Canadian Solar Inc.
Form 20-F
May 29, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 20-F

(Mark One)

- o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

- þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
  For the fiscal year ended December 31, 2006.

or

- o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
  For the transition period from to

or

- o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
  Date of event requiring this shell company report

Commission file number: 001-33107

CANADIAN SOLAR INC.

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant s name into English)

Canada

(Jurisdiction of incorporation or organization)

Xin Zhuang Industry Park
Changshu, Suzhou
Jiangsu 215562
People s Republic of China

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common shares with no par value	The NASDAQ Stock Market LLC

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None

(Title of Class)

Indicate the number of outstanding shares of each of the Issuer s classes of capital or common stock as of the close of the period covered by the annual report.

27,270,000 common shares issued and outstanding,
excluding 566,190 restricted shares, which were subject to restrictions on voting and dividend rights and transferability, as of December 31, 2006.

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer o Non-accelerated filer þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed

by a court. Yes o No o

TABLE OF CONTENTS

Table of Contents

INTRODUCTION

Unless otherwise indicated, references in this annual report on Form 20-F to:

CSI, we, us, our company and our are to Canadian Solar Inc., its predecessor entities and its consolidated subsidiaries;

$ and U.S. dollars are to the legal currency of the United States;

RMB and Renminbi are to the legal currency of China;

C$ refers to the legal currency of Canada;

Euro or refers to the legal currency of the European Union; and

China and the PRC are to the People s Republic of China, excluding, for the purposes of this annual report on Form 20-F only, Taiwan and the special administrative regions of Hong Kong and Macau.

This annual report on Form 20-F includes our audited consolidated financial statements for the years ended December 31, 2004, 2005 and 2006 and as of December 31, 2005 and 2006.

All translations from Renminbi to U.S. dollars were made at the noon buying rate in The City of New York for cable transfers in Renminbi per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise stated, the translation of Renminbi into U.S. dollar has been made at the noon buying rate in effect on December 29, 2006, which was RMB7.8041 to $1.00. We make no representation that the Renminbi or dollar amounts referred to in this annual report on Form 20-F could have been or could be converted into dollars or Renminbi, as the case may be, at any particular rate or at all. See Item 3. Key Information D. Risk Factors Risk Related to Doing Business in China Fluctuation in the value of the Renminbi may have a material adverse effect on your investment. On May 25, 2007, the noon buying rate was RMB7.6527 to $1.00.

In November 2006, we and certain selling shareholders of our company completed the initial public offering of 7,700,000 common shares and we listed our common shares on the Nasdaq Global Market of The NASDAQ Stock Market LLC, or the Nasdaq, under the symbol CSIQ.

PART I

ITEM 1. *Identity of Directors, Senior Management and Advisers*

Not Applicable.

ITEM 2. *Offer Statistics and Expected Timetable*

Not Applicable.

Table of Contents

ITEM 3. *Key Information*

A. Selected Financial Data

Selected Consolidated Financial and Operating Data

The following selected statement of operations data for the years ended December 31, 2004, 2005 and 2006 and the balance sheet data as of December 31, 2005 and 2006 have been derived from our audited consolidated financial statements, which have been audited by Deloitte Touche Tohmatsu CPA, Ltd., an independent registered public accounting firm. The report of Deloitte Touche Tohmatsu CPA, Ltd. on those financial statements is included elsewhere in this annual report on Form 20-F. You should read the selected consolidated financial data in conjunction with those financial statements and the related notes and Item 5. Operating and Financial Review and Prospects included elsewhere in this annual report on Form 20-F.

The audited financial statements are prepared and presented in accordance with U.S. GAAP. Our historical results do not necessarily indicate results expected for any future periods. Our selected consolidated statement of operations data for the year ended December 31, 2003 and our consolidated balance sheet data as of December 31, 2003 have been derived from our audited consolidated financial statements, which are not included in this annual report. Our selected consolidated statement of operations data for the year ended December 31, 2002 and our consolidated balance sheet data as of December 31, 2002 have been derived from our unaudited consolidated financial statements, which are not included in this annual report, but which have been prepared based on the same basis as our audited consolidated financial statements.

	Year Ended December 31,				
	2002	2003	2004	2005	2006
	(In thousands of US$, except share and per share data, and operating data and percentages)				
Statement of operations data:					
Net revenues	$ 4,042	$ 4,113	$ 9,685	$ 18,324	$ 68,212
Cost of revenues[1]	2,628	2,372	6,465	11,211	55,872
Gross profit	1,414	1,741	3,220	7,113	12,340
Operating expenses[1]					
Selling expenses	81	39	269	158	2,909
General and administrative expenses	405	1,039	1,069	1,708	7,923
Research and development expenses[2]	7	20	41	16	398
Total operating expenses	493	1,098	1,379	1,882	11,230
Income from operations	921	643	1,841	5,231	1,110
Interest expenses				(239)	(2,194)
Interest income		1	11	21	363
Loss on change in fair value of derivatives related to convertible notes				(316)	(6,997)
				(263)	(1,190)

Loss on financial instruments related to convertible notes					
Other net	(3)	10	(32)	(25)	(90)
Income tax expense	(81)	(34)	(363)	(605)	(432)
Minority interests	(215)	(209)			

Table of Contents

	Year Ended December 31,				
	2002	2003	2004	2005	2006
	(In thousands of US$, except share and per share data, and operating data and percentages)				
Income/(loss) before extraordinary gain	625	411	1,457	3,804	(9,430)
Extraordinary gain		350			
Net income/(loss)	$ 625	$ 761	$ 1,457	$ 3,804	$ (9,430)
Earnings per share, basic and diluted					
Extraordinary gain	$	$ 0.02	$	$	$
Net income (loss)	$ 0.04	$ 0.05	$ 0.09	$ 0.25	$ (0.50)
Shares used in computation					
Basic and diluted	15,427,995	15,427,995	15,427,995	15,427,995	18,986,498
Other financial data:					
Gross margin	35.0%	42.3%	33.2%	38.8%	18.1%
Operating margin	22.8%	15.6%	19.0%	28.5%	1.6%
Net margin	15.5%	18.5%	15.0%	20.8%	(13.8)%
Selected operating data:					
Products sold (in MW)					
Standard solar modules			1.8	3.4	14.7
Specialty solar modules and products	0.7	0.7	0.4	0.7	0.2
Total	0.7	0.7	2.2	4.1	14.9
Average selling price (in $ per watt)					
Standard solar modules			3.62	3.92	3.97
Specialty solar modules and products	$ 5.36	$ 5.70	$ 5.23	$ 5.13	5.89

(1) Share-based compensation expenses are included in our cost of revenues and operating costs and expenses. See Item 5A. Operating Results Overview of Financial Results Share-based Compensation Expenses.

(2) We also conduct research and development activities in connection with our implementation of solar power development projects. These expenditures are included in our cost of revenues. See Item 4. Information on the

Company B. Business Overview Solar Power Development Projects.

(3) Less than one thousand.

