17.00	$ 14.20
Second Quarter 2005	19.87	16.40
Third Quarter 2005	22.24	18.15
Fourth Quarter 2005	20.70	15.30
First Quarter 2004	$ 10.46	$ 8.75
Second Quarter 2004	14.88	9.48
Third Quarter 2004	13.23	10.14
Fourth Quarter 2004	15.49	10.76

On August 17, 2005 our shareholders approved a 2-for-1 stock split of our common stock payable to the shareholders of record on August 24, 2005. On August 25, 2005, the Company s common stock began trading on the post-split basis. The stock split reduced the par value of our common stock to US$0.60 (approx. CI$0.50) from US$1.20 (approx. CI$1.00).

All share and dividend amounts presented here have been retroactively adjusted to reflect the stock split.

There is no trading market for our redeemable preferred shares, which are only issued to, or purchased by, long-term employees of our company and must be held by these employees for a period of four years before they vest.

On October 1, 2005, we issued 8,970 shares of common stock to our directors under the Non-Executive Directors Share Plan.

On September 27, 2005, the Company entered into a Second Deed of Amendment (the Amendment) to its Option Deed dated as of August 6, 1997 and as amended on August 8, 2005 between the Company and American Stock Transfer & Trust Company (the Option Deed).

The Option Deed granted to each holder of a common and preferred share an option to purchase one one-hundredth of a class B common share at an exercise price of $100.00, subject to adjustment. If an attempt to take over control of the Company occurs, each shareholder of the Company would be able to exercise the option and receive common shares with a value equal to twice the exercise price of the option. Under circumstances described in the Option Deed, as amended, instead of receiving common shares, the Company may issue to each shareholder cash or other equity or debt securities of the Company, or the equity securities of the acquiring company, as the case may be, with a value equal to twice the exercise price of the option.

Pursuant to the Amendment to the Option Deed, each holder of a common and redeemable preferred share has the option to purchase one one-hundredth of a class B common share at an exercise price of $50.00, subject to adjustment. The Amendment does not modify the Option Deed in any other material respect.

The options are attached to each common share and redeemable preferred share, and presently have no monetary value. The options will not trade separately from the Company s shares unless and until they become exercisable. The options, which expire on July 31, 2007, may be redeemed, at the option of the Company s board of directors, at a price of CI$.01 per option at any time until ten business days following the date that a group or person acquires ownership of 20% or more of the Company s outstanding common shares.

Our 2,023,850 Bahamian Depository Receipts (BDRs) are listed and traded only on the Bahamian International Stock Exchange (BISX). There are currently 404,770 shares of our common stock underlying the BDRs held in a custodial account in The Bahamas. The BDRs are subject to dividend payments in proportion to their relative value our common shares when and if declared.

Holders

On February 28, 2006, we had 802 holders of record of our common stock.

Dividends

We have consistently paid dividends to owners of our common and redeemable preferred shares since we began declaring dividends in 1985. Our Board of Directors has established a policy, but not a binding obligation, that we will seek to maintain a dividend payout ratio in the range of 50% to 60% of net income. This policy is subject to modification by our Board of Directors. Our payment of any future cash dividends, however, will depend upon our earnings, financial condition, capital demand and other factors, including conditions of our loan agreement with Scotiabank (Cayman Islands) Ltd. that dividends be paid only from current cash flows.

The board of directors declares and approves all interim dividends. It is a requirement of our Articles of Association for the board of directors to seek shareholder approval of the final dividend, if any, at the annual meeting of our shareholders.

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Listed below, for each quarter of the last two fiscal years, is the amount of interim dividends declared on our issued and outstanding shares of common stock and redeemable preferred shares. No final dividend was declared during the last two fiscal years.

First Quarter 2005	$0.0575 Per Share
Second Quarter 2005	0.0600 Per Share
Third Quarter 2005	0.0600 Per Share
Fourth Quarter 2005	0.0600 Per Share
First Quarter 2004	$0.0575 Per Share
Second Quarter 2004	0.0575 Per Share
Third Quarter 2004	0.0575 Per Share
Fourth Quarter 2004	0.0575 Per Share

Exchange Controls and Other Limitations Affecting Security Holders

Our Company is not subject to any governmental laws, decrees or regulations in the Cayman Islands which restrict the export or import of capital, or that affect the remittance of dividends, interest or other payments to non-resident holders of our securities. The Cayman Islands does not impose any limitations on the right of non-resident owners to hold or vote our common stock other than stated below. There are no exchange control restrictions in the Cayman Islands.

Taxation

The Cayman Islands presently impose no taxes on profit, income, distribution, capital gains, or appreciations of our Company and no taxes are currently imposed in the Cayman Islands on profit, income, capital gains, or appreciations of the holders of our securities or in the nature of estate duty, inheritance, or capital transfer tax. There is no income tax treaty between the United States and the Cayman Islands.

As discussed in Part I, Item 1, we were subject in the Cayman Islands to a stamp tax when our shares are transferred. Prior to our common shares becoming quoted in the United States, we paid this tax on private share transfers. We have never paid the tax on transfers of our publicly traded shares. Since 1994, we requested that the Cayman Islands government exempt us from the share transfer tax. On April 10, 2003, we received notice that the Cayman Islands government had granted an exemption from taxation for all transfers of our shares. We believe it is unlikely that government will seek to collect this tax on transfers of our publicly traded shares during the period 1994 through April 10, 2003.

The information required by Item 201(d) of Regulation S-K is provided under Item 12 of this Annual Report.

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ITEM 6. SELECTED FINANCIAL DATA

The Company s consolidated financial statements are prepared in accordance with the accounting principles generally accepted in the United States (US-GAAP). As a result, all financial information presented herein has been prepared in accordance with US-GAAP.

The consolidated financial statements include the accounts of the Company s wholly-owned subsidiaries Cayman Water Company Limited, Belize Water Limited, Ocean Conversion (Cayman) Limited, DesalCo Limited, DesalCo (Barbados) Ltd., Aquilex, Inc. and its majority owned subsidiary Waterfields Company Limited. The operating results of Ocean Conversion (Cayman) Limited, DesalCo Limited and DesalCo (Barbados) Ltd. have been included in the consolidated financial statements effective February 1, 2003. The operating results of Waterfields Company Limited have been included in the consolidated financial statements effective August 1, 2003. The results of operations of our investment in Ocean Conversion (BVI) Ltd. is accounted for using the equity method of accounting. All inter-company balances and transactions have been eliminated.

Set forth below is selected financial data based upon our consolidated financial statements. The table contains information, expressed in US dollars, derived from our audited consolidated financial statements for the five-year period ended December 31, 2005. This selected financial data should be read in conjunction with the more detailed financial statements and related notes thereto contained elsewhere in this Annual Report. The audited consolidated financial statements for the years ended December 31, 2002 and 2001 and accountant s reports thereon are not included in this Annual Report.

	Year Ended December 31,				
	2005	2004	2003	2002	2001
Statement of Income Data:					
Revenue	$ 26,187,205	$ 23,281,413	$ 19,054,205	$ 12,154,689	$ 11,248,105
Net Income	5,514,258	6,197,383	4,177,081	2,576,310	2,764,573
Balance Sheet Data:					
Total Assets	88,365,191	70,825,049	68,562,126	25,507,637	22,721,178
Long Term Debt Obligations	19,378,212	12,856,226	16,633,437	2,074,609	1,213,804
Redeemable Preferred Stock	19,382	16,705	16,302	23,688	30,234
Dividends Declared Per Share	0.24	0.23	0.21	0.21	0.20
Basic Earnings Per Share	$ 0.47	$ 0.54	$ 0.43	$ 0.33	$ 0.36
Weighted Average Number of Shares	11,767,573	11,474,264	9,834,366	7,939,722	7,795,938
Diluted Earnings Per Share	$ 0.45	$ 0.53	$ 0.42	$ 0.32	$ 0.35
Weighted Average Number of Shares	12,161,407	11,759,010	10,075,060	8,175,064	7,999,382

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Our objective is to provide water services in areas where the supply of potable water is scarce and where the use of reverse osmosis (RO) technology to produce potable water is economically feasible.

We intend to increase revenues by developing new business opportunities both within our current service areas and in new areas. We expect to maintain operating efficiencies by continuing to focus on our successful business model and by properly executing our equipment maintenance and water loss mitigation programs. We also believe that many Caribbean basin and adjacent countries, being water scarce, present opportunities for operation of our plants in favorable regulatory environments.

Our operations and activities are conducted at eleven plants in five countries: the Cayman Islands, Belize, Barbados, The British Virgin Islands and The Bahamas and in three business segments: Retail, Bulk and Services.

Comparative Operations

2005			2004		
Location	Plants	Capacity*	Location	Plants	Capacity*
Cayman Islands	6	5.5	Cayman Islands	6	5.3
Bahamas	2	4.2	Bahamas	2	2.7
Belize	1	0.4	Belize	1	0.4
Barbados	1	1.3	Barbados	1	1.3
British Virgin Islands	1	1.7	British Virgin Islands	1	1.2
Total	11	13.1	Total	11	10.9

*Million U.S. gallons per day.

Prior to our acquisitions in 2003, we operated 5 plants with a capacity of 2.9 million U.S. gallons per day.

Cayman Islands

We have been operating our business on Grand Cayman Island since 1973 and have been using RO technology to convert seawater to potable water since 1989. There is a limited natural supply of fresh water on the Cayman Islands. We currently have an exclusive license from the Cayman Islands government to process potable water from seawater and then sell and distribute that water by pipeline to Seven Mile Beach and West Bay, Grand Cayman. Our operations consist of six reverse osmosis seawater conversion plants which provide water to approximately 3,800 Retail residential and commercial customers within a government licensed area and Bulk water sales to the Water Authority-Cayman. Our pipeline system in the Cayman Islands covers the Seven Mile Beach and West Bay areas of Grand Cayman and consists of approximately 68 miles of polyvinyl chloride pipe. During 2005, we supplied approximately 594 million U.S. gallons (2004: 582 million U.S. gallons) of water to our Retail water customers and 878 million U.S. gallons (2004: 805 million U.S. gallons) to our Bulk customers in Grand Cayman.

Belize

Our Belize operation, which was acquired on July 21, 2000, consists of one reverse osmosis seawater conversion plant on Ambergris Caye, Belize, Central America capable of producing 420,000 U.S. gallons per day. We sell water to one customer, Belize Water Services Limited, which then distributes the water through its own distribution system to residential, commercial and tourist properties on Ambergris Caye. During 2005, we supplied approximately 116 million U.S. gallons (2004: 110 million U.S. gallons) of water to our Bulk water customer in Belize.

Bahamas

Our Bimini plant is capable of producing 115,000 U.S. gallons per day and provides potable water to Bimini Sands Resort and to the Bimini Beach Hotel. During 2005, we supplied approximately 5 million U.S. gallons (2004: 5 million U.S. gallons) of water to our retail water customer in Bimini, Bahamas.

As a result of our acquisition of Waterfields Company Limited in August 2003, we acquired an additional reverse osmosis seawater conversion plant in The Bahamas. Waterfields produces potable water from one reverse osmosis seawater conversion plant in New Providence and has a total installed capacity of 2.6 million U.S. gallons per day. Waterfields Company Limited provides water from one plant, the Windsor plant, on the island of New Providence on a take or pay basis to the Water and Sewerage Corporation of the Bahamas under a long-term build, own and operate supply agreement. In October 2005, we expanded the capacity of this plant by 1.5 million U.S. gallons per day. During 2005, we supplied approximately 853 million U.S. gallons (2004: 831 million U.S. gallons) of water to our Bulk water customer.

Barbados

The Barbados operation consists of a service agreement to operate one reverse osmosis seawater conversion plant with a capacity of 1.3 million U.S. gallons per day, which is owned by Sandy Lane Resort. This plant is operated by DesalCo (Barbados) Ltd., the wholly owned subsidiary of DesalCo Limited. The plant provides water to the Sandy Lane Resort and during 2005 we produced approximately 124 million U.S. gallons (2004: 140 million U.S. gallons).

British Virgin Islands

We are in the market in the British Virgin Islands with an equity position and shared management control of Ocean Conversion (BVI) Ltd., which produces potable water from two reverse osmosis seawater conversion plants in Tortola. The plants have a total installed capacity of 1.7 million U.S. gallons per day and provides water to the Department of Water and Sewerage of the Ministry of Communications and Works of the Government of the British Virgin Islands. During 2005, we supplied approximately 479 million U.S. gallons (2004: 471 million U.S. gallons) of water to our bulk water customer.

Critical Accounting Policies

We have identified the accounting policies below as those policies critical to our business operations and the understanding of results of operations. The preparation of consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of

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assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to trade accounts receivable, goodwill and other intangible assets and property, plant and equipment. Our Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions. We believe the following critical accounting policies are most important to the portrayal of our financial condition and results of operations and require management s more significant judgments and estimates in the preparation of our condensed consolidated financial statements.

Goodwill and other intangible assets: Goodwill represents the excess costs over 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 in accordance with the provisions of SFAS No. 142, Goodwill and Other Intangible Assets . SFAS No. 142 also requires that intangible assets with estimatable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets . The Company periodically evaluates the possible impairment of goodwill. Management identifies its 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. The Company determines the fair value of each reporting unit and compares it 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, the Company is 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, the Company compares 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, in accordance with SFAS No. 141, Business Combinations . 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. Our annual tests resulted in no goodwill impairment.

Property, plant and equipment: Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation commences in the month the asset is placed in service and is calculated using a straight-line method with an allowance for estimated residual value. Rates are determined based on the estimated useful lives of the assets as follows:

Buildings	5 to 40 years
Plant and equipment	4 to 40 years
Distribution system	3 to 40 years
Office furniture, fixtures and equipment	3 to 10 years
Vehicles	3 to 10 years
Leasehold improvements	Lesser of 5 years or operating lease term
Lab equipment	5 to 10 years

Additions to property, plant and equipment are comprised of the cost of the contracted services, direct labor and materials. Assets under construction are recorded as additions to property, plant and equipment upon completion of a project. Improvements that significantly increase the value of property, plant and equipment are capitalized. Maintenance, repairs and minor improvements are charged to expense as incurred.

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Construction in progress: The cost of borrowed funds directly attributable to the acquisition and construction of qualifying assets, which are assets that necessarily take a substantial period of time to be ready for their intended use, are added to the cost of those assets until such time as the assets are substantially ready for use or sale.