Table of Contents

	As of December 31,				
	2002	2003	2004	2005	2006
	(In thousands of US$)				
Balance Sheet Data:					
Cash and cash equivalents	$ 596	$ 1,879	$ 2,059	$ 6,280	$ 40,911
Inventories	312	313	2,397	12,163	39,700
Accounts receivable, net	1,047	257	636	2,067	17,344
Advances to suppliers	3	81	370	4,740	13,484
Value added tax recoverable		142	22	815	2,281
Other current assets		76	95	163	2,398
Property, plant and equipment, net	291	244	453	932	7,910
Intangible assets					39
Prepaid-rental					1,103
Deferred tax assets (non-current)		31	15	65	3,639
Total assets	2,476	3,053	6,145	27,430	129,634
Short-term borrowings				1,300	3,311
Accounts payable	488	426	824	4,306	6,874
Advances from suppliers and customers	113	18	273	2,823	3,225
Income tax payable	92	119	407	914	112
Embedded derivatives related to convertible notes				3,679	
Total current liabilities	831	1,201	2,756	15,367	15,855
Accrued warranty costs	39	79	167	341	875
Convertible notes				3,387	
Financial instruments related to convertible notes				1,107	
Total liabilities	1,131	1,541	3,184	20,463	16,730
Total shareholders equity	779	1,512	2,961	6,967	112,904
Total liabilities and shareholders equity	$ 2,476	$ 3,053	$ 6,145	$ 27,430	$ 129,634
Number of shares outstanding	15,427,995	15,427,995	15,427,995	15,427,995	27,270,000(4)

(4) Excluding 566,190 restricted shares, which were subject to restrictions on voting and dividend rights and transferability, as of December 31, 2006.

Exchange Rate Information

Our manufacturing activities are primarily conducted in China and a portion of our expenses are denominated in RMB. Periodic reports made to shareholders will be expressed in U.S. dollars using the then current exchange rates. The conversion of RMB into U.S. dollars in this annual report on Form 20-F is based on the noon buying rate in The City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report on Form 20-F were made at a rate of RMB 7.8041 to $1.00, the noon buying rate in effect as of December 29,

2006. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, the rates stated below, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the

Table of Contents

conversion of RMB into foreign exchange and through restrictions on foreign trade. On May 25, 2007, the noon buying rate was RMB 7.6527 to $1.00.

The following table sets forth information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated.

		Noon Buying Rate		
Period	Period End	Average	Low	High
		(RMB per $1.00)		
2002	8.2800	8.2772	8.2800	8.2700
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
2005	8.0702	8.1826	8.2765	8.0702
2006	7.8041	7.9579	8.0702	7.8041
November	7.8340	7.8622	7.8750	7.8303
December	7.8041	7.8220	7.8350	7.8041
2007				
January	7.7714	7.7876	7.8127	7.7705
February	7.7410	7.7502	7.7632	7.7410
March	7.7232	7.7369	7.7454	7.7232
April	7.7090	7.7247	7.7345	7.7090
May (through May 25)	7.6527	7.6816	7.7065	7.6490

We also translated the Euro amounts with regards to certain industry data into U.S. dollars at a rate of 1.3197 to $1.00, the noon buying rate in effect as of December 29, 2006 in this annual report solely for the reader s convenience. We make no representation that the Euro or U.S. dollar amounts contained in this annual report could have been or could be converted into U.S. dollar or Euro, as the case may be, at any particular rate or at all.

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Risks Related to Our Company and Our Industry

Evaluating our business and prospects may be difficult because of our limited operating history.

There is limited historical information available about our company upon which you can base your evaluation of our business and prospects. We began business operations in October 2001 and shipped our first solar module products in March 2002. With the rapid growth of the solar power industry, we have experienced a high growth rate since our inception and, in particular, in 2004, 2005 and 2006 after we began to sell standard solar modules. As such our

historical operating results may not provide a meaningful basis for evaluating our business, financial performance and prospects. We may not be able to achieve a similar growth rate in future periods and our business model at higher volumes is unproven. Accordingly, you should not rely on our results of operations for any prior periods as an indication of our future performance. You should consider our business and prospects in light of the risks, expenses and challenges that we will face as an early-stage company seeking to develop and manufacture new products in a rapidly growing market.

Table of Contents

The current industry-wide shortage of high-purity silicon may constrain our revenue growth and decrease our margins and profitability.

We produce solar modules, which are an array of interconnected solar cells encased in a weatherproof package, and products that use solar modules. We recently began to produce solar cells ourselves but still source most of them from other companies, either through direct purchases or toll manufacturing arrangements. High-purity silicon is an essential raw material in the production of solar cells and is also used in the semiconductor industry generally. There is currently an industry-wide shortage of high-purity silicon because of increased demand as a result of recent expansions of, and increased demand in, the solar power and semiconductor industries. The shortage of high-purity silicon has driven the overall increase in silicon feedstock prices. For example, according to a March 2007 report by Solarbuzz, the average long-term silicon feedstock contracted price increased from approximately $28-32 per kilogram in 2004 to $60-65 per kilogram in 2007. In addition, according to Solarbuzz, prices of silicon feedstock obtained through spot purchases or short-term contracts went as high as $300 per kilogram in 2006, peaking in the third quarter of 2006 before decreasing by 10% from this peak by the first quarter of 2007. The shortage of high-purity silicon has also resulted in a shortage of, and significant price increases for, solar cells. According to Solarbuzz, the average selling price of solar cells increased from the fourth quarter of 2004 to the fourth quarter of 2005 by approximately 20% to 25%, depending on the size of the solar cells and the type of technology; mainstream multicrystalline silicon cell prices increased from the first quarter of 2006 to the first quarter of 2007 by an average of 8%, while monocrystalline silicon PV cell prices increased by a similar proportion.

Based on our experience, we believe the average price of silicon feedstock and solar cells will remain high in 2007. Any further increase in the demand from the semiconductor industry will compound the shortage and price increases. The shortage of high-purity silicon has constrained our revenue growth in the past and may continue to do so. Increases in the prices of silicon feedstock and solar cells have in the past increased our production costs and may impact our cost of revenues and net income in the future. The production of high-purity silicon is capital intensive and adding additional capacity requires significant lead time. While we are aware that several new facilities for the manufacture of high-purity silicon are under construction, we do not believe that the supply shortage will be remedied in the near term. We expect that demand for high-purity silicon will continue to outstrip supply for the near future. Furthermore, if solar cells are not available to us at commercially viable prices, this could adversely affect our margins and operating results. This would have a material negative impact on our business and operating results.

If we are unable to secure an adequate and cost effective supply of solar cells or reclaimable silicon, our revenue, margins and profits could be adversely affected.

Solar cells are the most important component of solar module products. We engage in supply chain management to secure a sufficient and cost-effective supply of solar cells through our sourcing of silicon feedstock, toll manufacturing arrangements with suppliers of ingots, wafers and cells and direct purchases from solar cell suppliers. While we have been able to secure silicon to meet our production needs in the past, due to ongoing industry shortages of silicon feedstock and solar cells, we cannot assure you that we will be able to continue to successfully manage our supply chain and secure an adequate and cost-effective supply of solar cells. For example, we have entered into several long-term contracts with silicon raw material suppliers, but we cannot assure you that we will be able to obtain adequate supplies from them under these contracts or from other suppliers in sufficient quantities and at commercially viable prices in the future. Moreover, toll manufacturing arrangements may not be available to us in the future or at higher volumes, in particular as high-purity silicon becomes more readily available in the future, which could have an adverse effect on our margins and profitability. Moreover, if we are unable to procure an adequate supply of solar cells, either through direct purchasing or through toll manufacturing arrangements or if solar cells are not available to us at commercially viable prices, we may be unable to meet demand for our products and could lose our customers and market share, and our margins and revenues could decline. We have recently begun to produce solar cells to meet

a portion of our solar cell needs. However, we cannot guarantee you that we will be able to successfully produce enough solar cells to supplement our solar cell needs.