Trade accounts receivable: We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. Management continuously evaluates the collectibility of accounts receivable and records allowances based on estimates of the level of actual write-offs that might be experienced. These estimates are based on, among other things, comparisons of the relative age of accounts and consideration of actual write-off history.

Quarterly Results of Operations

The following table presents unaudited quarterly results of operations for the eight quarters ended December 31, 2005. We believe that all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly such quarterly information.

	For the year ended December 31, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$ 6,057,485	$ 6,552,868	$ 6,204,386	$ 7,372,466
Gross profit	2,397,860	2,782,229	2,202,414	2,971,894
Net income	1,374,051	1,481,359	1,009,349	1,649,499
Diluted earnings per share	0.12	0.12	0.08	0.13

	For the year ended December 31, 2004			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$ 6,337,697	$ 6,409,364	$ 5,279,054	$ 5,255,298
Gross profit	2,907,223	2,849,545	1,942,423	1,910,509
Net income	1,923,922	1,764,040	424,032	2,085,389
Diluted earnings per share	0.17	0.15	0.04	0.17

Results of Operations

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Revenue

Total revenue increased by 12.5% from $23,281,413 to $26,187,205 for the year ended December 31, 2005 when compared to the same period in 2004.

Revenue from Retail increased 10.6% from $12,089,491 to $13,372,103 in 2005 when compared to 2004. This variation primarily reflected increased demand by residential customers in Grand Cayman, particularly in the West Bay service area, which experienced a 29.0% increase in volume sales. We believe many residents relocated to West Bay in the wake of Hurricane Ivan s damage in late 2004.

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Efforts to rebuild damaged tourist properties are continuing at a rapid pace but one hotel and a number of condominiums within our Cayman market have not yet fully reopened and new construction projects experienced problems due to storm threats, labor shortages and delayed material deliveries. Commercial sales were down 5.4% in 2005 versus 2004. Until tourism returns to the 2004 pre-hurricane levels in the Cayman market, revenues from commercial customers within our Retail segment may continue to be flat or lower in the future.

Revenue from Bulk increased 13.8% from $10,303,074 to $11,724,438 for the year ended December 31, 2005 when compared to the same period in 2004. This increase was primarily the twofold result of additional consumption by our customer (Water Authority-Cayman) in the Cayman Islands and to a lesser extent increased consumption by our customer in Belize.

In addition, although we did experience higher revenue related to the recovery of energy costs at our Windsor plant in The Bahamas, this was more than offset by pricing adjustments of approximately $571,000 in 2005 and $313,000 in 2004 related to reduced deliveries associated with the fouling of RO membrane elements throughout 2005 and 2004. We are in the process of remediating this problem through various cleaning procedures and equipment modifications, and have placed six containerized desalination units on the Windsor site which are being used to supply water under our new Blue Hills contract and to supplement water production capacity at Windsor.

Revenue from services (Services) increased 22.7% from $888,848 to $1,090,664 for the year ended December 31, 2005 when compared to the same period in 2004 due to additional engineering fees charged to our affiliate, Ocean Conversion (BVI) Ltd., for work on the new water plant in Tortola, British Virgin Islands.

Cost of Sales

Total cost of sales increased by 15.8% from $13,671,713 to $15,832,808 for the year ended December 31, 2005 when compared to the same period in 2004.

Cost of Retail sales increased 2.3% from $5,250,372 to $5,369,550 for the year ended December 31, 2005 compared to the same period in 2004 due to additional variable costs associated with the 10.6% increase in sales.

Cost of Bulk sales increased 26.1% from $7,798,225 to $9,832,109 for the year ended December 31, 2005 when compared to the same period in 2004. The increase in cost of sales is disproportionately higher than the corresponding increase in revenues due to the additional operating costs related to fouling of RO membrane elements and higher energy costs at our Windsor plant in The Bahamas.

Cost of sales from Services increased by $8,033 (1.3%) for the year ended December 31, 2005 when compared to the same period in 2004 due to additional non-capitalized payroll expense and employee recruiting fees associated with the general expansion of our business.

Gross Profit

The gross profit margin decreased from 41.3 % to 39.5% for the year ended December 31, 2005 when compared to the same period in 2004, for the reasons explained above.

General and Administrative Expense

Total general and administrative expense (G&A) increased by $1,007,029 (19.6%) from $5,138,182 to $6,145,211 for the year ended December 31, 2005 when compared to the same period in 2004. G&A was 23.5% and 22.1% of total revenue for the respective years ended December 31, 2005 and 2004.

Retail G&A increased by $1,019,385 (23.7%) from $4,300,916 to $5,320,301 for the year ended December 31, 2005 when compared to the same period in 2004 due to (i) an additional $400,000 in unanticipated audit, accounting and legal fees involving the Sarbanes-Oxley internal control review and certification process, (ii) increase in the number of Director s meetings held during the year, (iii) increased legal fees associated with our enhanced level of contract bidding, contract awards and financing initiatives and (iv) a general increase in expenses to support our higher level of activity. Our policy is and has been to allocate all non-direct corporate G&A to Retail.

Bulk G&A decreased $14,294 (1.8%) from $786,337 to $772,043 for the year ended December 31, 2005 when compared to the same period in 2004.

Services G&A increased $1,938 to $52,867 for the 2005 year.

Other Income (Expense)

Total other income increased by 4.8% from $1,216,870 to $1,275,158 for the year ended December 31, 2005 when compared to the same period in 2004.

Although interest expense increased $202,884 due to rising LIBOR rates, this was more than offset by an increase in both profit sharing and equity income from the investment in OCBVI, which has benefited from higher sales since the customer made significant repairs to their distribution system.

Net Income

Net income decreased 11.0% from $6,197,383 to $5,514,258 for the year ended December 31, 2005 when compared to the same period in 2004. The prior year, however, included a one time gain of $591,404 attributable to an insurance recovery with respect to Hurricane Ivan. The decrease in net income, after taking this gain into effect, was 1.6% from the prior year.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Revenue

Revenue increased by 22.2% from $19,054,205 to $23,281,413 for the year ended December 31, 2004 when compared to the same period in 2003.

Revenue from our retail water (Retail) operations increased by 10.7% from $10,918,151 to $12,089,151 for the year ended December 31, 2003 and 2004, respectively. This increase is due to higher water sales in our primary market in the Cayman Islands, as a result of an increased demand in both our tourist volume and residential developments before Hurricane Ivan affected the Cayman Islands in mid September 2004. Published tourist air arrival records thru August 2004 indicate a 13.5% increase for the eight months ended August 31, 2004 over the same period in the prior year. After Hurricane Ivan no overnight tourist visitors were allowed on to the Island until the end of November 2004.

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Hurricane Ivan reduced our budgeted Cayman Islands Retail sales for September by more than half. In the last half of September, our operations were operating at limited capacity, due to the damage to our plants and many of our retail customers were unable to take any water due to damage to their premises. Since Hurricane Ivan we have repaired our plants and are able to meet the demand with our current facilities. The sales trends since the Hurricane indicate that subsequent to Hurricane Ivan water sales were higher than anticipated due to the clean up efforts but December water sales in our tourist market were down 18.2% and residential sales were down 31.6% compared to December 2003. January 2005 sales trends indicate that water sales are reduced from January 2004 levels but more in line with 2003 results.

Revenue from our bulk water (Bulk) operations increased by 46.2% from $7,045,761 to $10,303,074 for the year ended December 31, 2003 and 2004, respectively. This increase was primarily due to an additional month of revenue from our acquisition of Ocean Conversion (Cayman) Limited operations and seven months of revenue from our acquisition of Waterfields Company Limited operations when compared to 2003. Our Bulk operations on the Cayman Islands were less affected by Hurricane Ivan than our Cayman Islands Retail operations. The sales volume is 9.3% higher for the fourth quarter 2004 compared to the same period in 2003.

Revenues from our Belize operations declined by 16.4% during 2004 due to the reduced water rates in the new long-term contract which was signed in 2003 and came into full effect on June 1, 2004 after all conditions precedent had been met or waived. These reduced rates have been partially offset by reduced annual amortization costs on an intangible asset representing the Belize water sale contract, which is now being amortized over 23 years. The new contract, however, made us the exclusive producer of potable water for our customer on Ambergris Caye for the term of the agreement.

Revenue from services (Services) decreased by 18.5% from $1,090,293 to $888,848 for the year ended December 31, 2003 and 2004, respectively. All Services revenues pertain to DesalCo Limited and its wholly-owned subsidiary DesalCo (Barbados) Ltd. The decrease was due to fewer construction projects and the related decrease in engineering fees that are charged on labour and material costs associated with these projects. During 2003, we substantially completed our existing construction projects and did not commence any new construction projects.

Other Income (Expenses)

Total other income (expenses) increased by 565.9% from income of $182,748 to $1,216,870 for the years ended December 31, 2003 and 2004, respectively. This increase was due to both decreased interest expense resulting from the repayment of our bridge loan facility on July 8, 2003 with proceeds from our 2003 equity offering and the associated reduction of amortization of financing costs from the prior year and increased profit sharing and equity income from our investment in Ocean Conversion (BVI) Ltd.

The increase in our equity income from our investment in Ocean Conversion (BVI) Ltd. was due to increased sales. In 2003, we completed the expansion of this plant but were unable to increase sales due to damaged distribution equipment of our customer. In 2004, our customer made significant repairs to its distribution system.

Cost of Sales

Total cost of sales increased by 21.6% from $11,240,448 to $ 13,671,713 for the year ended December 31, 2004 when compared to the same period in 2003. During this same period, our total revenue increased by 22.2%.

Cost of sales of our Retail operations increased by 5.6% from $4,972,300 to $5,250,372 for the years ended December 31, 2003 and 2004, respectively, while our Retail revenue increased by 10.7% for the year ended December 31, 2004. This increase in cost of sales resulted primarily from additional variable costs related to the production of the additional water sold up to September 12, 2004 when Hurricane Ivan damaged our Cayman Island operations. From that point until December31, 2004 we produced significantly less water than last year but still incurred fixed operating costs.

Cost of sales of our Bulk operations increased by 35.0% from $5,776,555 to $7,798,225 for the years ended December 31, 2003 and 2004, respectively, while our Bulk revenue increased by 46.2% for the same period. This increase in cost of sales was due to an additional month of expenses from our Ocean Conversion (Cayman) Limited operations and an additional seven months of expenses from our Waterfields Company Limited operations when compared to 2003. This increase also resulted from increased maintenance costs in our Belize operations. We have changed management and a number of other staff in our Belize operations and are working successfully to reduce these unscheduled repair costs by improving the capabilities of our staff and preventative maintenance program.

Cost of sales of our Services reporting segment increased by 26.8% from $491,593 to $623,116 for the years ended December 31, 2003 and 2004, respectively. This increase was due to additional labour expense because of an increase in idle time resulting from reduced construction projects. In addition, the increase in cost of sales is due to an additional month of operations from both DesalCo Limited and its wholly-owned subsidiary DesalCo (Barbados) Ltd. Our Barbados operation also experienced increased maintenance when compared to 2003, however, the necessary repairs have been made and we do not expect these problems to continue.

Gross Profit

The gross profit margin increased from 41.0% to 41.3% for the year ended December 31, 2004 when compared to the same period in 2003, for the reasons explained above.

General and Administrative Expenses

Total general and administrative expenses increased by 36.1% from $3,775,357 to $5,138,182 for the year ended December 31, 2004 when compared to the same period in 2003. General and administrative expenses were at 19.8% and 22.1% of total revenue for the years ended December 31, 2003 and 2004, respectively.

General and administrative expenses related or allocated to our Retail operations increased by 60.2% from $2,684,216 to $4,300,916 for the years ended December 31, 2003 and 2004, respectively. This increase is comprised of additional audit costs expensed in 2004 related to the work performed on the 2003 acquisitions, higher 2004 audit fees, legal and consulting fees related to Sarbanes-Oxley internal control review process, increases in salaries and bonuses, additional administrative staff costs, increases in director fees and higher insurance premiums.

General and administrative expenses related or allocated to our Bulk operations decreased by 12.3% from $896,716 to $786,337 for the years ended December 31, 2003 and 2004, respectively. This decrease is due to the reduction of our general and administrative expenses in Ocean Conversion (Cayman) Limited resulting from the assimilation of administrative functions of our Cayman Islands acquisition. This was offset by additional expenses incurred by our Waterfields Company Limited operations for bank and government fees relating to the exchange of Bahamian dollars to U.S. dollars, higher directors fees and expenses, and increased legal fees. The increase was also the result of an additional seven months of expense from our Waterfields Company Limited operations when compared to 2003.

General and administrative expenses related or allocated to our Services reporting segment decreased by 73.8% from $194,425 to $50,929 for the years ended December 31, 2003 and 2004, respectively. In May 2003, we closed our Bermuda office and relocated operations to the Cayman Islands. These decreases are the result of assimilation of the administrative functions of that office.

Net insurance recovery from Hurricane Ivan

On September 11 and 12, 2004, Hurricane Ivan significantly affected our Cayman Islands operations. As a result, we suffered damage to our seawater conversion plants. Five out of six of our seawater conversion plants suffered minor to moderate damage and our Britannia plant suffered catastrophic damage. Based on our assessment, the Britannia water production, post treatment and distribution equipment was a total loss and had been included in our insurance claim. We met all of our customers water demands without this plant in operation and expected to replace this equipment before the end of May 2005. Our remaining production capacity was sufficient to meet the needs of our customers until the production capacity of our Britannia plant was replaced. The Britannia plant was rebuilt and re-commissioned in October 2005 with an expanded production capacity of 750,000 U.S. gallons per day.

Under generally accepted accounting principles, we are required to record the loss of any property, which must be replaced or now has a revised useful life, in the period the loss occurs, and record any gain from the related insurance claim only when the recovery is probable. We estimated a loss of $2,541,501 consisting of plant and equipment of $1,351,563, spare parts inventories of $111,839 and $1,078,099 relating to the rebuilding of the Cayman Islands operations as of December 31, 2004. These amounts were recorded as part of income from operations as an unusual gain in the income statement as Net insurance recovery due to Hurricane Ivan . The Company also suffered loss of profits during the period that we were unable to sell water to our Cayman Islands customers and we have quantified this loss of profits at $818,700. This has been fully covered as part of claim for such loss to our insurer under our Loss of Profits insurance.

In February 2005, we accepted a final settlement from the insurance company of $3,132,905, offsetting our total loss of $2,541,501.

Net Income

Net income increased by 48.4% from $4,177,081 to $6,197,383 for the year ended December 31, 2004 when compared to the same period in 2003.