In addition, while we have been able to generate cost savings in the past through our recycling of reclaimable silicon, we cannot assure you that we will be able to secure sufficient reclaimable silicon at higher volumes and reasonable prices in the future as we believe there is a limited supply of reclaimable silicon available in the market

Table of Contents

and intensified competition for these materials as a result of more new competitors entering the market. Recently, there has been increased scrutiny by the Chinese Customs authorities on the import of scrap silicon over a concern that the recycling process for certain types of scrap silicon may cause environmental damage if not performed in a fully licensed factory. This has created certain disruptions to our silicon reclamation business. We have 1.2 tons of scrap silicon currently detained by the Chinese Customs authorities, 816 kg of which may involve the concerned type of scrap silicon with a goods value of $36,720. If the investigation deems this scrap silicon to be prohibited solid waste, the scrap silicon will have to be returned to its origination and we may be fined with a penalty ranging from RMB100,000 (US$12,813.8) to RMB1 million (US$128,137.7). We are actively working with local industry groups, the Chinese Customs authorities and the Chinese Environment Protection Administration to define new procedures and regulations. These new regulations may increase the cost of reclamation and limit our ability to sustain or expand our silicon reclamation program. If we are unable to secure a sufficient supply of reclaimable silicon at reasonable prices and reclaim this silicon on a cost-efficient basis, we cannot assure you that we will be able to save cost through our reclamation program and maintain our profit margin as a result of further negative changes in the government policy.

Because the markets in which we compete are highly competitive and many of our competitors have greater resources than us, we may not be able to compete successfully and we may lose or be unable to gain market share.

We compete with a large number of competitors in the solar module market. These include international competitors such as BP Solar International Inc., or BP Solar, Sharp Solar Corporation, or Sharp Solar, SolarWorld AG, or SolarWorld, and competitors located in China such as Suntech Power Holdings Co., Ltd. or Suntech Power. We expect to face increasing competition in the future. Further, many of our competitors are developing and are currently producing products based on new solar power technologies that may ultimately have costs similar to, or lower than, our projected costs. For example, some of our competitors are developing or currently producing products based on alternative solar technologies, such as thin film photovoltaic materials, which they believe will ultimately cost the same as or less than crystalline silicon technologies, which we use. Solar modules produced using thin film materials, such as amorphous silicon and cadmium telluride, require significantly less silicon to produce than crystalline silicon solar modules, such as our products, and are less susceptible to increases in silicon costs. We may also face competition from semiconductor manufacturers, several of which have already announced plans to start production of solar modules. In addition, the entry barriers are relatively low in the solar module manufacturing business given the low capital requirements and relatively less technological complexity involved. Due to the scarcity of high-purity silicon, supply chain management and access to financing are key entry barriers at present. However, if high-purity silicon capacity increases, these barriers may no longer exist and many new competitors may enter into the industry resulting in rapid industry fragmentation and loss of our market share.

Many of our current and potential competitors have longer operating histories, greater name recognition, access to larger customer bases and resources and significantly greater economies of scale. In addition, our competitors may have stronger relationships or may enter into exclusive relationships with some of the key distributors or system integrators to whom we sell our products. As a result, they may be able to respond more quickly to changing customer demand or to devote greater resources to the development, promotion and sales of their products than we can. The sale of our solar module products generated 97.7% and 87.6% of our net revenues in 2005 and 2006, respectively. Our competitors with more diversified product offerings may be better positioned to withstand a decline in the demand for solar power products. Some of our competitors have also become vertically integrated, from upstream silicon wafer manufacturing to solar power system integration. It is possible that new competitors or alliances among existing competitors could emerge and rapidly acquire significant market share, which would harm our business. If we fail to compete successfully, our business would suffer and we may lose or be unable to gain market share.

In the immediate future, we believe that the competitive arena will continue to be contested on securing silicon feedstock and forming strategic relationships to secure a supply of solar cells and on sales and marketing efforts in

securing customer orders. Many of our competitors have greater access to silicon raw materials and cell supply, including stronger strategic relationships with leading global and domestic silicon feedstock suppliers, or have upstream silicon wafer and cell manufacturing capabilities. We believe that as the supply of high-purity silicon

Table of Contents

stabilizes and customers become more knowledgeable and selective, the key to competing successfully in the industry will shift to more traditional sales and marketing activities. We have conducted very limited advertising to date, focusing primarily on medium-sized regional solar power distributors in the European market in the past, and cannot assure you that we will be able to make that transition successfully. The greater name recognition of some of our competitors may make it difficult for us to compete as a result of this industry transition. In addition, the solar power market in general competes with other sources of renewable energy and conventional solar power generation. If prices for conventional and other renewable energy resources decline, or if these resources enjoy greater policy support than solar power, the solar power market could suffer.

The reduction or elimination of government subsidies and economic incentives for solar power could cause demand for our products, our revenues, profits and margins to decline.

We believe that the near-term growth of the market, particularly for on-grid applications, depends in large part on the availability and size of government subsidies and economic incentives. Because a substantial portion of our sales is made in the on-grid market, the reduction or elimination of government subsidies and economic incentives may adversely hinder the growth of this market or result in increased price competition, which could cause our revenues to decline.

Today, the cost of solar power substantially exceeds the cost of power provided by the electric utility grid in many locations. Governments around the world have used different policy initiatives to accelerate the development and adoption of solar power and other renewable energy sources. Renewable energy policies are in place in the European Union, most notably Germany and Spain, certain countries in Asia, and many of the states in Australia and the United States. Examples of customer-focused financial incentives include capital cost rebates, feed-in tariffs, tax credits and net metering and other incentives to end users, distributors, system integrators and manufacturers of solar power products to promote the use of solar power in both on-grid and off-grid applications and to reduce dependency on other forms of energy. These government economic incentives could be reduced or eliminated altogether. Reductions in, or eliminations of, government subsidies and economic incentives before the solar power industry reaches a scale of economy sufficient to be cost-effective in a non-subsidized market place could result in decreased demand for our products and decrease our revenues, profits and margins.

Existing regulations and policies and changes to these regulations and policies may present technical, regulatory and economic barriers to the purchase and use of solar power products, which may significantly reduce demand for our products.

The market for electricity generation products is heavily influenced by government regulations and policies concerning the electric utility industry, as well as policies promulgated by electric utilities. These regulations and policies often relate to electricity pricing and technical interconnection of customer-owned electricity generation. In a number of countries, these regulations and policies have been modified and may continue to be modified. Customer purchases of, or further investment in the research and development of, alternative energy sources, including solar power technology, could be deterred by these regulations and policies, which could result in a significant reduction in the potential demand for our products. For example, without a regulatory mandated exception for solar power systems, utility customers are often charged interconnection or standby fees for putting distributed power generation on the electric utility grid. These fees could increase the cost to our customers of using our solar module products and make them less desirable, thereby harming our business, prospects, results of operations and financial condition. In addition, pricing regulations and policies may place limits on our ability to increase the price of our solar module products in response to increases in our solar cells and silicon raw materials costs. We anticipate that our products and their installation will be subject to oversight and regulation in accordance with national and local regulations relating to building codes, safety, environmental protection, utility interconnection and metering and related matters. It is difficult to track the requirements of individual jurisdictions and design products to comply with the varying

standards. For example, the European Union s Restriction of Hazardous Substances Directive, which took effect in July 2006, is a general directive. Each European Union member state will adopt its own enforcement and implementation policies using the directive as a guide. Therefore, there could be many different versions of this law that we will have to comply with to maintain or expand our sales in Europe. Any new government regulations or utility policies pertaining to our solar module products may result in significant

Table of Contents

additional expenses to us and, as a result, could cause a significant reduction in demand for our solar module products. In particular, any changes to existing regulations and policies or new regulations and policies in Germany could have a material adverse effect on our business and operating results. Sales to customers located in Germany accounted for 75.3% and 56.9% of our net revenues in 2005 and 2006, respectively, in part because of the availability and amounts of government subsidies and economic incentives in Germany.

If solar power technology is not suitable for widespread adoption, or sufficient demand for solar power products does not develop or takes longer to develop than we anticipate, our revenues may not continue to increase or may even decline, and we may be unable to sustain our profitability.

The solar power market is at a relatively early stage of development, and the extent of acceptance of solar power products is uncertain. Market data on the solar power industry are not as readily available as those for other more established industries where trends can be assessed more reliably from data gathered over a longer period of time. In addition, demand for solar power products in our targeted markets, including Germany, Spain and Italy, may not develop or may develop to a lesser extent than we anticipate. Many factors may affect the viability of widespread adoption of solar power technology and demand for solar power products, including:

- cost-effectiveness, performance and reliability of solar power products compared to conventional and other renewable energy sources and products;
- availability of government subsidies and incentives to support the development of the solar power industry;
- success of other alternative energy generation technologies, such as wind power, hydroelectric power and biomass;
- fluctuations in economic and market conditions that affect the viability of conventional and other renewable energy sources, such as increases or decreases in the prices of oil and other fossil fuels;
- capital expenditures by end users of solar power products, which tend to decrease when the economy slows down;
- deregulation of the electric power industry and broader energy industry; and
- changes in seasonal demands for our products, as illustrated by the slowdown of our sales to Germany in the fourth quarter of 2006.

If solar power technology is not suitable for widespread adoption or sufficient demand for solar power products does not develop or takes longer to develop than we anticipate, our revenues may suffer and we may be unable to sustain our profitability.

The lack or unavailability of financing for on-grid and off-grid solar power applications could cause our sales to decline.

Our solar module products are used in both on-grid applications and off-grid applications. Off-grid applications are used where access to utility networks is not economical or physically feasible. In some developing countries, government agencies and the private sector have, from time to time, provided financing on preferential terms for rural electrification programs. We believe that the availability of financing programs could have a significant effect on the level of sales of solar modules for both on-grid and off-grid applications. If existing financing programs for on-grid and off-grid applications are eliminated or if financing programs are inaccessible or inadequate, the growth of the

market for on-grid and off-grid applications may be materially and adversely affected, which could cause our sales to decline. In addition, a rise in interest rates could render existing financings more expensive and present an obstacle for potential financings that would otherwise spur the growth of the solar power industry, which could materially and adversely affect our business.

Table of Contents

Our dependence on a limited number of solar cell and silicon raw material suppliers could prevent us from timely delivering our products to our customers in the required quantities, which could result in order cancellations and decreased revenues.

We purchase silicon raw materials, solar wafers and solar cells from a limited number of third-party suppliers. Our major suppliers of silicon raw materials include Kunical International Ltd., or Kunical International, of the United States and Luoyang Zhong Gui High Tech Co. Ltd., or Luoyang Poly, of China, which provide us specified minimum levels of silicon feedstock; Jiangxi Saiwei LDK Solar Energy High-Tech Limited, or LDK, of China, and Deutsche Solar AG, or Deutsche Solar, of Germany, which provide us specified minimum levels of solar wafers; and JA Solar Ltd., or JA Solar, of China, which provides us specified minimum levels of solar cells. These suppliers may not be able to meet the specified minimum levels set forth in the contracts. We also have a limited number of suppliers from whom we either purchase directly or obtain solar cells through our toll manufacturing arrangements. If we fail to develop or maintain our relationships with these or our other suppliers, we may not be able to secure a supply of solar cells at cost-effective prices, or at all. If that were to occur, we may be unable to manufacture our products in a timely manner or our products may be manufactured only at a higher cost, and we could be prevented from delivering our products to our customers in the required quantities and at prices that are profitable. Problems of this kind could cause us to experience order cancellations and loss of market share and harm our reputation. The failure of a supplier to supply solar cells or silicon raw materials that meet our quality, quantity and cost requirements in a timely manner could impair our ability to manufacture our products or increase our costs, particularly if we are unable to obtain these solar cells or silicon raw materials from alternative sources on a timely basis or on commercially reasonable terms. For example, in late 2006, one of our major suppliers of solar wafers incurred serious fire damage with its silicon cast ingot furnaces. This resulted in a chain reaction and caused the shortage and price increase of multi-crystalline solar wafers, which is a key material for our products.

Our dependence on a limited number of customers and our lack of long-term contracts may cause significant fluctuations or declines in our revenues.

We currently sell a substantial portion of our solar module products to a limited number of customers, including distributors and system integrators, and various manufacturers who either integrate our products into their own products or sell them as part of their product portfolio. In 2006, our top five customers collectively accounted for approximately 53.4% of our net revenues. Each of Iliotec, Maass and Bihler contributed over 10% of our net revenues in 2006. See Item 4 Information on the Company B. Markets and Customers. Sales to our customers are typically made through one-year agreements with quarterly prices and product amounts as adjusted with the confirmations by the customers. We anticipate that our dependence on a limited number of customers will continue for the foreseeable future. Consequently, any one of the following events may cause material fluctuations or declines in our revenues:

- reduction, delay or cancellation of orders from one or more of our significant customers;
- loss of one or more of our significant customers and our failure to identify additional or replacement customers; and
- failure of any of our significant customers to make timely payment for our products.

Even though our top five customers have contributed to a significant portion of our revenues, we have experienced changes in our top customers. As we continue to grow our business and operations, we expect our top customers may continue to change. We cannot assure you that we will be able to develop a consistent customer base.

We may not be able to manage our expansion of operations effectively.

We commenced business operations in October 2001 and have since grown rapidly. We expect to continue to significantly expand our business to meet the growth in demand for our products, as well as to capture new market opportunities. To manage the potential growth of our operations, we will be required to improve our operational and financial systems and procedures and controls. Our rapid growth has strained our resources and made it difficult to maintain and update our internal procedures and controls as necessary to meet the expansion of our overall business. We must also increase production output, expand, train and manage our growing employee base, and successfully

Table of Contents

establish new subsidiaries to operate new or expanded facilities. Additionally, access to additional funds to support the expansion of our business may not always be available to us. Furthermore, our management will be required to maintain and expand our relationships with our customers, suppliers and other third parties.

We cannot assure you that our current and planned operations, personnel, systems and internal procedures and controls will be adequate to support our future growth. If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities, execute our business strategies or respond to competitive pressures.

Technological changes in the solar power industry could render our products uncompetitive or obsolete, which could reduce our market share and cause our revenues and profit to decline.

The solar power market is characterized by evolving technology standards that require improved features, such as more efficient and higher power output, improved aesthetics and smaller size. This requires us to develop new solar module products and enhancements for existing solar module products to keep pace with evolving industry standards and changing customer requirements. Technologies developed by others may prove more advantageous than ours for the commercialization of solar module products and may render our technology obsolete. Our failure to further refine our technology and develop and introduce new solar module products could cause our products to become uncompetitive or obsolete, which could reduce our market share and cause our revenues to decline. We will need to invest significant financial resources in research and development to maintain our market position, keep pace with technological advances in the solar power industry and effectively compete in the future.

If our future innovations fail to enable us to maintain or improve our competitive position, we may lose market share. If we are unable to successfully design, develop and introduce or bring to market competitive new solar module products, or enhance our existing solar module products, we may not be able to compete successfully. Competing solar power technologies may result in lower manufacturing costs or higher product performance than those expected from our solar module products. In addition, if we are unable to manage product transitions, our business and results of operations would be negatively affected.

Our business depends substantially on the continuing efforts of our executive officers, and our business may be severely disrupted if we lose their services.