Liquidity and Capital Resources

Overview

Our cash flows are dependent upon the timely receipt of customer payments, operating expenses, the timeliness and adequacy of rate increases (excluding automatic adjustments to our rates for inflation and electricity costs) and various factors affecting tourism in the areas we operate such as weather conditions and the world economy.

Cash is provided by debt offerings, bank credit facilities, the exercise of options by management, from all of our business segment operations and from the collection of loans receivable.

We use cash to fund our various business segments in the Cayman Islands, Belize, The Bahamas, Barbados, the British Virgin Islands and the United States of America to fund new projects, to expand our infrastructure, to pay dividends, to repay borrowings, to repurchase our shares when appropriate and to take advantage of new investment opportunities which expand operations.

Operating Activities

In the year ended December 31, 2005, we generated $7,824,572 in cash primarily from operations and the collection of a payment from an insurance claim.

Investing Activities

Cash used in investing activities during the year ended December 31,2005 was $16,456,265.

Our investing activities primarily consisted of expenditures for new property, plant and equipment to replace equipment destroyed by Hurricane Ivan, a new water storage tank in Belize, the Lower Valley plant in the Cayman Islands, the Blue Hills and Windsor plants in The Bahamas, six containerized RO desalination units to be used at our existing Bahamas plant and a loan to an affiliate to design and construct a new plant in Tortola, British Virgin Islands.

Financing Activities

Cash provided by financing activities during the year ended December 31, 2005 was $11,370,374.

Our primary financing activities consisted of the issuance of $10.0 million in bonds and an equity offering of Bahamian Depository Receipts (BDRs), the latter which provided net proceeds of approximately $6.8 million, both to finance the Blue Hills project. We also collected $1,311,597 from the issuance of shares though the exercise of stock options by certain employees and members of management.

Dividend payments of $2,750,341 and principal payments on long term debt of $3,738,828 were made.

Material Commitments, Expenditures and Contingencies

The following table summaries our contractual obligations as at December 31, 2005:

	Total	2006	2007 - 2009	2010 -2012	2013 and Thereafter
Long term debt	$ 12,850,542	$ 3,472,331	$ 8,663,929	$ 714,282	$
Series A bond	10,000,000				10,000,000
Employment agreements	2,694,700	1,160,800	1,533,900		
Operating leases	1,027,416	317,189	583,878	126,349	
Other	349,628	96,809	202,819		50,000

On February 16, 2005, the Government of the Commonwealth of the Bahamas accepted the bid of the Company and Waterfields Company Limited to build the Blue Hills

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plant, expand the existing Windsor plant and to provide engineering services and equipment to reduce the amount of water that is lost throughout its pipeline distribution system on New Providence. We believe the total cost of this project (the Blue Hills Project) will be approximately $29.0 million.

To finance a portion of this project, on July 1, 2005 Waterfields Company Limited sold $10,000,000 Series A bonds solely to Bahamian citizens and permanent resident investors in the Bahamas. The bonds mature on June 30, 2015 and accrue interest at the annual fixed rate of 7.5% of the outstanding principal amount. Interest is payable quarterly. Waterfields has the option to redeem the bonds in whole or in part without penalty commencing after June 30, 2008. The Company has issued a guarantee of Waterfields obligations to pay all principal and accrued interest due to the Waterfields Series A bondholders if and when there is an event of default, as defined in the Guarantee. If the Company pays any amounts to the bondholders pursuant to the provisions of the Guarantee, the Company will be subrogated to all rights of the bondholders in respect of any such payments. The Guarantee is a general unsecured obligation of the Company junior to any secured creditor.

On November 4, 2005, the Company completed the offering of 2,023,850 Bahamian Depositary Receipts representing 404,770 shares of the Company s common stock. The net proceeds of the offering were approximately $6.8 million and will also be used to finance the Blue Hills Project.

The Company is constructing a 500,000 Imperial gallon per day seawater desalination plant in Tortola, British Virgin Islands which is expected to cost approximately $7.0 million and be operational in July, 2006.

On May 25, 2005, the Company entered into a loan agreement with its affiliate in Tortola pursuant to which the Company has agreed to loan it $3.0 million. The loan principal is due and payable on June 1, 2007 and interest accrues at the LIBOR rate plus 3.5% and is payable quarterly on amounts drawn down commencing July 2005. The loan can be repaid at any time without penalty and is subordinated to existing bank indebtedness. The balance outstanding at December 31, 2005 was $800,000. The Company currently owns a 43.5% interest in OCBVI.

In addition, the Company expects to commit between $2.5 and $3.0 million for capital expenditures related to various other projects, in various stages of completion, in all of our operations.

Our Scotiabank $20.0 million loan facility had an outstanding balance of $12,42,858 at December 31, 2005. We are required to make monthly payments of interest for all borrowings (currently none) under a $2.0 million revolving line of credit and quarterly payments of interest for all amounts drawn down under this term loan facility.

We have collateralized all borrowings under the Scotiabank loan facilities by providing a first lien on all of our assets, including the capital stock of subsidiaries and the investment in equity we acquired. The loan agreement for the two facilities contains standard terms and conditions for similar bank loans made in the Cayman Islands, including acceleration of the repayment of all borrowings upon the demand of Scotiabank & Trust (Cayman) Ltd. in the event of default.

We have guaranteed to Scotiabank 50% of the OCBVI loan of $255,000. This loan is repayable in semi-annual installments of $125,000 with the balance of principal due May 31, 2006, bearing interest at 3-month LIBOR plus 1.5%.

Our Royal Bank of Canada loan facility had an outstanding balance of $255,631 at December 31, 2005. We are required to make quarterly payments of principal and interest on the loans through 2007. We also have an unused $500,000 line of credit with Royal Bank of Canada.

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As a result of our acquisition of interests in Waterfields Company Limited, we guaranteed the performance of Waterfields Company Limited to the WSC as it relates to the water supply contract between the two parties.

Through performance and operation bonds, the Royal Bank of Canada, Nassau has made guarantees in the total amount of $3,910,775 to WSC that the Company shall duly perform and observe all terms and provisions pursuant to contracts between the parties. In the event of default, the Royal Bank of Canada shall satisfy and discharge any damages sustained by WSC up to the guaranteed amount. The Company has guaranteed reimbursement to Royal Bank of Canada for any payments made thereon.

In July 2005, the Company entered into an Engineering & Consulting Agreement with Industrial Services, Inc. (ISI) and the sole shareholder of ISI, Scott Shumway, pursuant to which both will provide certain industrial project design, engineering and management services as requested. Mr. Shumway has unconditionally guaranteed the performance of ISI.

The term of the agreement is approximately 17 months but can be terminated by the Company with 14 days notice in the event of the death or incapacity of the sole shareholder.

The estimated total aggregate maximum payments over the term of the agreement are approximately $600,000.

In addition to current available cash, cash flow from operations and current available bank lines of credit, we may need to obtain additional debt or equity financing to complete our plant construction projects and fund our other capital commitments. We believe such additional financing, if required, will be available to us. However, we may not be successful in obtaining this financing on terms we consider acceptable, in which case we may be required to delay or eliminate certain planned capital expenditures, reduce the planned scope of our operations or take other actions that could adversely impact our financial condition and results of operations.

Dividends

On January 31, 2005, we paid a dividend of $0.0575 to shareholders of record on December 31, 2004, and on April 30, 2005, we paid a dividend of $0.0575 to shareholders of record on March 31, 2005.

On July 31, 2005, we paid a dividend of $0.06 to shareholders of record on June 30, 2005, and on October 31, 2005 we paid a dividend of $0.06 to shareholders of record on September 30, 2005.

On January 31, 2006 we paid a dividend $0.06 to shareholders of record on December 31, 2005.

We have consistently paid dividends to owners of our common and redeemable preferred shares since we began declaring dividends in 1985. Our Board of Directors has established a policy, but not a binding obligation, that we will seek to maintain a dividend payout ratio in the range of 50% to 60% of net income. This policy is subject to modification by our Board of Directors. Our payment of any future cash dividends, however, will depend upon our earnings, financial condition, capital demand and other factors, including conditions of our loan agreement with Scotiabank (Cayman Islands) Ltd. that dividends be paid only from current cash flows.

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. It also accepts optional cash payments to purchase additional shares at prevailing market prices.

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Impact of Inflation

Under the terms of our Cayman Islands license and our water sales agreements in Belize, Bahamas, British Virgin Islands and Barbados, 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 net income, measured in consistent dollars, will not be material.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Credit Risk

We are not exposed to significant credit risk on retail customer accounts in the Cayman Islands, and Bimini, Bahamas, as our policy is to cease supply of water to customers whose accounts are more than 45 days overdue. Our primary exposure to credit risk is from bulk water sales customers in Belize, The Bahamas, The British Virgin Islands, Barbados and the Cayman Islands. In addition, the entire balance of our loan receivable is due from the Water Authority-Cayman.

Interest Rate Risk

As of December 31, 2005, we had loans outstanding totaling $12,850,542, all of which bear interest at various lending rates such as LIBOR, Cayman Island s Prime Rate or Nassau Prime Rate. We are subject to interest rate risk to the extent that any of these lending rates change and to the extent that our annually adjusted floating LIBOR rate changes as a function of our consolidated debt to our consolidated earnings before, interest, taxes and depreciation.

The interest rate on our Series A bonds is fixed at 7.5% annually.

Foreign Exchange Risk

All of our foreign currencies have fixed exchanged rates to the U.S. dollar. If any of these fixed exchange rates become a floating exchange rate, however, our results of operation could be adversely affected.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
CONSOLIDATED WATER CO. LTD.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

OCEAN CONVERSION (BVI) LTD.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Consolidated Water Co. Ltd.

We have audited the accompanying consolidated balance sheet of Consolidated Water Co. Ltd. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, stockholders equity, and cash flows for the year ended December 31, 2005. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consolidated Water Co. Ltd. as of December 31, 2005, and the results of their operations and their cash flows for the year ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Consolidated Water Co. Ltd. s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 8, 2006 expressed an unqualified opinion on management s assessment of, and an unqualified opinion on the effectiveness of, internal control over financial reporting.

/s/ Rachlin Cohen & Holtz LLP
Fort Lauderdale, Florida
March 8, 2006

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Consolidated Water Co. Ltd.:

We have audited the accompanying consolidated balance sheets of Consolidated Water Co. Ltd. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consolidated Water Co. Ltd. and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Consolidated Water Co. Ltd. s internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 15, 2005 expressed an unqualified opinion on management s assessment of, and an adverse opinion on the effective operation of, internal control over financial reporting.

/s/ KPMG
George Town, Cayman Islands
April 15, 2005

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CONSOLIDATED WATER CO. LTD.
CONSOLIDATED BALANCE SHEETS
(Expressed in United States dollars)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets		
Cash and cash equivalents	$ 11,955,589	$ 9,216,908
Accounts receivable, net	5,659,975	4,879,410
Insurance claim receivable		1,932,905
Inventory	2,032,209	1,629,348
Prepaid expenses and other current assets	858,870	625,563
Current portion of loans receivable	669,855	924,020
Total current assets	21,176,498	19,208,154
Loans receivable , including $800,000 from affiliate in 2005	2,436,702	2,270,326
Property, plant and equipment, net	32,667,615	27,218,589
Construction in progress, including interest of $375,000 and $nil in 2005 and 2004, respectively	12,172,402	1,642,813
Other assets	534,368	424,564
Investment in affiliates	11,317,731	11,070,848
Intangible assets, net	4,491,501	5,421,381
Goodwill	3,568,374	3,568,374
Total assets	$ 88,365,191	$ 70,825,049
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Dividends payable	$ 828,709	$ 783,854
Accounts payable and other liabilities	3,939,538	3,860,511
Current portion of long term debt	3,472,330	3,733,144
Total current liabilities	8,240,577	8,377,509
Long term debt, including Series A bond issue of $10,000,000	19,378,212	12,856,226
Security deposits and other liabilities	349,628	357,957
Minority Interest in Waterfields Company Limited	833,695	861,463
Total liabilities	28,802,112	22,453,155
Commitments		
Stockholders equity		
	19,382	16,705

Redeemable preferred stock, $0.60 par value. Authorized 200,000 shares; issued and outstanding 32,304 shares in 2005 and 27,842 shares in 2004		
Class A common stock, $0.60 par value. Authorized 19,680,000 shares; issued and outstanding 12,181,778 shares in 2005 and 11,506,970 shares in 2004	7,309,066	6,904,183
Class B common stock, $0.60 par value. Authorized 120,000 shares; issued and outstanding $nil shares for 2005 and $nil shares for 2004		
Stock and options earned but not issued	28,802	20,746
Additional paid-in capital	35,338,235	27,281,728
Retained earnings	16,867,594	14,148,532
Total stockholders equity	59,563,079	48,371,894
Total liabilities and stockholders equity	$ 88,365,191	$ 70,825,049

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

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CONSOLIDATED WATER CO. LTD.
CONSOLIDATED STATEMENTS OF INCOME
(Expressed in United States dollars)

	For the year ended December 31, 2005	2004	2003
Retail water sales	$ 13,372,103	$ 12,089,491	$ 10,918,151
Bulk water sales	11,724,438	10,303,074	7,045,761
Services revenue	1,090,664	888,848	1,090,293
Total revenues	26,187,205	23,281,413	19,054,205
Retail cost of sales	5,369,550	5,250,372	4,972,300
Bulk cost of sales	9,832,109	7,798,225	5,776,555
Services cost of sales	631,149	623,116	491,593
Total cost of sales	15,832,808	13,671,713	11,240,448
Gross profit	10,354,397	9,609,700	7,813,757
General and administrative expenses	6,145,211	5,138,182	3,775,357
Net insurance recovery from Hurricane Ivan		591,404	
Income from operations	4,209,186	5,062,922	4,038,400
Other income (expense):			
Interest income	208,375	81,560	82,334
Interest expense	(885,628)	(682,744)	(1,163,637)
Other income	562,097	533,974	438,022
Equity in earnings of affiliate	1,390,314	1,284,080	826,029
Other income, net	1,275,158	1,216,870	182,748
Income before income taxes and minority interest	5,484,344	6,279,792	4,221,148
Provision for income taxes benefit (expense)	2,146	(30,150)	(23,743)
Minority interest recovery (expense)	27,768	(52,259)	(20,324)
Net income	$ 5,514,258	$ 6,197,383	$ 4,177,081