Our future success depends substantially on the continued services of our executive officers, especially Dr. Shawn Qu, our chairman, president and chief executive officer, Bencheng Li, general manager of CSI Luoyang, Gregory Spanoudakis, our vice president of international sales and marketing, Robert Patterson, our vice president of corporate and product development and general manager of Canadian operations, and Bing Zhu, our chief financial officer. If one or more of our executive officers are unable or unwilling to continue in their present positions, we may not be able to replace them readily, if at all. Therefore, our business may be severely disrupted, and we may incur additional expenses to recruit and retain new officers, in particular those with a significant mix of both international and China-based solar power industry experience as many of our current officers have. In addition, if any of our executives joins a competitor or forms a competing company, whether in violation of their agreements with us or otherwise, we may lose some of our customers.

We face risks associated with the marketing, distribution and sale of our solar module products internationally. If we are unable to effectively manage these risks, they could impair our ability to expand our business abroad.

In 2005 and 2006, we sold approximately 97.2% and 79.3%, respectively, of our products to customers located outside of China. The marketing, distribution and sale of our solar module products in the international markets expose us to a number of risks, including:

fluctuations in the currency exchange rates of the Euro, U.S. dollar and RMB;

difficulty in engaging and retaining distributors who are knowledgeable about and, can function effectively in, overseas markets;

increased costs associated with maintaining marketing efforts in various countries;

Table of Contents

difficulty and cost relating to compliance with the different commercial and legal requirements of the overseas markets in which we offer our products;

cultural, language and logistical barriers to working with customers in different countries; and

trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses, which could increase the prices of our products and make us less competitive in some countries.

Problems with product quality or product performance, including defects, in our products could damage our reputation, or result in a decrease in customers and revenue, unexpected expenses and loss of market share.

Our products may contain defects that are not detected until after they are shipped or are installed because we cannot test for all possible scenarios. These defects could cause us to incur significant costs, divert the attention of our personnel from product development efforts and significantly affect our customer relations and business reputation. If we deliver solar module products with errors or defects, or if there is a perception that our products contain errors or defects, our credibility and the market acceptance and sales of our solar module products could be harmed. In one instance in 2005 and another in 2006, customers raised concerns about the stated versus actual performance output of some of our solar modules. We determined that these concerns resulted from differences in calibration methodologies and we resolved the issue with these customers. However, the corrective actions and procedures that we took may turn out to be inadequate to prevent further incidents of the same problem or to protect against future errors or defects. In addition, some of our ingot, wafer and cell suppliers with whom we have toll manufacturing arrangements previously raised concerns about the quality and consistency of the silicon feedstock, in particular the reclaimable silicon that we recycle through our silicon reclamation program for re-use in the solar power industry, that we have provided to them for their ultimate conversion into solar cells. The use of reclaimed silicon in the solar power supply chain has an inherent risk as it is difficult to maintain the consistency and quality of reclaimed silicon at the same level as high-purity silicon. The successful use of reclaimed silicon requires extensive experience, know-how and additional quality control measures from both the provider of reclaimed silicon and the toll manufacturers. If we cannot successfully maintain the consistency and quality of the reclaimed silicon from our silicon reclamation program at an acceptable level, this may result in less efficient solar cells for our solar modules or in a lower conversion ratio of solar cells per ton of silicon feedstock that we provide, and may potentially delay and reduce our supply of solar cells. This may reduce or eliminate the cost advantages of recycling silicon through our silicon reclamation program. This could also cause problems with product quality or product performance, including defects in our products, and increase the cost of producing our products.

In addition, as we obtain the majority of the solar cells that we use in our products from third parties, either directly or through toll manufacturing arrangements, we have limited control over the quality of a substantial portion of the solar cells we incorporate into our solar modules. Unlike solar modules, which are subject to certain uniform international standards, solar cells generally do not have uniform international standards, and it is often difficult to determine whether solar module product defects are a result of the solar cells or other components or reasons. In addition, we only recently began to produce our solar cells and have limited data as to the effectiveness and track record of these solar cells as used in our solar module products. We also rely on third party suppliers for other components that we use in our products, such as glass, frame and backing for our solar modules, and electronic components for our specialty solar modules and products. Furthermore, the solar cells and other components that we purchase from third party suppliers are typically sold to us without any, or with only limited, warranty. The possibility of future product failures could cause us to incur substantial expense to repair or replace defective products. Furthermore, widespread product failures may damage our market reputation, reduce our market share and cause our revenues to decline.

Since we cannot test our products for the duration of our standard warranty periods, we may be subject to unexpected warranty expense.

Our standard solar modules are typically sold with a two-year guarantee for defects in materials and workmanship and a 10-year and 25-year warranty against declines of more than 10.0% and 20.0%, respectively, of the initial minimum power generation capacity at the time of delivery. Our specialty solar modules and products

Table of Contents

are typically sold with a one-year guarantee against defects in materials and workmanship and may, depending on the characteristics of the product, contain a limited warranty of up to ten years, against declines of the minimum power generation capacity specified at the time of delivery. We believe our warranty periods are consistent with industry practice. Due to the long warranty period, we bear the risk of extensive warranty claims long after we have shipped our products and recognized revenue. We began selling specialty solar modules and products in 2002 and only began selling standard solar modules in 2004. Any increase in the defect rate of our products would cause us to increase the amount of warranty reserves and have a corresponding negative impact on our operating results. Although we conduct quality testing and inspection of our solar module products, our solar module products have not been and cannot be tested in an environment simulating the up to 25-year warranty periods. As a result, we may be subject to unexpected warranty expense and associated harm to our financial results as long as 25 years after the sale of our products.

Our future growth depends in part on our ability to make strategic acquisitions and investments and to establish and maintain strategic relationships, and our failure to do so could have a material adverse effect on our market penetration and revenue growth.

The solar power industry has only recently emerged as a high growth market and is currently experiencing shortages of its key component, high-purity silicon, due to rapid industry growth and demand. We believe it is critical that we continue to manage upstream silicon supply sources by, among other strategies, pursuing strategic acquisitions and investments in solar cell and silicon raw materials suppliers to secure a guaranteed supply and better control the specifications and quality of the materials delivered and fostering strategic relationships, particularly with silicon feedstock, solar wafer and solar cell suppliers. We cannot assure you, however, that we will be able to successfully make such strategic acquisitions and investments or establish strategic relationships with third parties that will prove to be effective for our business. Our inability in this regard could have a material adverse effect on our market penetration, our revenue growth and our profitability.

Strategic acquisitions, investments and relationships with third parties could subject us to a number of risks, including risks associated with sharing proprietary information and loss of control of operations that are material to our business. Moreover, strategic acquisitions, investments and relationships may be expensive to implement and subject us to the risk of non-performance by a counterparty, which may in turn lead to monetary losses that materially and adversely affect our business.

We may not succeed in developing a cost-effective solar cell manufacturing capability.

We plan to expand into areas further up the supply chain, including manufacturing solar cells to support our core solar module manufacturing business. We completed our first solar cell production line in the first quarter of 2007. We target to install a second solar cell production line before the end of the second quarter of 2007 and the third and fourth lines by the end of 2007. We expect the annual solar cell production capacity from these production lines to reach 100 MW by the end of 2007. However, we only have limited and recent operating experience in this area and we will face significant challenges in the solar cell business. Manufacturing solar cells is a highly complex process and we may not be able to produce solar cells of sufficient quality to meet our solar module manufacturing standards. Minor deviations in the manufacturing process can cause substantial decreases in yield and in some cases cause production to be suspended or yield no output. We will need to make capital expenditures to purchase manufacturing equipment for solar cell production and will also need to make significant investments in research and development to keep pace with technological advances in solar power technology. The technologies, designs and customer preferences for solar cells change more rapidly, and solar cell product life cycles are shorter than those for solar modules. We may not be able to successfully address these new challenges. We will also face increased costs to comply with environmental laws and regulations. Any failure to successfully develop a cost-effective solar cell manufacturing capability may have a material adverse effect on our business and prospects.