Basic earnings per common share	$ 0.47	$ 0.54	$ 0.42
Diluted earnings per common share	$ 0.45	$ 0.53	$ 0.41
Weighted average number of common shares used in the determination of:			
Basic earnings per share	11,767,573	11,474,264	9,834,366
Diluted earnings per share	12,161,407	11,759,010	10,075,060

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

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CONSOLIDATED WATER CO. LTD.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED DECEMBER 31, 2005
(Expressed in United States dollars)

	Redeemable preferred stock		Common stock		Stock and options earned but not issued	Additional paid-in capital	Retained earnings	Total stockholders equity
	Shares	Dollars	Shares	Dollars				
Balance at December 31, 2002	39,480	$ 23,688	7,986,838	$ 4,792,103	$ 424,841	$ 7,354,395	$ 8,531,197	$ 21,126,224
Public offering of common shares, net of issuance costs			2,784,300	1,670,580		16,118,254		17,788,834
Issue of share capital	7,674	4,604	582,926	349,756	(544,756)	3,300,838		3,110,442
Conversion of preferred shares	(19,956)	(11,973)	19,956	11,973				
Redemption of preferred shares	(28)	(17)				(145)		(162)
Net income							4,177,081	4,177,081
Dividends declared							(2,095,301)	(2,095,301)
Issue of options and share grants					141,409			141,409
Balance at December 31, 2003	27,170	16,302	11,374,020	6,824,412	21,494	26,773,342	10,612,977	44,248,527
Issue of share capital	5,448	3,269	128,174	76,905	(95,568)	508,386		492,992
Conversion of preferred shares	(4,776)	(2,866)	4,776	2,866				
Net income							6,197,383	6,197,383
Dividends declared							(2,661,828)	(2,661,828)
Issue of options and share grants					94,820			94,820

Balance at December 31, 2004	27,842	16,705	11,506,970	6,904,183	20,746	27,281,728	14,148,532	48,371,894
Public offering of common shares, net of issuance costs			404,770	242,862		6,476,000		6,718,862
Issue of share capital	8,644	5,187	265,856	159,511	(150,715)	1,580,507		1,594,490
Conversion of preferred shares	(4,182)	(2,510)	4,182	2,510				
Net income							5,514,258	5,514,258
Dividends declared							(2,795,196)	(2,795,196)
Issue of options and share grants					158,771			158,771
Balance at December 31, 2005	32,304	$ 19,382	12,181,778	$ 7,309,066	$ 28,802	$ 35,338,235	$ 16,867,594	$ 59,563,079

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

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CONSOLIDATED WATER CO. LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in United States dollars)

	For the year ended December 31, 2005	2004	2003
Cash flows provided by (used in) operating activities			
Net income	$ 5,514,258	$ 6,197,383	$ 4,177,081
Add (deduct) items not affecting cash			
Depreciation	2,156,478	2,079,475	1,699,140
Amortization of intangible assets and bank fees	1,031,585	1,017,207	1,318,102
Stock compensation on share grants	256,032	155,388	138,750
Net loss on disposal of fixed assets	37,585	1,331,563	
Undistributed income from affiliates	(1,875,508)	(1,718,338)	(1,060,188)
Minority interest (recovery)	(27,768)	52,259	20,324
Increase in accounts receivable	(780,565)	(1,019,914)	(82,939)
(Increase) decrease in insurance claim receivable	1,932,905	(1,932,905)	
Increase in inventory	(402,861)	(83,163)	(10,088)
(Increase) decrease in prepaid expenses and other assets	(233,307)	(29,177)	60,041
Increase in other assets		(9,239)	
Increase (decrease) in accounts payable and other liabilities	224,067	1,788,267	230,725
Increase (decrease) in other liabilities	(8,329)	5,462	15,878
Net cash provided by operating activities	7,824,572	7,834,268	6,506,826
Cash flows provided by (used in) investing activities			
Purchase of property, plant and equipment	(6,246,251)	(1,101,030)	(1,726,667)
Construction in progress	(11,926,428)	(1,614,857)	(433,193)
Business combinations, net of cash acquired			(19,495,005)
Investment in affiliate	1,628,625	681,750	(8,961,622)
Loan to affiliate	(800,000)		
Collection of loans receivable	887,789	1,098,732	970,492
Proceeds from sale of property, plant and equipment		20,000	
Net cash provided by (used in) investing activities	(16,456,265)	(915,405)	(29,645,995)
Cash flows provided by (used in) financing activities			
Net proceeds from credit facility			27,187,035
Dividends declared and paid	(2,750,341)	(2,564,092)	(1,924,067)
Net proceeds from issuance of stock	8,071,052	432,424	19,037,034
Net proceeds from issuance of Series A bonds	9,788,491		
Principal repayments of long term debt	(3,738,828)	(3,807,211)	(13,492,213)
Net cash provided by (used in) financing activities	11,370,374	(5,938,879)	30,807,789
Net increase in cash and cash equivalents	2,738,681	979,984	7,668,620

Cash and cash equivalents at beginning of year	9,216,908	8,236,924	568,304
Cash and cash equivalents at end of year	$ 11,955,589	$ 9,216,908	$ 8,236,924
Interest paid in cash	$ 1,152,262	$ 591,795	$ 770,438
Interest received in cash	$ 197,584	$ 81,560	$ 81,836
Incomes taxes paid	$ 14,138	$ 14,281	$ 40,090

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

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principal activity

Consolidated Water Co. Ltd., its wholly-owned subsidiaries, majority-owned subsidiary and affiliate (together 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, Bahamas, Barbados and British Virgin Islands. 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 generally determined by the terms of the license and contracts, which provide for adjustments based upon the movement in the government price indices specified in the license and contracts, as well as monthly adjustments for changes in the cost of energy. The Company also provides consulting services under long-term agreements under which the Company designs and constructs desalination plants, and manages and operates plants owned by other companies.

2. Accounting policies

Basis of preparation: The consolidated financial statements presented are prepared in accordance with accounting principles generally accepted in the United States of America.

Use of estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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. Significant items subject to estimates and assumptions include the carrying value of property, plant and equipment, intangible assets, goodwill, allowances for receivables and inventory. Actual results could differ from those estimates.

Basis of consolidation: The consolidated financial statements include the accounts of the Company s wholly-owned subsidiaries Cayman Water Company Limited, Belize Water Limited, Ocean Conversion (Cayman) Limited, DesalCo Limited, DesalCo (Barbados) Ltd, Aquilex, Inc. and its majority owned subsidiary Waterfields Company Limited. The operating results of Ocean Conversion (Cayman) Limited, DesalCo Limited, DesalCo (Barbados) Ltd. have been included in the consolidated financial statements effective February 1, 2003. The operating results of Waterfields Company Limited have been included in the financial statements effective August 1, 2003. All inter-company balances and transactions have been eliminated.

Foreign currency: The Company s reporting currency is the United States dollar. The functional currency of the Company and its foreign subsidiaries is the currency for each respective country. The exchange rates between the Cayman Islands dollar, the Belize dollar, the Bahamian dollar and the Barbados dollar have been fixed to the United States dollar during all periods presented.

Monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at the balance sheet date. Foreign currency transactions are translated at the rate ruling on the date of the transaction. Net exchange gains and losses are included in other income in the consolidated statements of income.

Cash and cash equivalents: Cash and cash equivalents comprise cash at banks on call and highly liquid deposits with an original maturity of three months or less.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting policies (continued)

Trade accounts receivable: Trade accounts receivable are recorded at invoiced amounts based on meter readings. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in the Company s existing accounts receivable balance. The Company determines the allowance for doubtful accounts based on historical write-off experience and monthly review of delinquent accounts. Past due balances are reviewed individually for collectibility and disconnection. Account balances are charged off against the allowance for doubtful accounts after all means of collection have been exhausted and the potential for recovery is considered by management to be remote.

Inventory: Inventory primarily includes replacement spares and parts that are valued at the lower of cost and net realizable value on a first-in, first-out basis. Inventory also includes potable water held in the Company s reservoirs. The carrying amount of the water inventory is the lower of the average cost of producing or purchasing water during the year or its net realizable value.

Loans receivable: Loans receivable relate to amounts advanced to customers to facilitate the construction of water desalination plants. The allowance for loan losses, if any, is the Company s best estimate of the amount of potable credit losses in the Company s existing loans and is determined on an individual loan basis. Management believes the loans receivable are collectible and, therefore, no loan allowance has been established as of December 31, 2005 and 2004.

Property, plant and equipment: Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is calculated using a straight line method with an allowance for estimated residual values. Rates are determined based on the estimated useful lives of the assets as follows:

Buildings	5 to 40 years
Plant and equipment	4 to 40 years
Distribution system	3 to 40 years
Office furniture, fixtures and equipment	3 to 10 years
Vehicles	3 to 10 years
Leasehold improvements	Shorter of 5 years or operating lease term outstanding
Lab Equipment	5 to 10 years

Additions to property, plant and equipment are comprised of the cost of the contracted services, direct labour and materials. Assets under construction are recorded as additions to property, plant and equipment upon completion of the projects. Depreciation commences in the month of addition.

Interest costs directly attributable to the acquisition and construction of qualifying assets, which are assets that necessarily take a substantial period of time to be ready for their intended use, are added to the cost of those assets until such time as the assets are substantially ready for use or sale.

Construction in progress*:* The cost of borrowed funds directly attributable to the acquisition and construction of qualifying assets, which are assets that necessarily take a substantial period of time to be ready for their intended use, are added to the cost of those assets until such time as the assets are substantially ready for use or sale.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting policies (continued)

Goodwill and intangible assets: Goodwill represents the excess costs over 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 in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimatable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets . The Company periodically evaluates the possible impairment of goodwill. Management identifies its 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. The Company determines the fair value of each reporting unit and compares it 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, the Company is 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, the Company compares 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, in accordance with SFAS No. 141, Business Combinations . 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. The Company s annual impairment valuation resulted in no goodwill impairment.

Investments: Investments where the Company does not exercise significant influence over the operating and financial policies of the investee and holds less than 20% of the voting stock are recorded at cost. Investments where the Company has significant influence over the operating and financial policies of the investee and holds 20% to 50% of the voting stock are recorded using the equity method of accounting for investments in common stock. The Company recognizes an impairment loss on declines in value that are other than temporary.

Other assets: Other assets consist of the bank financing fees paid on the drawdown of the Company s long term debt and are being amortized on a straight line basis over the term of the loans.

Other liabilities: Other liabilities consist of security deposits and advances in aid of construction. Security deposits are received from large customers as security for trade receivables. Advances in aid of construction are recognized as a liability when advances are received from condominium developers in the licensed area to help defray the capital expenditure costs of the Company. These advances do not represent loans to the Company and are interest free. However, the Company allows a discount of ten percent on future supplies of water to these developments until the aggregate discounts allowed are equivalent to advances received. Discounts are charged against advances received.

Shares repurchased: Under Cayman Islands law, shares repurchased out of capital by the Company are treated as cancelled upon redemption, and the Company s issued share capital is reduced by the par value of those shares, with the difference being adjusted to additional paid up capital.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting policies (continued)

Stock and stock option incentive plans: The Company issues stock under incentive plans that form part of employees and non-executive directors remuneration. The Company also grants options to purchase ordinary shares as part of remuneration for certain long-serving employees and certain management employees.

During the year ended December 31, 2003, the option plan for certain management employees was amended as part of renegotiations of employee contracts. The amended contracts terminated the stock option plans for all years commencing from January 1, 2004.

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25 Accounting for Stock Issued to Employees , and related interpretations to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. SFAS No. 123 Accounting for Stock-Based Compensation established accounting and disclosure requirements using a fair-valued-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company continues to apply the intrinsic-value method of accounting described above and has adopted the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

	2005	2004	2003
Net income, as reported	$ 5,514,258	$ 6,197,383	$ 4,177,081
Add stock-based employee compensation expense included in reporting net income	256,032	155,388	138,750
Deduct total stock-based employee compensation expense determined under fair-value-based method for all rewards	(330,308)	(216,346)	(950,147)
Pro forma net income	$ 5,439,982	$ 6,136,425	$ 3,365,684
Earnings per share:			
Basic as reported	$ 0.47	$ 0.54	$ 0.42
Basic pro forma	$ 0.46	$ 0.53	$ 0.34
Diluted as reported	$ 0.45	$ 0.53	$ 0.41
Diluted pro forma	$ 0.45	$ 0.52	$ 0.33

The intrinsic value of stock based compensation is recorded in stockholders equity and is expensed to the consolidated statements of income based on the vesting period of the options. On exercise of options, proceeds up to the par value of the stock issued are credited to ordinary share capital; any proceeds in excess of the par value of the stock issued are credited to additional paid in capital in the period in which the options are exercised. Options that expire without exercise are also credited to additional paid in capital in the period in which the option expired.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting policies (continued)

Revenue and cost of sales: Customers are billed monthly based on meter readings performed at or near each month end and in accordance with agreements which stipulate minimum monthly charges for water service. An accrual, where necessary, is made for water delivered but unbilled at year end when readings are not performed at the year end date. The accrual is matched with the direct costs of producing, purchasing and delivering water.

Consulting revenue is recognized on the accrual basis based upon time spent at agreed upon rates and is included under service revenue.

Plant construction revenue is recognized using the percentage-of-completion method. The recognized income is that percentage of estimated total income that incurred costs to date bear to estimated total costs after giving effect to estimates of costs to complete based upon most recent information. This revenue is included under services revenue.

Interest income is recognized by the Company over the term of a loan based on the interest rate stated in the loan and is included in interest income.

Repairs and maintenance: All repair and maintenance costs are expensed as incurred.

Comparative figures: Certain prior year amounts have been adjusted to conform to the current year s presentation. The Company has reallocated various maintenance expenses to cost of sales from general and administrative expenses. In addition, the Company has adjusted the cost and amortization of the Belize water production and supply agreement intangible asset to reflect a 2003 revaluation. On August 25, 2005, the Company s common stock began trading on a post-split 2 for 1 basis. The stock split reduced the par value of the Company s common stock to $0.60 from $1.20. The record date was August 17, 2005. All shares and dividend amounts presented here have been retroactively adjusted to reflect the stock split. These adjustments have no impact on the net income of the Company.

3. Acquisitions

Effective February 1, 2003, the Company acquired 100% of the outstanding voting common shares of DesalCo Limited, its wholly owned subsidiary DesalCo (Barbados) Limited and Ocean Conversion (Cayman) Limited. The consideration paid was $26,976,648, comprised of $24,202,651 in cash and 185,714 ordinary shares of the Company and $482,286 in costs related to the acquisitions.