In addition, although we intend to continue direct purchasing of solar cells and our toll manufacturing arrangements, if we engage in the large scale production of solar cells it may disrupt our existing relationships with solar cell suppliers. If solar cell suppliers discontinue or reduce the supply of solar cells to us, either through direct sales or through toll manufacturing arrangements, and we are not able to compensate for the loss or reduction with

Table of Contents

our own manufacturing of solar cells, our business and results of operations may be materially and adversely affected.

We may fail to successfully bring to market our new specialty solar modules and products, which may prevent us from achieving increased sales, margins and market share.

We expect to continue to derive part of our revenues from sales of our new specialty solar modules and products and will increase our research and development expenses in connection with developing these products. If we fail to successfully develop our new specialty solar modules and products, we will likely be unable to recover the expenses that we will incur to develop these products and may be unable to increase our sales and market share and to increase our margins. Many of our new specialty solar modules and products have yet to receive market acceptance, and it is difficult to predict whether we will be successful in completing their development or whether they will be commercially successful. We may also need to develop new manufacturing processes that have yet to be tested and which may result in lower production output.

Our failure to protect our intellectual property rights in connection with new specialty solar modules and products may undermine our competitive position.

As we develop and bring to market new specialty solar modules and products, we may need to increase our expenses to protect our intellectual property and our failure to protect our intellectual property rights may undermine our competitive position. We currently use contractual arrangements with employees and trade secret protections to protect our intellectual property. Nevertheless, these afford only limited protection and the actions we take to protect our intellectual property rights as we develop new specialty solar modules and products may not be adequate. We currently only have one patent and two patent applications pending in China for products that make up a relatively small percentage of our net revenues and one trademark application pending in China. Policing unauthorized use of proprietary technology can be difficult and expensive. Also, litigation, which can be costly and divert management attention, may be necessary to enforce our intellectual property rights, protect our trade secrets or determine the validity and scope of the proprietary rights of others.

We may be exposed to infringement, misappropriation or other claims by third parties, which, if determined adversely to us, could cause us to pay significant damage awards.

Our success depends on our ability to use and develop our technology and know-how and sell our solar module products without infringing the intellectual property or other rights of third parties. We do not have, and have not applied for, any patents for our proprietary technologies outside China, although we have sold, and expect to continue to sell, a substantial portion of our products outside China. The validity and scope of claims relating to solar power technology patents involve complex scientific, legal and factual questions and analysis and, therefore, may be highly uncertain. We may be subject to litigation involving claims of patent infringement or violation of intellectual property rights of third parties. In addition, we have not yet registered our trade name, CSI, outside of China, and our trademark application in China is still pending. As a result, we could be subject to trademark disputes and may not be able to police the unauthorized use of our trade name. The defense and prosecution of intellectual property suits, patent opposition proceedings and related legal and administrative proceedings can be both costly and time consuming and may significantly divert the efforts and resources of our technical and management personnel. An adverse determination in any such litigation or proceedings to which we may become a party could subject us to significant liability to third parties, require us to seek licenses from third parties, to pay ongoing royalties, or to redesign our products or subject us to injunctions prohibiting the manufacture and sale of our products or the use of our technologies. Protracted litigation could also result in our customers or potential customers deferring or limiting their purchase or use of our products until resolution of such litigation.

In addition, our competitors and other third parties may initiate legal proceedings against us or our employees that may strain our resources, divert our management attention and damage our reputation. For example, in March 2002, ICP Global Technologies Inc., or ICP Global, a manufacturer of solar power products, filed an action in the Superior Court of the Province of Quebec, Canada (Action No. 500-05 071241-028) against our vice president of international sales and marketing, Gregory Spanoudakis, and ATS Automation Tooling Systems Inc., or ATS. ICP Global subsequently amended the complaint to include us, our subsidiary, CSI Solartronics, and our chairman and

Table of Contents

chief executive officer, Dr. Shawn Qu, as defendants. The amended complaint contends that all of the defendants jointly engaged in unlawful conduct and unfair competition in directing a business opportunity away from ICP Global to us. Although there have been no meaningful discovery, court filings or communications from the plaintiff on this matter since early 2004, we cannot assure you that ICP Global will not move forward with this case or that the litigation will not be determined adversely to us. See Item 8 Financial Information Legal and Administrative Proceedings for more details. We also cannot assure you that similar proceedings will not occur in the future.

If we are unable to attract, train and retain technical personnel, our business may be materially and adversely affected.

Our future success depends, to a significant extent, on our ability to attract, train and retain technical personnel. Recruiting and retaining capable personnel, particularly those with expertise in the solar power industry, are vital to our success. There is substantial competition for qualified technical personnel, and there can be no assurance that we will be able to attract or retain our technical personnel. If we are unable to attract and retain qualified employees, our business may be materially and adversely affected.

Fluctuations in exchange rates could adversely affect our business.

Historically, a major portion of our sales were denominated in Euros, with the remainder in Renminbi and U.S. dollars. Since June 2005, a substantial portion of our sales contracts have been denominated in U.S. dollars. The major portion of our costs and expenses is denominated in U.S. dollars and Renminbi. Our Renminbi costs and expenses primarily related to domestic sourcing of solar cells, wafers, silicon and other raw materials, toll manufacturing fees, labor costs and local overhead expenses. From time to time, we also have loan arrangements with Chinese commercial banks that are denominated in Renminbi. Therefore, fluctuations in currency exchange rates could have a material adverse effect on our financial condition and results of operations. Fluctuations in exchange rates, particularly among the U.S. dollar, Renminbi and Euro, affect our gross and net profit margins and could result in fluctuations in foreign exchange and operating gains and losses. We cannot predict the impact of future exchange rate fluctuations on our results of operations and we may incur net foreign currency losses in the future.

Product liability claims against us could result in adverse publicity and potentially significant monetary damages.

As with other solar module product manufacturers, we are exposed to risks associated with product liability claims if the use of our solar module products results in injury. Since our products generate electricity, it is possible that users could be injured or killed by our products as a result of product malfunctions, defects, improper installation or other causes. We only shipped our first products in March 2002 and, because of our limited operating history, we cannot predict whether product liability claims will be brought against us in the future or the effect of any resulting negative publicity on our business. Although we carry limited product liability insurance, we may not have adequate resources to satisfy a judgment if a successful claim is brought against us. The successful assertion of product liability claims against us could result in potentially significant monetary damages and require us to make significant payments. Even if the product liability claims against us are determined in our favor, we may suffer significant damage to our reputation.

Our quarterly operating results may fluctuate from period to period in the future.

Our quarterly operating results may fluctuate from period to period based on the seasonality of consumer spending and industry demand for solar power products. In addition, purchases of solar products tend to decrease during the winter months in our key markets, such as Germany, due to adverse weather conditions that can complicate the installation of solar power systems. As a result, you may not be able to rely on period to period comparisons of our operating results as an indication of our future performance. See Item 5. Operating and Financial Review and

Prospects A. Operating Results Overview for factors that are likely to cause our operating results to fluctuate.

Table of Contents

Our founder, Dr. Shawn Qu, has a substantial influence over our company and his interests may not be aligned with the interests of our other shareholders.

As of April 15, 2007, Dr. Shawn Qu, our founder, chairman and chief executive officer, beneficially owned 49.8% of our outstanding share capital comprised of 27,436,595 common shares, excluding restricted shares granted but yet to be vested and subject to restrictions on voting and dividend rights and transferability. As such, Dr. Qu has substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our common shares. These actions may be taken even if they are opposed by our other shareholders.