Effective February 1, 2003, the Company also acquired as part of this acquisition of DesalCo Limited, 12.7% of the outstanding voting common shares of Waterfields Company Limited (Waterfields). On July 30, 2003, the Company acquired a further 13.5% of Waterfields and effective August 1, 2003, acquired an additional 64.7% interest, resulting in total controlling interest of 90.9% of Waterfields. The total consideration paid was $9,652,491, comprised of $9,431,610 in cash and $220,881 in costs related to the acquisition.

These acquisitions provided the Company with a reverse osmosis plant design, a construction and facilities management and engineering services firm, as well as facilities and contracts to supply additional bulk potable water services in the Cayman Islands, Bahamas and Barbados.

CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Acquisitions (continued)

The following table summarizes the estimated fair values of assets acquired and liabilities assumed at the date of the acquisitions.

Current assets	$ 7,187,798
Property, plant and equipment, net	8,947,932
Investments in affiliates	12,069,998
Intangible assets	5,766,886
Goodwill	3,395,752
Other assets	4,190,883
Total assets acquired	41,559,249
Current liabilities	1,877,490
Long term debt and liabilities	2,266,784
Total liabilities assumed	4,144,274
Less: Minority interest in Waterfields Company Limited	785,836
Net assets acquired	$ 36,629,139

The results of operations of DesalCo Limited, DesalCo (Barbados) Limited and Ocean Conversion (Cayman) Limited are included in the consolidated statements of income from February 1, 2003 and the results of operations of Waterfields Company Limited are included in the consolidated statements of income from August 1, 2003. The unaudited pro forma consolidated results of operations of Consolidated Water Co. Ltd., DesalCo Limited, DesalCo (Barbados) Limited, Ocean Conversion (Cayman) Limited, Waterfields Company Limited and an equity interest in Ocean Conversion (BVI) Ltd., had the companies been acquired at January 1, 2003 would be as follows:

		Year ended December 31, 2003
Pro forma revenue	$	21,841,916
Pro forma net income	$	4,704,114
Pro forma earnings per share:		
Basic	$	0.42
Diluted	$	0.41

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Cash and cash equivalents

Cash and cash equivalents are not restricted as to withdrawal or use. At December 31, 2005, the equivalent United States dollars are denominated in the following currencies:

	December 31, 2005	December 31, 2004
Bank accounts		
United States dollar	$ 2,303,660	$ 1,980,944
Cayman Islands dollar	930,228	4,413,496
Bahamian dollar	1,356	466,193
Belize dollar	126,354	83,157
Barbadian dollar	88,824	95,065
	3,450,422	7,038,855
Short term deposits		
United States dollar		1,521,188
Bahamian dollar	8,505,167	493,699
Belize dollar		163,166
	8,505,167	2,178,053
Total cash and cash equivalents	$ 11,955,589	$ 9,216,908

5. Accounts receivable

	December 31, 2005	December 31, 2004
Trade accounts receivable	$ 5,777,190	$ 4,939,985
Other accounts receivable	90,015	104,767
	5,867,205	5,044,752
Allowance for doubtful accounts	(207,230)	(165,342)
	$ 5,659,975	$ 4,879,410

The activity of the allowance for doubtful accounts consisted of the following:

	December 31, 2005	December 31, 2004
Opening allowance for doubtful accounts	$ 165,342	$ 74,867
Provision for doubtful accounts	41,888	90,475
Accounts written off during the year		

Ending allowance for doubtful accounts	$ 207,230	$ 165,342

Significant concentrations of credit risk are disclosed in Note 24.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Insurance claim receivable

On September 11 and 12, 2004, Hurricane Ivan significantly affected the Company s Cayman Islands operations. As a result, the Company suffered damage to its seawater conversion plants, which are covered by property insurance. Under generally accepted accounting principles, the Company is required to record the loss of any property which must be replaced in the period the loss occurs, and record any gain from related insurance claims only when the recovery is probable.

As at December 31, 2004, the Company has estimated the total loss to be $2,541,501, consisting of plant and equipment of $1,351,563, spare parts inventories of $111,839 and $1,078,099 relating to the rebuilding of the Cayman Islands operations. These amounts have been recorded against the insurance recovery and appear as a gain on the income statement as Net insurance recovery due to Hurricane Ivan .

The Company also suffered loss of profits during the period that it was unable to sell water to its Cayman Islands customers. The Company has quantified this loss of profits at $818,700 and has been fully covered in the Company s claim for such loss to its insurer under its Loss of Profits insurance. The Company has recorded total recoveries from insurance of $3,132,905 offsetting the total estimated loss of $2,541,501.

On February 8, 2005, the Company accepted a proposal from the insurance company for a final settlement sum of $1,932,905 towards claims for loss and damage to property and loss of profits. This amount was recorded as an Insurance claim receivable on the December 31, 2004 balance sheet and is part of the gain of $591,404.

7. Inventory

	December 31, 2005	December 31, 2004
Water stock	$ 44,624	$ 33,659
Consumables stock	318,945	194,307
Spare parts stock	1,668,640	1,401,382
	$ 2,032,209	$ 1,629,348

8. Loans receivable

As part of the acquisition of Ocean Conversion (Cayman) Limited, the following loans receivable were acquired. Management estimates these loans to be fully collectible and as such no impairment allowance has been provided at December 31, 2005.

	December 31, 2005	December 31, 2004
Due from Water Authority Cayman: Original loan of $1,216,000, non-interest bearing, in monthly installments of $14,476 to November 30, 2008. Loan secured by Red Gate plant, machinery and equipment.	$ 506,667	$ 680,381
Due from Water Authority Cayman: Two loans originally aggregating $1,819,920, bearing interest at 5% per annum, receivable in combined monthly installments of principal and interest of $25,721 to March 2005, and secured by Lower Valley plant, machinery and equipment.		76,529

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Loans receivable (continued)

	December 31, 2005	December 31, 2004
Due from Water Authority Cayman: Two loans originally aggregating $1,168,600, bearing interest at 5% per annum, receivable in combined monthly installments of principal and interest of $16,516 to March 2006, and secured by Lower Valley plant, machinery and equipment.	49,140	239,686
Due from Water Authority Cayman: Two non-interest bearing loans originally aggregating $3,129,000, receivable in monthly installments of $37,250 to November 2009, and secured by North Sound Road plant, machinery and equipment.	1,750,750	2,197,750
Due from affiliate: loan bearing interest at LIBOR plus 3.5%. Interest is payable quarterly and the principal is due June 1, 2007.	800,000	
Total loans receivable	3,106,557	3,194,346
Less current portion	669,855	924,020
Loans receivable, excluding current portion	$ 2,436,702	$ 2,270,326

9. Property, plant and equipment and construction in progress

	December 31, 2005	December 31, 2004
Cost		
Land	$ 475,679	$ 475,679
Buildings	4,388,100	4,373,382
Plant and equipment	20,279,578	14,209,510
Distribution system	18,560,540	18,278,146
Office furniture, fixtures and equipment	1,272,159	551,911
Vehicles	812,609	556,825
Leasehold improvements	186,387	
Lab equipment	21,700	20,877
	45,996,752	38,466,330
Less accumulated depreciation	13,329,137	11,247,741

Property, plant and equipment, net	$ 32,667,615	$ 27,218,589
Construction in progress	$ 12,172,402	$ 1,642,813

At December 31, 2005, the Company had outstanding non-project capital commitments of approximately $2.5 million (2004: $780,000). It is the Company s policy to maintain adequate insurance for loss or damage to all fixed assets that may be susceptible to loss. The Company does not insure its underground distribution system, which cost approximately $10.0 million. (2004: $9.9 million).

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Investment in affiliates

As part of the acquisition described in Note 3, the Company acquired 50% and 100% of the outstanding voting common shares and non-voting common shares, respectively, of Ocean Conversion (BVI) Ltd. On May 9, 2003, the Company sold 100% of its non-voting shares in Ocean Conversion (BVI) Ltd. to Sage Water Holdings (BVI) Limited for $2,120,250. The Company now owns 50% of the voting common shares of Ocean Conversion (BVI) Ltd., representing a 43.5% interest in the company.

The Company s investment in Ocean Conversion (BVI) Ltd. is accounted for using the equity method of accounting. The excess cost over the Company s share of fair value net assets acquired of Ocean Conversion (BVI) Ltd. is $6,654,362, which is considered equity-method goodwill. In accordance with SFAS No. 142, this equity-method goodwill is not being amortized, but is analyzed for impairment. At December 31, 2005 and 2004, management believes there is no impairment of this equity-method goodwill.

Summarized financial information of Ocean Conversion (BVI) Ltd. is presented as follows:

	December 31,	
	2005	**2004**
Current assets	$ 4,736,398	$ 4,552,059
Non-current assets	5,226,212	4,189,764
Total assets	$ 9,962,610	$ 8,741,823
Current liabilities	$ 1,369,094	$ 1,085,589
Non-current liabilities	2,341,979	1,682,604
Total liabilities	$ 3,711,073	$ 2,768,193

	December 31,	
	2005	**2004**
Water sales	$ 7,715,827	$ 6,872,366
Cost of water sales	$ 3,003,920	$ 2,475,304
Income from operations	$ 2,893,678	$ 2,754,200
Net income	$ 3,019,328	$ 2,771,198

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Intangible assets

Effective February 1, 2003, the Company acquired 100% of the outstanding voting common shares of DesalCo Limited, its wholly-owned subsidiary DesalCo (Barbados) Ltd., and Ocean Conversion (Cayman) Limited. A portion of the purchase price was allocated to the following identifiable intangible assets.

(a) As part of the acquisition of DesalCo Limited, the Company originally attributed $726,902 to an intangible asset which was adjusted in 2004 by $129,454 for a total balance of $856,356. This represents the fair value of a Management Services Agreement originally dated December 4, 2000, under which DesalCo Limited provides management and engineering services to Ocean Conversion (BVI) Ltd., an affiliated company. The original agreement was amended on February 7, 2003 such that there is no expiration term. Management of the Company has determined that this intangible asset has an indefinite life, and therefore it is not being amortized.

(b) As part of the acquisition of DesalCo Limited, the Company attributed $337,149 to another intangible asset, the DWEER Distribution Agreement between DesalCo Limited and DWEER Technology Limited, which expires on October 31, 2009. Under this agreement, DesalCo Limited was granted an exclusive right, within certain geographical areas in the Caribbean, Central and South America, to distribute certain patented equipment which can increase the operational efficiency of reverse osmosis seawater desalination plants. The estimated fair value attributable to the intangible asset of the DWEER Distribution Agreement is being amortized over the remaining term of the seven-year agreement and has a weighted average useful life of 6.83 years.

(c) As part of the acquisition of DesalCo Limited, the Company attributed $104,050 to an intangible asset which represents the fair value of an operations agreement between Sandy Lane Properties Ltd. and DesalCo (Barbados) Limited, a wholly owned subsidiary of DesalCo Limited. Under the terms of the agreement, DesalCo (Barbados) Limited provides operations and maintenance services for a seawater reverse osmosis desalination plant. The carrying amount attributable to the intangible asset of the operations agreement is being amortized over the remaining term of the five-year agreement and has a weighted average useful life of 3.0 years.

(d) As part of the acquisition of Ocean Conversion (Cayman) Limited, the Company originally attributed $4,598,785 to intangible assets, which was adjusted in 2004 by $213,289 for a total balance of $4,385,496. This represents the fair value of three Water Production and Supply Agreements between Ocean Conversion (Cayman) Limited and the Government of the Cayman Islands, dated April 25, 1994, June 18, 1997 and December 31, 2001. Under these agreements, Ocean Conversion (Cayman) Limited built reverse osmosis seawater desalination plants for the Government of the Cayman Islands. Ocean Conversion (Cayman) Limited operates the plants until the expiration of the agreement term, as extended, at which time the plant operations will be transferred to the Government of the Cayman Islands for no consideration. The carrying amounts attributable to the intangible assets of the Water Production and Supply Agreements are being amortized over the remaining term of the agreements, which are approximately 6, 3 and 7 years, respectively, and have a weighted average useful life of 5.8 years.

(e) On September 17, 2003, the Company signed a new agreement with its Belize customer for the provision of water from a seawater desalination plant for an initial term of 23 years. The new agreement was effective on June 1, 2004 after certain conditions precedent were met or waived. The carrying amount of the Belize Water Production and Supply Agreement was revalued in 2003 to its fair market value upon signing of the new agreement. The revised carrying amount which was previously being amortized over its weighed average useful life of 10.75 years is now being amortized over the term of the new 23-year agreement and now has a weighted average useful life of 23.0 years.

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11. Intangible assets (continued)

	December 31, 2005	December 31, 2004
Cost		
Non-amortizable intangible asset Management service agreement	$ 856,356	$ 856,356
Amortizable intangible assets DWEER™ distribution agreement	337,149	337,149
Operations agreement with Sandy Lane	104,050	104,050
Cayman water production and supply agreements	4,385,496	4,385,496
Belize water production and supply agreement	1,522,419	1,522,419
	7,205,470	7,205,470
Accumulated amortization		
DWEER™ distribution agreement	(143,976)	(94,613)
Operations agreement with Sandy Lane	(101,160)	(66,476)
Cayman water production and supply agreements	(2,274,488)	(1,494,847)
Belize water production and supply agreement	(194,345)	(128,153)
	(2,713,969)	(1,784,089)
Intangible assets, net	$ 4,491,501	$ 5,421,381

Amortization for each of the next five years is as follows:

2006	$ 820,943
2007	788,659
2008	639,249
2009	234,855
2010	154,327
Thereafter	997,112

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Goodwill

As of January 1, 2002, the Company adopted SFAS No. 142 Goodwill and Other Intangible Assets , and in accordance with this statement goodwill is not amortized, but is analyzed for impairment annually.

The carrying amount of goodwill allocated to the reporting units for the years ended December 31, 2005 and 2004 are as follows:

	Retail Segment	Bulk Segment	Services Segment	Total
Balance as of December 31, 2003	$ 1,170,511	$ 2,136,524	$ 88,717	$ 3,395,752
Goodwill acquired during the year		172,622		172,622
Balance as of December 31, 2004	1,170,511	2,309,146	88,717	3,568,374
Goodwill acquired during the year				
Balance as of December 31, 2005	$ 1,170,511	$ 2,309,146	$ 88,717	$ 3,568,374

In 2004, goodwill and intangible assets were adjusted by $172,622 due to a revaluation of the fair market value of those assets.