Compliance with environmental regulations can be expensive, and noncompliance with these regulations may result in adverse publicity and potentially significant monetary damages, fines and suspensions of our business operations.

We are required to comply with all national and local regulations regarding protection of the environment. We believe that our manufacturing processes do not generate any material levels of noise, waste water, gaseous wastes and other industrial wastes and that we are in compliance with present environmental protection requirements and have all necessary environmental permits to conduct our business as it is presently conducted. However, if more stringent regulations are adopted in the future, the costs of compliance with these new regulations could be substantial. For example, we increased our expenditures to comply with the European Union s Restriction of Hazardous Substances Directive, which took effect in July 2006, by reducing the amount of lead and other restricted substances used in our solar module products. Furthermore, we may need to comply with the European Union s Waste Electrical and Electronic Equipment Directive if we begin to sell specialty solar modules and products to customers located in Europe or if our customers located in other markets demand that our products be compliant. In addition, as we expand our silicon reclamation program and research and development activities and continue to expand into solar cell manufacturing, we are generating material levels of noise, waste water, gaseous wastes and other industrial wastes in the course of our business operation.

If we fail to comply with present or future environmental regulations, we may be required to pay substantial fines, suspend production or cease operations. For instance, the Chinese Customs have recently increased their scrutiny on the import of scrap silicon over a concern that the recycling process for certain types of scrap silicon may cause environmental damage if not performed in a fully licensed factory and have subjected certain importations of recyclable silicon by some China-based companies, including us. See If we are unable to secure an adequate and cost effective supply of solar cells or reclaimable silicon, our revenue, margins and profits could be adversely affected. Any failure by us to control the use of, or to restrict adequately the discharge of, hazardous substances could subject us to potentially significant monetary damages and fines or suspensions of our business operations.

We may not be successful in establishing our brand names among all consumers in important markets and the products we sell under our brand name may compete with the products we manufacture on an OEM basis for our customers.

We sell our products primarily under our own brand name and also on an OEM basis for our customers. In certain markets our brand may not be as prominent as other more established solar power vendors, and there can be no assurance that the CSI brand name or any of our potential future brand names, will gain acceptance among customers. Moreover, because the range of products we sell under our own brands and those we manufacture for our customers may be substantially similar, there can be no assurance that, currently or in the future, there will not be direct or

indirect competition between products sold under the CSI brand, or any of our other potential future brands, and products that we manufacture on an OEM basis. This could negatively affect our relationship with these customers.

Table of Contents

If we grant employee share options, restricted shares or other share-based compensation in the future, our net income could be adversely affected.

We adopted a share incentive plan in 2006. As of the date of this annual report on Form 20-F, we have issued 1,380,488 share options and 566,190 restricted shares under our share incentive plan. In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 123R, Share-Based Payment. This statement, which became effective in our first quarter of 2006, will prescribe how we account for share-based compensation, and may have an adverse or negative impact on our results of operations or the price of our common shares. SFAS No. 123R requires us to recognize share-based compensation as compensation expense in the statement of operations based on the fair value of equity awards on the date of the grant, with the compensation expense recognized over the period in which the recipient is required to provide service in exchange for the equity award. This statement also requires us to adopt a fair value-based method for measuring the compensation expense related to share-based compensation. The additional expenses associated with share-based compensation may reduce the attractiveness of issuing share options or restricted shares under our share incentive plan. However, if we do not grant share options or restricted shares, or reduce the number of share options or restricted shares that we grant, we may not be able to attract and retain key personnel. If we grant more share options or restricted shares to attract and retain key personnel, the expenses associated with share-based compensation may adversely affect our net income.

There have been historical deficiencies with our internal controls and there remain areas of our internal and disclosure controls that require improvement. If we fail to maintain an effective system of internal controls, we may be unable to accurately report our financial results or prevent fraud, and investor confidence and the market price of our common shares may be adversely impacted.

We are subject to reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, adopted rules requiring every public company to include a management report on such company s internal controls over financial reporting in the company s annual report, which contains management s assessment of the effectiveness of the company s internal controls over financial reporting. In addition, an independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of the company s internal controls over financial reporting. These requirements will first apply to our annual report on Form 20-F for the fiscal year ending on December 31, 2007. Our management may conclude that our internal controls over our financial reporting are not effective. Moreover, even if our management concludes that our internal controls over financial reporting is effective, our independent registered public accounting firm may still decline to attest to our management s assessment or may issue a report that is qualified if it is not satisfied with our internal controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us. Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems in the foreseeable future.

Prior to our initial public offering, we were a private company of limited operating history with limited accounting and other resources with which to adequately address our internal controls and procedures. As a result, in our past audits, our auditors had identified material weaknesses and deficiencies with our internal controls. In our audit for the fiscal year ended December 31, 2006, our auditors observed a number of weaknesses and deficiencies with respect to our internal controls under the standards established by the Public Company Accounting Oversight Board. The material weaknesses identified by our independent registered public accounting firm include (i) insufficient accounting resources to properly identify adjustments, analyze transactions and prepare financial statements in accordance with U.S. GAAP, and (ii) a lack of formal accounting policies and procedures for U.S. GAAP to ensure that our accounting policies and procedures are appropriately or consistently applied. Following the identification of

these material weaknesses and other deficiencies, we have undertaken remedial steps and plan to continue to take additional remedial steps to improve our internal and disclosure controls, including hiring additional staff, training our new and existing staff and installing new enterprise resource planning, or ERP systems, in order to build up a unified and integrated database of our company. In addition, since the beginning of 2007, we have engaged an advisory firm to advise us about complying with requirements of the Sarbanes-Oxley Act of 2002, or SOX, and have hired an individual experienced in handling compliance with the requirements of SOX.

Table of Contents

However, if we are unable to implement solutions to deficiencies in our existing internal and disclosure controls and procedures, or if we fail to maintain an effective system of internal and disclosure controls in the future, we may be unable to accurately report our financial results or prevent fraud and as a result, investor confidence and the market price of our common shares may be adversely impacted. Furthermore, we anticipate that we will incur considerable costs and devote significant management time and efforts and other resources to comply with Section 404 of the Sarbanes Oxley Act of 2002.

Risks Related to Doing Business in China

Uncertainties with respect to the Chinese legal system could have a material adverse effect on us.

We conduct substantially all of our manufacturing operations through our subsidiaries in China. These subsidiaries are generally subject to laws and regulations applicable to foreign investment in China and, in particular, laws applicable to wholly foreign-owned enterprises. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, since these laws and regulations are relatively new and the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

Fluctuation in the value of the Renminbi may have a material adverse effect on your investment.

The change in value of the Renminbi against the U.S. dollar, Euro and other currencies is affected by, among other things, changes in China s political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an approximately 5.7% appreciation of Renminbi against the U.S. dollar between July 21, 2005 and December 31, 2006. While the international reaction to the Renminbi revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. As a portion of our costs and expenses is denominated in Renminbi, the revaluation in July 2005 and potential future revaluation has and could further increase our costs in U.S. dollar terms. In addition, as we rely entirely on dividends paid to us by our operating subsidiaries in China, any significant revaluation of the Renminbi may have a material adverse effect on our revenues and financial condition, and the value of, and any dividends payable on, our common shares. For example, to the extent that we need to convert U.S. dollars into Renminbi for our operations, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we receive from the conversion. Conversely, if we decide to convert our Renminbi into U.S. dollars for the purpose of making payments for dividends on our common shares or for other business purposes, appreciation of the U.S. dollar against the Renminbi would have a negative effect on the U.S. dollar amount available to us.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

Certain portions of our revenue and expenses are denominated in Renminbi. If our revenues denominated in Renminbi increase or expenses denominated in Renminbi decrease in the future, we may need to convert a portion of our revenues into other currencies to meet our foreign currency obligations, including, among others, payment of dividends declared, if any, in respect of our common shares. Under China s existing foreign exchange regulations, our PRC subsidiaries are able to pay dividends in foreign currencies, without prior approval from the State Administration of Foreign Exchange, or SAFE, by complying with certain procedural requirements. However, we cannot assure you

that the PRC government will not take further measures in the future to restrict access to foreign currencies for current account transactions.