The reporting segments are tested for impairment in the fourth quarter by comparing the fair value of the reporting segments to the carrying value. The fair value is determined using discounted cash flow methodology based on management s best estimates for each segment. At December 31, 2005, the Company s impairment tests resulted in no impairment loss.

13. Dividends

Quarterly interim dividends were declared in respect of Class A common stock and redeemable preferred stock as follows:

	2005	2004	2003
March 31	$ 0.0575	$ 0.0575	$ 0.0525
June 30	0.0600	0.0575	0.0525
September 30	0.0600	0.0575	0.0525
December 31	0.0600	0.0575	0.0525

Dividends as stated have been adjusted for a 2 for 1 stock split in August, 2005.

Interim dividends for the first three quarters were paid during each respective year. The Board of Directors declares the interim dividend for the fourth quarter in October of each year. These quarterly interim dividends are subject to no further ratification and consequently the fourth quarter interim dividends have been recorded as a liability in each respective year. Included in dividends payable at December 31, 2005 are unclaimed dividends of $120,574 (2004: $120,174).

On August 25, 2005, the Company s common stock began trading on a post-split 2 for 1 basis. The stock split reduced the par value of the Company s common stock to $0.60 from $1.20. The record date was August 17, 2005. Certain prior year amounts have been adjusted to conform to the current year s presentation post-split. These adjustments have no impact on the net income of the Company.

CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Long term debt

	December 31, 2005	December 31, 2004
Scotiabank $20,000,000 term loan bearing interest at an annually adjusted floating rate of LIBOR plus 1.5% to 3.0%, depending on the ratio of the Company s consolidated debt to its consolidated earnings before interest, taxes and depreciation; payable in quarterly installments of $714,286 plus interest; due February 6, 2010 (6.11% at December 31, 2005 and 3.68% at December 31, 2004).	$ 12,142,858	$ 15,000,000
Scotiabank $1,428,000 term loan bearing interest at 3-month LIBOR plus 1.5%; payable in semi-annual installments of $240,000 plus Interest; due December 31, 2007 (6.03% at December 31, 2005 and 3.61% at December 31, 2004).	228,000	708,000
Royal Bank of Canada loan bearing interest at LIBOR plus 1.75%; payable in quarterly installments of principal and interest; due in 2007 (6.16% at December 31, 2005 and 3.11% at December 31, 2004).	251,633	527,215
Royal Bank of Canada loan bearing interest at Nassau Prime Lending Rate plus 1.5%; payable in quarterly installments of principal and Interest; due in 2007 (7.00% at December 31, 2005 and 7.50% at December 31, 2004).	228,051	354,155
Series A bonds bearing interest at the annual fixed rate of 7.5%; payable quarterly and maturing on June 30, 2015.	10,000,000	
Total long term debt	22,850,542	16,589,370
Less current portion	3,472,330	3,733,144
Long term debt, excluding current portion	$ 19,378,212	$ 12,856,226

In addition to these facilities, as at December 31, 2005, the Company has available but unused lines of credit with Scotiabank for $2,000,000, bearing interest at the floating base rate as established by Cayman Islands Class A licensed banks from time to time, and with Royal Bank of Canada for $500,000, bearing interest at the Nassau Prime Lending Rate plus 1.0%.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Long term debt (continued)

The Company has collateralized all borrowings under the Scotiabank term loan due February 6, 2010 and the $2,000,000 unused line of credit by providing Scotiabank with a first debenture over fixed and floating assets, a first legal charge over land and buildings, a security interest in all insurance policies and claims, a reimbursement agreement for standby letters of credit, a pledge of capital stock of each subsidiary and guarantees and negative pledges from each company where a majority interest exists.

The assets of Waterfields Company Limited have collateralized the two Royal Bank of Canada loans.

On July 1, 2005, Waterfields sold $10,000,000 Series A bonds solely to Bahamian citizens and permanent resident investors in the Bahamas. The bonds mature on June 30, 2015, at which time the outstanding principal amount must be paid in full. The bonds accrue interest at the annual fixed rate of 7.5% of the outstanding principal amount and interest payments are payable to the bondholders each year in March, June, September and December. Waterfields has the option to redeem the bonds in whole or in part without penalty commencing after June 30, 2008.

The Company is in compliance with restrictive covenants associated with all its long term debt.

The aggregate capital repayment obligations over the next five years are as follows:

2006	$ 3,472,330
2007	2,949,641
2008	2,857,144
2009	2,857,144
2010	714,283
Thereafter	10,000,000

15. Share capital and additional paid in capital and stock split

Redeemable preferred stock (preferred shares) is issued under the Company s Employee Share Incentive Plan as discussed in Note 21 and carries the same voting and dividend rights as ordinary shares of common stock (ordinary share). Preferred shares vest over four years and convert to common stock on a share for share basis on the fourth anniversary of each grant date. Preferred shares are only redeemable with the Company s agreement. Upon liquidation, preferred shares rank in preferred to the ordinary shares to the extent of the par value of the preferred shares and any related additional paid in capital.

The Company has an Option Deed in place which is designed to deter coercive takeover tactics. Pursuant to this plan, holders of ordinary shares and preferred shares were granted options which entitle them to purchase 1/100 of a share of Class B stock at an exercise price of $50.00 if a person or group acquires or commences a tender offer for 20% or more of the Company s ordinary shares. Option holders (other than the acquiring person or group) will also be entitled to buy, for the $37.50 exercise price, ordinary shares with a then market value of $100.00 in the event a person or group actually acquires 20% or more of the Company s ordinary shares. Options may be redeemed at $0.01 under certain circumstances. 120,000 of the Company s authorized but unissued ordinary shares have been reserved for issue as Class B stock. The Class B stock has priority over ordinary shares with respect to dividend and voting rights. No Class B stock options have been exercised or redeemed up to December 31,2005.

On August 25, 2005, the Company s common stock began trading on a post-split 2 for 1 basis. The stock split reduced the par value of the Company s common stock to $0.60 from $1.20. The record date was August 17, 2005. Certain prior year amounts have been adjusted to conform to the current year s presentation post-split. These adjustments have no impact on the net income of the Company.

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16. Expenses

	For the year ended December 31,		
	2005	2004	2003
Cost of water sales consist of the following:			
Water purchases	$ 93,433	$ 76,399	$ 263,586
Depreciation	2,033,464	1,945,476	1,586,217
Amortization of intangible assets	929,880	926,739	954,804
Employee costs	2,857,676	2,906,249	2,351,727
Fuel oil	2,244,204	1,536,780	639,434
Royalties	930,602	868,324	781,632
Electricity	3,015,037	2,586,723	2,499,695
Insurance	670,339	516,133	403,944
Maintenance	2,063,985	1,712,673	1,209,391
Other direct costs	994,188	596,217	550,018
	$ 15,832,808	$ 13,671,713	$ 11,240,448
General and administrative expenses consist of the following:			
Employee costs	$ 2,230,891	$ 2,475,511	$ 1,904,454
Depreciation	104,911	122,932	112,923
Professional fees	1,328,272	961,851	341,246
Insurance	368,172	287,068	234,968
Directors fees and expenses	515,546	348,439	164,794
Maintenance	84,914	28,086	165,864
Other indirect costs	1,512,505	914,295	851,108
	$ 6,145,211	$ 5,138,182	$ 3,775,357

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. Earnings per share

Basic earnings per common share (EPS) is calculated by dividing net income 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. In addition, the dilutive effect of stock options is considered in earnings per common share calculations, if dilutive, using the treasury stock method.

The following summarizes information related to the computation of basic and diluted earnings per share for the three years ended December 31, 2005

	2005	2004	2003
Net income	$ 5,514,258	$ 6,197,383	$ 4,177,081
Less:			
Dividends paid and earnings attributable on preferred shares	(9,128)	(7,751)	(5,706)
Net income available to common shares in the determination of basic earnings per ordinary share	$ 5,505,130	$ 6,189,632	$ 4,171,375
Weighted average number of common shares in the determination of basic earnings per ordinary share	11,767,573	11,474,264	9,834,366
Plus:			
Weighted average number of preferred shares outstanding during the year	27,757	27,148	39,208
Potential dilutive effect of unexercised options	366,077	257,598	201,486
Weighted average number of shares used for determining diluted earnings per ordinary share	12,161,407	11,759,010	10,075,060

18. Segment information

Due to acquisitions, management changed the Company s internal organizational structure to effectively assimilate the business activities of the acquired companies. Consequently, management no longer considers it appropriate to report separate business segments based on geographical location. Under Statement of Financial Accounting Standards No. 131, Disclosure about Segments of an Enterprise and Related Information , management now considers; (i) the operations to supply water to retail customers, (ii) the operations to supply water to bulk customers, and (iii) the provision of engineering and management services, as separate business segments.

Included in our Bulk segment is our proportional share of results of operations, property, plant and equipment and total assets of Ocean Conversion (BVI) Ltd. An adjustment has been made in Reconciliation to adjust the Company s interest in its investment under the equity method of accounting.

Also included in Reconciliation are corporate expenses that do not directly relate to any specific operating segment.

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CONSOLIDATED WATE CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Segment information (continued)

	At December 31 and for the year then ended								
	Bulk			Services			Reconciliation		
2003	2005	2004	2003	2005	2004	2003	2005	2004	2003
10,918,151	15,083,138	13,294,615	9,130,741	1,090,664	888,848	1,090,293	(3,358,700)	(2,991,541)	(2,084,98
(297,793)	(633,203)	(590,985)	(420,445)	(116,426)	(90,075)	(51,694)	1,886,294	1,680,790	952,68
11,597	201,088	90,596	89,679			197	(88,117)	(24,832)	(19,13
422,510	441,493	349,693	368,462	120,566	88,532	99,281	323,457	244,519	273,38
4,972,300	11,139,715	8,878,939	6,484,560	631,149	623,116	491,593	(1,307,606)	(1,080,714)	(708,00
2,684,216	1,144,402	1,123,086	1,166,640	52,867	50,929	194,425	(372,359)	(336,749)	(269,92
1,077,609	1,506,851	1,542,093	835,315	9,767	8,439	5,105	(307,066)	(312,619)	(218,88
	845,834	842,693	877,761	84,046	84,046	77,043			
				2,146	(30,150)	(23,743)			
2,963,842	2,187,170	2,645,635	1,038,772	292,368	94,578	328,838	213,975	110,423	(154,37
19,164,702	10,610,163	10,835,142	11,657,108	2,809,874	11,998	14,095	(1,393,229)	(1,719,253)	(1,802,11
536,485	12,887,219	850,636	297,662		5,879		(881,741)	(104,551)	(205,64
45,028,169	33,839,026	22,734,565	22,224,004	4,653,788	3,696,868	4,255,510	(4,336,724)	(3,811,845)	(2,945,55

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CONSOLIDATED WATE CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Segment information (continued)

Revenues from the Cayman Island operations were $19,931,745 in 2005 (2004: $17,514,609 and 2003: $15,541,455). Revenues from all foreign country operations were $6,255,460 in 2005 (2004: $5,766,804 and 2003: $3,512,750). Included in the revenues from foreign countries is $4,735,016 in 2005 (2004: $4,374,135 and 2003: $1,869,077) from the operations in Bahamas, $1,109,743 in 2005 (2004: $990,039 and 2003: $1,245,744) from our operations in Belize and $410,701 in 2005 (2004: $402,631 and 2003: $397,929) from our operations in Barbados.

For the year ended December 31, 2005, revenues in the amount of $6,020,125 (2004: $5,066,004 and 2003: $4,022,544) were earned from one customer and revenues in the amount of $4,594,570 in 2005 (2004: $4,247,031 and 2003: $1,777,698) were earned from another customer. These revenues are included in the Bulk segment.

During the year ended December 31, 2005, revenues which were earned in the Service segment from the Bulk segment through various management service agreements and an engineering service agreement amounted to $1,357,784 (2004: $867,995 and 2003: $1,038,435). Any intercompany amounts included in this amount have been eliminated in accordance with the basis of consolidation.

At December 31, 2005 and 2004, property, plant and equipment located in the Cayman Islands was $22,803,620 and $18,588,073, respectively. Property, plant and equipment in all the foreign country operations was $9,863,995 and $10,273,329 at December 31, 2005 and 2004, respectively. Included in property, plant and equipment from foreign operations is $7,830,973 in 2005 and $8,509,679 in 2004, from the operations in Bahamas and $1,109,743 in 2005 and $1,756,381 in 2004 from our operations in Belize.

19. Related party transactions

On May 25, 2005, the Company entered into a loan agreement with an affiliate of the Company, OCBVI pursuant to which the Company has agreed to loan up to $3.0 million for the design and construction of a 500,000 Imperial gallon per day seawater desalination plant in Tortola, British Virgin Islands.

On May 25, 2005, OCBVI entered into a twenty five year lease agreement with Bar Bay Estate Holdings Limited (Bar Bay), a private company incorporated in the Territory of the British Virgin Islands, pursuant to which OCBVI agreed to lease from Bar Bay approximately 50,000 square feet of land on Tortola, British Virgin Islands on which the above mentioned seawater desalination plant and wells will be constructed. Under the terms of the lease agreement, a lease premium payment of $750,000 was made on June 10, 2005, annual lease and easement payments of $15,020 are due annually and royalty payments of 2.87% of annual sales are payable quarterly.

A Director of Sage Water Holdings (BVI) Limited, the latter which currently owns 100% of the non-voting stock, 50% of the voting common stock and 50% of the profit sharing rights of OCBVI, is also a Director of OCBVI and holds 50% of the outstanding shares of Bar Bay.

A professional service firm, of which a director is an ex-partner, provided professional services during the year ended December 31, 2005 for which it charged $6,383 (2004:$29,730;2003: $200,685).

As at December 31, 2005, the amounts receivable from Ocean Conversion (BVI) Ltd. relating to revenue earned of $679,963 (2004: $486,271) was $180,196 (2004: $232,971).

20. Commitments

The Company leased a premise in the Cayman Islands for a period of three years from February 1, 2005 to January 31, 2008 at approximately $119,000 per annum. On March 4, 2005, the Company exercised its right to terminate this lease and this lease was terminated on March 26, 2005.

CONSOLIDATED WATE CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

20. Commitments (continued)

On April 1, 2005, the Company signed a lease for approximately 5,451 square feet of office space at the Regatta Business Park, West Bay Road, Grand Cayman, Cayman Islands. The term of the lease is three years at $196,240 per annum and upon expiration may be renewed at our option for a further three-year period.

On July 25, 2005, the Company entered into a lease agreement with KTR Quorum LLC (KTR), pursuant to which it s wholly owned subsidiary Aquilex, Inc. agreed to lease from KTR approximately 7,142 square feet of office and warehouse space in Deerfield Beach, Florida for a period of five years. The aggregate total of the monthly rental payments over the five-year period will be approximately $492,000.

Aquilex has been formed to provide financial, engineering and supply chain management support services to certain operating segments of the Company.

The Company is obligated to supply water, where feasible, to customers in the Cayman Islands within its licence area in accordance with the terms of the licence. Royalties are paid to the Government of the Cayman Islands at the rate of 7.5% of gross water sales.

The Company has six water supply agreements under which it is required to provide minimum water quantities.

As part of the acquisition of the Company s interests in Ocean Conversion (Cayman) Limited, with the approval of Scotiabank (Cayman Islands) Ltd., the Company has guaranteed the performance of Ocean Conversion (Cayman) Limited to the Cayman Islands government, pursuant to the water supply contract with the Water Authority-Cayman dated April 25, 1994, as amended.

The Company has guaranteed to Scotiabank 50% of the Ocean Conversion (BVI) Ltd. loan in the original amount of $880,056. At December 31, 2005 the outstanding balance of this loan was $255,000 and is collateralized by other assets of Ocean Conversion (BVI) Ltd.

On May 25, 2005, the Company entered into a loan agreement with an affiliate of the Company, OCBVI pursuant to which the Company has agreed to loan up to $3.0 million for the design and construction of a 500,000 Imperial gallon per day seawater desalination plant in Tortola, British Virgin Islands.

As a result of the Company s acquisition of interests in Waterfields Company Limited, it guaranteed the performance of Waterfields Company Limited to the Water & Sewerage Corporation of the Bahamas in relation to the water supply contract between Waterfields Company Limited and the Water & Sewerage Corporation.

Through performance and operation bonds, the Royal Bank of Canada, Nassau, has made guarantees in the amount of $3,910,775 to WSC that the Company shall duly perform and observe all terms and provisions pursuant to contracts between the parties. In the event of default, the Royal Bank of Canada, Nassau, shall satisfy and discharge any damages sustained by WSC up to the guaranteed amount. The Company has guaranteed reimbursement to the bank for any payments made thereon.

21. Stock compensation

The Company has various stock compensation plans that form part of employees remuneration. Stock compensation expense of $256,032 in 2005 (2004: $155,388; 2003: $138,750) is recorded in accordance with APB Opinion No. 25 and included within employee costs. Had compensation cost for the Company s stock based compensation plans been determined on the fair value at the grant dates for award under those plans consistent with the method of SFAS 123, the Company s net income and earnings per shares would have been the pro forma amounts below:

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CONSOLIDATED WATE CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. Stock compensation (continued)

	For the year ended December 31, 2005	2004	2003
Net income as reported	$ 5,514,258	$ 6,197,383	$ 4,177,081
Net income pro forma	$ 5,439,982	$ 6,136,425	$ 3,365,684
Earnings per share:			
Basic as reported	$ 0.47	$ 0.54	$ 0.42
Basic pro forma	$ 0.46	$ 0.53	$ 0.34
Diluted as reported	$ 0.45	$ 0.53	$ 0.41
Diluted pro forma	$ 0.45	$ 0.52	$ 0.33

In calculating the fair value for these options under SFAS 123 the Black-Scholes model was used with the following weighted average assumptions:

	2005	2004	2003
Exercise price	$ 19.52	$ 12.14	$ 9.80
Grant date market value	$ 15.42	$ 10.15	$ 9.75
Risk free interest rate	3.79%	2.65%	2.37%
Expected life	2.49 years	2.82 years	3.22 years
Expected volatility	30.81%	36.28%	35.55%
Expected dividend yield	1.22%	1.90%	2.16%

Employee Share Incentive Plan (Preferred Shares)

The Company awards preferred shares for $nil consideration under the Employee Share Incentive Plan as part of compensation for certain eligible employee, excluding Directors and Officers, that require future services as a condition to the delivery of ordinary shares. In addition, options are granted to purchase preferred shares at a fixed price, determined annually, which will typically represent a discount to the market value of the common stock. In consideration for preferred shares, the Company issues shares of common stock on a share for share basis. Under the plan, the conversion is conditional on the grantee s satisfying requirements outlined in the award agreements. Preferred shares are only redeemable with the Company s approval.

The details of preferred shares and preferred share options granted and exercised under the Employee Share Incentive Plan are as follows:

	Year of Grant	Granted	Strike Price	Options Exercised	Options Expired
Preferred shares	2003	5,986	$nil	N/A	N/A
	2004	3,920	$nil	N/A	N/A
	2005	5,544	$nil	N/A	N/A
Preferred share options	2003	5,986	$ 4.48	1,688	4,298
	2004	3,920	$ 6.73	1,528	2,392
	2005	5,544	$ 9.16	3,100	2,444

Each employee s option to purchase preferred shares must be exercised within 30 days of the grant date, which is the 90^{th} day after the date of the auditor s opinion on the financial statements for the relevant year.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. Stock compensation (continued)

Employee Share Option Plan (Common Stock Options)

In 2001, the Company introduced an employee stock option plan for certain long-serving employees of the Company. Under the plan, these employees are granted in each calendar year, as long as the employee is a participant in the Employee Share Incentive Plan, options to purchase ordinary shares. The price at which the option may be exercised will be the closing market price on the grant date, which is the 90th day after the date of the auditor s opinion on the financial statements for the relevant year. The number of options each employee is granted is equal to five times the sum of (i) the number of preferred shares which that employee receives for $nil consideration and (ii) the number of preferred share options which that employee exercises in that given year. Options may be exercised during the period commencing on the fourth anniversary of the grant date and ending on the thirtieth day after the fourth anniversary of the grant date.

Non-Executive Directors Share Plan

In 1999, the Company introduced a stock grant plan, which forms part of Directors remuneration. Under the plan, Directors receive a combination of cash and common stock in consideration of remuneration for their participation in Board meetings. All Directors are eligible except Executive Officers, who are covered by individual employment contracts, and the Government elected board member. The number of common stock granted is calculated with reference to a strike price that is set on October 1 of the year preceding the grant. Stock granted during the year ended December 31, 2005 totaled 8,970 (2004: 9,260) at a strike price of $11.98 (2004: $8.88).

Directors and Senior Management Stock Compensation

Effective January 1, 2004, the option plan for senior management was amended as part of renegotiations of employee contracts. The amended contracts terminated the stock option plans for all years commencing from January 1, 2004. The 2003 stock option exercise price was set at the market price on December 31, 2003.

The following table summarizes information about the Company s stock option plans as of December 31, 2005, 2004 and 2003, and changes during the years ended on those dates.

	2005		2004		2003	
	Shares	Exercise price	Shares	Exercise price	Shares	Exercise price
Outstanding at beginning of year	848,402	$ 7.51	958,836	$ 6.98	789,060	$ 5.01
Granted	13,974	$ 15.42	12,400	$ 10.15	366,980	$ 9.75
Exercised	(250,622)	$ 5.35	(120,442)	$ 3.59	(192,906)	$ 4.26
Forfeited	(11,104)	$ 5.61	(2,392)	$ 6.73	(4,298)	$ 4.48
Outstanding at end of year	600,650	$ 8.63	848,402	$ 7.51	958,836	$ 6.98
Exercisable at end of year	526,860	$ 8.52	737,832	$ 7.64	856,746	$ 7.07

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. Stock compensation (continued)

The following table summarizes the weighted average grant date fair value of options during the year:

	For the year ended December 31, 2005	2004	2003
Options granted with an exercise price below market price on the date of grant:			
Employees preferred shares	$ 10.35	$ 6.26	$ 2.74
Overall weighted average	$ 10.35	$ 6.26	$ 2.74
Options granted with an exercise price at market price on the date of grant:			
Management employees	$	$	$ 2.35
Employees ordinary share options	$ 5.39	$ 3.33	$ 2.06
Overall weighted average	$ 5.39	$ 3.33	$ 2.33

Summary of options outstanding at December 31, 2005

At December 31, 2005, the range of exercise prices on outstanding options was $5.97 $10.03. Accordingly the following information is presented on options outstanding, which are all exercisable, at December 31,2005:

	Exercise prices from $5.97 - $10.03
Number of options outstanding at December 31, 2005	526,860
Weighted average exercise price	$ 8.52
Weighted average remaining contractual price	0.75 years

The weighted average fair value per share under SFAS No. 123 for shares granted during the year below market price on the date of grant follows:

	2005 Number	2005 Exercise price	2004 Number	2004 Exercise price	2003 Number	2003 Exercise price
Overall weighted average	14,484	$ 18.43	12,572	$ 11.56	22,934	$ 7.26

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. Taxation

Under current laws of the Cayman Islands, there are no income, estate, corporation, capital gains or other taxes payable by the Company on its Cayman Islands operations.

Under the current laws of Belize, the Company has received a tax exemption with respect to its Belize operations. The exemption expires in January 2006 and there is no certainty it will be renewed. However, if not renewed there would be no impact to the Company as any taxes paid will be passed through to the customer through a rate change.

Under current laws of The Commonwealth of The Bahamas, there are no income, corporation, capital gains or other taxes payable by the Company. The Company is required to pay an annual business license fee, the calculation of which is based on the preceding year s financial statements, and such fees are payable between January and April of the subsequent year.

Under the current laws of Barbados, the Company s Barbados operations are subject to a 40% Barbados corporate tax and all dividend payments and non-tax treaty supplier payments are subject to a Barbados withholding tax of 15%. As at December 31, 2005 and 2004, the Company has not recorded any deferred tax asset or liability as management believes that such items would be, if any, immaterial to the financial statements.

A substantial majority of the net income of the Company is currently not subject to taxation. The overall net tax expense is less than 1%, which is attributable to continuing operations in Barbados. There are no significant permanent reconciling items.

For the year ended December 31, 2005, total income before income taxes and minority interest was $5,484,344. Income before income taxes for domestic operations was $2,947,295 in 2005 (2004: $4,245,866 and 2003: $3,018,542) and income before taxes for all the foreign country operations was $2,569,109 in 2005 (2004: $1,981,667 and 2003: $1,182,282).

23. Pension benefits

Staff pension plans are offered to all employees in the Cayman Islands. The plans are administered by third party pension plan providers and are defined contribution plans whereby the Company matches the contribution of the first 5% of each participating employee s salary up to $72,000. The total amount recognized as an expense under the plan during the year ended December 31, 2005 was $146,241 (2004: $145,234; 2003: $119,800).

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

24. Financial instruments

Credit risk:

The Company is not exposed to significant credit risk on the vast majority of customer accounts as the policy is to cease supply of water to customers accounts that are more than 45 days overdue. The Company s exposure to credit risk is concentrated on receivables from its Bulk water customers. The balances from these customers are current or an allowance has been made for collection as at December 31, 2005. Management does not anticipate any losses on these concentrations.

Interest rate risk:

The interest rates and terms of the Company s loans are presented in Note 14 of these financial statements. The Company is subject to interest rate risk to the extent that the LIBOR or Nassau Prime Lending rates change.

Foreign exchange risk:

All relevant foreign currencies have fixed exchange rates to the United States dollar as detailed under the foreign currency accounting policy note. If any of these fixed exchange rates become floating exchange rates, the Company s results of operations could be adversely affected.

Fair values:

At December 31, 2005 and 2004, the carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and other liabilities and dividends payable approximate fair values due to the short term maturities of these assets and liabilities. Management considers that the carrying amounts for loans receivable and long term debt due to Scotiabank, the Royal Bank of Canada and Series A bond holders at December 31, 2005 approximate their fair value.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

25. Non-cash transactions

The Company executed the following non-cash transactions:

	2005	2004	2003
Redemption of preferred shares and issue of replacement common shares at $nil consideration	$ 2,509	$ 2,866	$ 11,974
Preferred shares issued to employees at $nil consideration	$ 3,326	$ 2,352	$ 3,592
Redemption of preferred shares at $nil consideration			(162)
Common stock issued under the Non-executive Directors Share Plan at $nil consideration	150,716	95,568	102,602
Common stock issued under senior management employment agreements in lieu of cash bonuses	145,040		
Common stock issued under senior management employment agreements at $nil consideration			28,715
Additional paid in capital from exercise of stock options	52,744		37,500
	$ 351,826	$ 97,920	$ 172,247
Addition of common stock and additional paid-in capital from issuance of shares in the acquisition	$	$	$ 2,291,711
Dividends declared but not paid	$ 828,709	$ 783,854	$ 686,118

26. Impact of recent accounting standards pronouncements

The Financial Accounting Standards Board issued one interpretation and three standards that affect the Company. A summary of this interpretation and these standards are given below:

In December 2004, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46R, Consolidation of Variable Interest Entities which replaces FASB Interpretation No. 46. This interpretation addresses the consolidation by business enterprises of variable interest entities, which have one or more of the characteristics defined in the Interpretation. Application of this Interpretation is required in financial statements of public entities that have interests in variable interest entities for periods ending after December 15, 2003. Application by public entities is required in financial statements for periods ending after March 15, 2004. The interpretation is intended to achieve more consistent application of consolidated policies to variable interest entities or disclose information about variable interest entities in which consolidation does not occur to help users assess the enterprises risks. The application of this Interpretation did not have a material effect on the Company s financial statements.

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CONSOLIDATED WATER CO. LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

26. Impact of recent accounting standards pronouncements (continued)

In December 2004, the FASB revised SFAS No. 123, Accounting for Stock Based Compensation , with the issuance of SFAS No. 123 (revised 2004), Share-Based Payment . SFAS No. 123R eliminates the alternative to use Opinion 25 s intrinsic value method of accounting and requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the reward. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. The Company is required to adopt SFAS No. 123R in the first quarter of 2006. The application of this standard is not expected to have a material effect on the Company s financial statements.

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 (FIN 47). This Interpretation is not expected to have an effect on the Company s financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting for Changes and Error Corrections , a replacement of APB Opinion No. 20 and SFAS No.3. The application of this standard is not expected to have an effect on the Company s financial statements.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 . The application of this standard is not expected to have an effect on the Company s financial statements.

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Ocean Conversion (BVI) Ltd.

We have audited the accompanying consolidated balance sheet of Ocean Conversion (BVI) Ltd. and its subsidiary (the Company) as of December 31, 2005, and the related consolidated statements of income, stockholders equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material aspects, the financial position of Ocean Conversion (BVI) Ltd. and subsidiary as of December 31, 2005, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Rachlin Cohen & Holtz LLP
Fort Lauderdale, Florida
March 8, 2006

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Independent Auditors Report

The Board of Directors
Ocean Conversion (BVI) Ltd.:

We have audited the accompanying consolidated balance sheets of Ocean Conversion (BVI) Ltd. and its subsidiary (the Company) as of December 31, 2004 and 2003 and the related consolidated statements of income, stockholders equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material aspects, the financial position of Ocean Conversion (BVI) Ltd. and its subsidiary as at December 31, 2004 and 2003, and the results of their operations and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG
George Town, Cayman Islands
April 15, 2005

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OCEAN CONVERSION (BVI) LTD.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 and 2004
(Expressed in United States Dollars)

	2005	2004
ASSETS		
Current assets		
Cash and cash equivalents	$ 944,574	$ 1,291,121
Accounts receivable	3,418,922	2,874,989
Deferred fees	3,837	11,401
Inventory	344,348	349,826
Prepaid expenses and other assets	24,717	24,722
Total current assets	4,736,398	4,552,059
Property, plant and equipment, net	3,200,618	3,949,583
Construction in progress	2,025,594	240,181
Total assets	$ 9,962,610	$ 8,741,823
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and other liabilities	$ 1,114,094	$ 835,589
Current portion of long term debt	255,000	250,000
Total current liabilities	1,369,094	1,085,589
Profit sharing provision	1,508,714	1,409,078
Long term debt, including $800,000 to affiliates in 2005	800,000	255,000
Minority interest in JVD Ocean Desalination Ltd.	33,265	18,526
Total liabilities	3,711,073	2,768,193
Commitments		
Stockholders equity		
Class A, voting shares, $1 par value. Authorized 600,000 shares: issued and outstanding 555,000 shares in 2005 and 2004	555,000	555,000
Class B, voting shares, $1 par value. Authorized 600,000 shares: issued and outstanding 555,000 shares in 2005 and 2004	555,000	555,000
Class C, non-voting shares, $1 par value. Authorized 600,000 shares: issued and outstanding 165,000 in 2005 and 2004	165,000	165,000
Additional paid-in capital	225,659	225,659
Retained earnings	4,750,878	4,472,971

Total stockholders equity	6,251,537	5,973,630
Total liabilities and stockholders equity	$ 9,962,610	$ 8,741,823

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

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OCEAN CONVERSION (BVI) LTD.
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2005, 2004 and 2003
(Expressed in United States Dollars)

	2005	2004	2003
Water sales	$ 7,715,827	$ 6,872,366	$ 4,819,605
Cost of water sales	(3,003,920)	(2,475,304)	(2,110,066)
Gross profit	4,711,907	4,397,062	2,709,539
General and administrative expenses	(1,818,229)	(1,642,862)	(1,046,186)
Income from operations	2,893,678	2,754,200	1,663,353
Other income (expense)			
Interest income	202,428	57,081	103,225
Interest expense	(62,150)	(31,557)	(28,378)
Other income	111		
	140,389	25,524	74,847
Income before minority interest	3,034,067	2,779,724	1,738,200
Minority interest	(14,739)	(8,526)	
Net income	$ 3,019,328	$ 2,771,198	$ 1,738,200

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

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OCEAN CONVERSION (BVI) LTD.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
YEARS ENDED DECEMBER 31, 2005, 2004 and 2003
(Expressed in United States Dollars)

	Common stock		Additional paid-in	Retained	Total stockholders
	Shares	**Dollars**	**capital**	**earnings**	**equity**
Balance at January 1, 2003	1,230,000	$ 1,230,000	$ 165,200	$ 2,704,823	$ 4,100,023
Issuance of Class C stock	45,000	45,000	60,459		105,459
Net income				1,738,200	1,738,200
Dividends declared				(1,593,750)	(1,593,750)
Balance at December 31, 2003	1,275,000	1,275,000	225,659	2,849,273	4,349,932
Net income				2,771,198	2,771,198
Dividends declared				(1,147,500)	(1,147,500)
Balance at December 31, 2004	1,275,000	1,275,000	225,659	4,472,971	5,973,630
Net income				3,019,328	3,019,328
Dividends declared				(2,741,421)	(2,741,421)
Balance at December 31, 2005	1,275,000	$ 1,275,000	$ 225,659	$ 4,750,878	$ 6,251,537

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

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OCEAN CONVERSION (BVI) LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005, 2004 and 2003
(Expressed in United States Dollars)

	2005	2004	2003
Cash flows from operating activities			
Net income	$ 3,019,328	$ 2,771,198	$ 1,738,200
Add/(deduct) items not affecting cash			
Depreciation	713,687	719,163	502,666
Amortization of bank fees	7,564	7,567	
Profit sharing	970,386	868,515	527,393
Minority interest	14,739	8,526	
(Increase) decrease in accounts receivable	(543,934)	(2,178,171)	1,606,496
(Increase) decrease in inventory	5,478	(132,221)	(38,779)
(Increase) decrease in other assets	5		(18,974)
Increase in accounts payable and other liabilities	278,506	78,856	466,116
Net cash provided by operating activities	4,465,759	2,143,433	4,783,118
Cash flows from investing activities			
Purchase of property, plant and equipment	(17,010)	(212,362)	(1,055,174)
Expenditures for construction in progress	(1,785,413)	(84,217)	(451,665)
Proceeds from sale of assets	52,288		
Net cash used in investing activities	(1,750,135)	(296,579)	(1,506,839)
Cash flows from financing activities			
Profit sharing rights paid	(870,750)	(364,500)	(506,250)
Minority interest from affiliate		10,000	
Proceeds from long term debt	800,000		880,000
Principal repayments of long term debt	(250,000)	(250,000)	(1,125,000)
Dividends paid	(2,741,421)	(1,147,500)	(1,593,750)
Net cash used in financing activities	(3,062,171)	(1,752,000)	(2,345,000)
Net increase (decrease) in cash and cash equivalents	(346,547)	94,854	931,279
Cash and cash equivalents at the beginning of the year	1,291,121	1,196,267	264,988
Cash and cash equivalents at the end of the year	$ 944,574	$ 1,291,121	$ 1,196,267

Interest paid in cash	$ 19,088	$ 20,659	$ 28,378
Interest received in cash	$ 184,389	$ 11,013	$ 103,225

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

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OCEAN CONVERSION (BVI) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Principal activity

Ocean Conversion (BVI) Ltd. (OCVBI) was incorporated in the British Virgin Islands under the Companies Act, Cap 285, on May 14, 1990 and is engaged in the production and sale of potable water to the Government of the British Virgin Islands (the Government). The Company has an agreement with the Government, its sole customer, to produce and supply a guaranteed quantity and quality of potable water. This agreement provides for specific penalties should the Company not be able to provide the guaranteed quantity of water.

On January 24, 1992, OCVBI amended the original agreement with the Government to allow for the expansion of its plant in order to increase its production capacity from 360,000 imperial gallons of water to 510,000 imperial gallons per day. Under this agreement, the Government had the option to purchase the facility in May 1999 at a cost of $1,420,000 or renew the agreement for a period of seven years. The Government did not exercise its option to purchase the plant but advised OCVBI of its desire to continue the agreement on a month-to-month basis until a new agreement is negotiated.

JVD Ocean Desalination Ltd. (JVD), a majority owned affiliate of OCBVI, was incorporated on January 2, 2003 and began producing potable water for the Government on July 10, 2003. On February 5, 2005, JVD executed a contract with the Government of the British Virgin Islands with the agreement that all water delivered before the contract was signed would be invoiced upon signing of the contract. During 2003, neither the amount of water delivered nor the expenses incurred were material to the financial statements. These amounts have been recorded in the consolidated financial statements of OCBVI along with the portion relating to the minority interests.

2. Accounting policies

Basis of preparation: The consolidated financial statements presented are prepared in accordance with accounting principles generally accepted in the United States of America.

Basis of consolidation: The consolidated financial statements include the financial statements of Ocean Conversion (BVI) Ltd. and its majority owned subsidiary, JVD Ocean Desalination Ltd., together the Company . All significant intercompany balances and transactions have been eliminated.

Use of estimates: The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Company 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. Significant items subject to estimates and assumptions include the carrying value of property, plant and equipment and inventory. Actual results could differ from those estimates.

Cash and cash equivalents: Cash and cash equivalents are comprised of cash at banks on call and highly liquid deposits with an original maturity of three months or less.

Trade accounts receivable: Trade accounts receivable are recorded at the invoiced amounts based on meter readings reduced by appropriate allowances for estimated uncollectible amounts. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in the Company s existing accounts receivable balance. The Company determines the allowance based on historical write-off experience.

Interest income: The Company earns interest income on trade accounts receivable based on the overdue invoices from its customer. The interest is earned on an accrual basis.

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OCEAN CONVERSION (BVI) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2. Accounting policies (continued)

Deferred fees: Deferred fees consist of the bank financing fees paid on the drawdown of the Company s long term debt and are being amortized on a straight line basis over the term of the loan.

Inventory: Inventory primarily includes replacement spares and parts that are valued at the lower of cost and net realizable value on a first-in, first-out basis.

Impairment of long-lived assets: In accordance with SFAS No. 144, long-lived assets, such as property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount exceeds the fair value of the asset.

Property, plant and equipment: Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is calculated using a straight line method with an allowance for estimated residual values. Rates are determined based on the estimated useful lives of the assets as follows:

Plant and equipment	4 to 40 years
Office furniture, fixtures and equipment	3 to 10 years
Vehicles	3 to 10 years
Lab Equipment	3 to 10 years

Additions to property, plant and equipment consist of the cost of the contracted services, direct labor and materials. Assets under construction are recorded as additions to property, plant and equipment upon completion of the projects. Depreciation commences in the month of addition.

Construction in progress*:* The cost of borrowed funds directly attributable to the acquisition and construction of qualifying assets, which are assets that necessarily take a substantial period of time to be ready for their intended use, are added to the cost of those assets until such time as the assets are substantially ready for use or sale.

Water sales and cost of water sales: The Government is billed monthly based on meter readings performed at or near each month end and in accordance with the water sales agreement, which stipulates minimum monthly charges for water service.

Repairs and maintenance: All repair and maintenance costs are expensed as incurred.

Comparative amounts: Certain prior year amounts have been adjusted to conform to the current year s presentation.

3. Cash and cash equivalents

Cash and cash equivalents are not restricted as to withdrawal or use.

4. Trade accounts receivable

Trade accounts receivable comprise receivables from our sole customer, the Government of the British Virgin Islands. Significant concentrations of credit risk are disclosed in Note 15.

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OCEAN CONVERSION (BVI) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5. Inventory

	December 31, 2005	December 31, 2004
Consumables stock	$ 43,679	$ 51,239
Spare parts stock	300,669	298,587
Total	$ 344,348	$ 349,826

6. Property, plant and equipment and construction in progress

	December 31, 2005	December 31, 2004
Plant and equipment	$ 9,416,015	$ 9,475,811
Office furniture, fixtures and equipment	37,027	33,182
Vehicles	71,600	71,600
Lab equipment	11,637	11,637
	9,536,279	9,592,230
Accumulated depreciation	(6,335,661)	(5,642,647)
Property, plant and equipment, net	$ 3,200,618	$ 3,949,583
Construction in progress	$ 2,025,594	$ 240,181

At December 31, 2005, the Company had approximately $4.0 million in capital commitments. It is the Company s policy to maintain adequate insurance for loss or damage to all fixed assets that in management s assessment may be susceptible to loss.

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OCEAN CONVERSION (BVI) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Long term debt

	December 31, 2005	2004
Scotiabank (Cayman Islands) loan bearing interest at three month LIBOR plus 1.5% per annum, with interest calculated daily and payable quarterly. Principal is repayable in semi-annual intallments of $125,000 through May 31, 2006.	$ 255,000	$ 505,000
CWCO loan bearing interest at three month LIBOR plus 3.5% per annum, with interest calculated daily and payable quarterly. Principal is due June 1, 2007.	800,000	
Total long term debt	1,055,000	505,000
Less current portion	(255,000)	(250,000)
Long term debt, excluding current portion	$ 800,000	$ 255,000

The future minimum aggregate principal repayments of long term debt at December 31, 2005 are as follows:

2006	$ 255,000
2007	800,000

Any amounts drawn under the Scotiabank facility are collateralized by a fixed and floating charge of $1,250,000. The fixed and the floating charge covers all other assets of the Company. The Scotiabank facility has been guaranteed equally by Consolidated Water Co. Ltd. and Sage Water Holdings (BVI) Ltd.

At December 31, 2005, the Company is in compliance with all restrictive covenants.

On May 25, 2005, the Company entered into a loan agreement with an affiliate, Consolidated Water Co. Ltd. (CWCO), pursuant to which CWCO has agreed to lend the Company up to $3.0 million for the design and construction of a 500,000 Imperial gallon per day seawater desalination plant in Tortola, British Virgin Islands. The loan principal is due and payable on June 1, 2007 and interest accrues at the LIBOR rate plus 3.5% and is payable quarterly on amounts drawn down commencing July 2005. The loan can be repaid at any time without penalty and is subordinated to existing bank indebtedness. The balance outstanding at December 31, 2005 was $800,000.

8. Commitments

The Company leases property adjacent to the Baughers Bay plant upon which it has installed walls and pipelines necessary for the production of water.

In addition, on May 25, 2005, the Company entered into a twenty five year lease agreement with Bar Bay Estate Holdings Limited (Bar Bay), a private company incorporated in the Territory of the British Virgin Islands, pursuant to which the Company agreed to lease from Bar Bay approximately 50,000 square feet of land on Tortola, British Virgin Islands on which a seawater desalination plant and wells will be constructed. Under the terms of the lease agreement, a lease premium payment of $750,000 was made on June 10, 2005, annual lease and easement payments of $15,020 are due annually and royalty payments of 2.87% of annual sales, as defined in the lease agreement, are payable quarterly.

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OCEAN CONVERSION (BVI) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

8. Commitments (continued)

Future minimum lease payments under non-cancelable operating leases at December 31, 2005 are as follows:

2006	$ 33,075
2007	33,075
2008	33,075
2009	33,075
2010	33,075
Thereafter	390,675

The Company leases property adjacent to the Baughers Bay plant upon which it has installed walls and pipelines necessary for the production of water.

9. Expenses