Foreign exchange transactions by our PRC subsidiaries under most capital accounts continue to be subject to significant foreign exchange controls and require the approval of PRC governmental authorities. In particular, if we

Table of Contents

finance our PRC subsidiaries by means of additional capital contributions, these capital contributions must be approved by certain government authorities including the Ministry of Commerce or its local counterparts. These limitations could affect the ability of our PRC subsidiaries to obtain foreign exchange through equity financing.

Our business benefits from certain PRC government incentives. Expiration of, or changes to, these incentives could have a material adverse effect on our operating results.

Under current PRC laws and regulations, a foreign invested enterprise, or FIE, in China is typically subject to enterprise income tax, or EIT, at the rate of 30% on taxable income, and local income tax at the rate of 3% on taxable income. The PRC government has provided various incentives to FIEs, such as each of our PRC subsidiaries, to encourage the development of foreign investments. Such incentives include reduced tax rates and other measures. FIEs that are determined by PRC tax authorities to be manufacturing companies with authorized terms of operation more than ten years, are eligible for: (i) a two-year exemption from EIT from their first profitable year; and (ii) a reduced EIT of 50% for the succeeding three years. CSI Solartronics is entitled to a preferential EIT rate of 24%, as it is a manufacturing enterprise located in a coastal economic development zone in Changshu. CSI Solartronic s first profitable year was 2002 and it is currently paying an EIT rate of 12% until the end of 2006. CSI Solar Manufacturing is entitled to a preferential EIT rate of 15%. CSI Solar Manufacturing s first profitable year was 2005 and it was exempt from EIT until 2006. It is now subject to an EIT rate of 7.5% until 2009. CSI Solar Technologies, CSI Luoyang, CSI Cells and CSI Advanced have not made a profit and have therefore not applied for preferential tax treatment. If these subsidiaries turn profitable, they will apply for preferential tax rates and tax holidays. However, with the new PRC EIT law becoming effective on January 1, 2008, a foreign-invested enterprise which has yet to enjoy preferential treatment due to lack of profitability, commencement of the preferential five-year tax holiday will coincide with the year the new EIT law comes into effect, i.e. January 1, 2008. As these tax benefits expire, the effective tax rate of our PRC subsidiaries may increase significantly, and any increase of their EIT rates in the future could have a material adverse effect on our financial condition and results of operations.

In addition, the National People s Congress, the Chinese legislature, recently passed a new enterprise income tax law, which is scheduled to take effect on January 1, 2008. The new law applies a uniform 25% enterprise income tax rate to both foreign invested enterprises and domestic enterprises. An enterprise registered under the laws of a jurisdiction outside China may be deemed a Chinese tax resident if its place of effective management is in China and it will consequently be subject to the EIT upon its worldwide income. Existing companies are required to transition to the new EIT rate over a five year period starting January 1, 2008. The new Enterprise Income Tax Law empowers the PRC State Council to promulgate detailed implementation rules. Since the implementation rules are not yet promulgated, there is uncertainty as to how the new law will be interpreted or implemented. Although we are carefully monitoring these legal developments and will timely adjust our effective income tax rate when necessary, we cannot assure you that the new Enterprise Income Tax Law will not cause increases in the EIT rates applicable to our PRC subsidiaries, which could have a material adverse effect on our financial condition and results of operations.

There may be some uncertainty surrounding a recently adopted PRC regulation that requires certain offshore listings to be approved by the China Securities Regulatory Commission.

On August 8, 2006, six PRC regulatory agencies, including the China Securities Regulatory Commission, or CSRC, promulgated a regulation that took effect on September 8, 2006. This regulation, among other things, requires offshore special purpose vehicles, or SPVs, formed for listing purposes through acquisitions of PRC domestic companies and controlled by Chinese domestic companies or PRC individuals to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange. On September 21, 2006, the CSRC published on its official website a notice specifying the documents and materials that are required to be submitted for obtaining CSRC approval. We believe, based on the advice of our PRC counsel, that this regulation does not apply to us and that CSRC approval is not required because we are not an SPV covered by the new regulation as we are owned and controlled by

non-PRC individuals and entities, and all our PRC subsidiaries are foreign-funded and have been incorporated through our direct investment instead of acquisition. However, since the regulation has been adopted only for a few months, there may be some uncertainty as to how this regulation will be interpreted or implemented. If the CSRC or other PRC regulatory body subsequently determines that we needed to obtain the

Table of Contents

CSRC s approval for our initial public offering in November 2006, we may face sanctions by the CSRC or other PRC regulatory agencies. In such event, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our operating privileges in the PRC, or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our common shares. In the future, we may grow our business in part by directly acquiring complementary businesses. Complying with the requirements of the new regulations and any other PRC laws to complete such transactions could be time consuming, and any required approval processes, including obtaining approval from the PRC regulatory agencies, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

We face risks related to health epidemics and other outbreaks.

Our business could be adversely affected by the effects of avian flu or another epidemic or outbreak. From 2005 to 2007, there have been reports on the occurrences of avian flu in various parts of China, including a few confirmed human cases and deaths. Any prolonged recurrence of avian flu or other adverse public health developments in China may have a material adverse effect on our business operations. These could include our ability to travel or ship our products outside of China, as well as temporary closure of our manufacturing facilities. Such closures or travel or shipment restrictions would severely disrupt our business operations and adversely affect our results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of avian flu or any other epidemic.

Risks Related to Our Common Shares

The market price for our common shares may be volatile.

The market price for our common shares has been and may continue to be highly volatile and subject to wide fluctuations during the period from November 9, 2006, the first day on which our common shares were listed on the Nasdaq, until May 25, 2007, the trading prices of our common shares ranged from $8.72 to $16.73 per share and the closing sale price on May 25, 2007 was $9.04 per share. The market price for our common shares may continue to be volatile and subject to wide fluctuations in response to factors including the following:

announcements of technological or competitive developments;

regulatory developments in our target markets affecting us, our customers or our competitors;

actual or anticipated fluctuations in our quarterly operating results;

changes in financial estimates by securities research analysts;

changes in the economic performance or market valuations of other solar power companies;

addition or departure of our executive officers and key research personnel;

announcements regarding patent litigation or the issuance of patents to us or our competitors;

fluctuations in the exchange rates between the U.S. dollar, the Euro and RMB;

release or expiry of lock-up or other transfer restrictions on our outstanding common shares; and

sales or perceived sales of additional common shares.

In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also have a material adverse effect on the market price of our common shares.

Substantial future sales or perceived sales of our common shares in the public market could cause the price of our common shares to decline.

Sales of our common shares in the public market, or the perception that these sales could occur, could cause the market price of our common shares to decline. As of April 15, 2007, we had 27,436,595 common shares

Table of Contents

outstanding, excluding restricted shares granted but yet to be vested and subject to restrictions on voting and dividend rights and transferability. Additional common shares outstanding will be available for sale, upon the expiration of the 180-day lock-up period beginning from November 8, 2006, the date of the effectiveness of the registration statement in connection with our initial public offering. Per the terms of the lock-up agreement, the lock-up period has been extended until June 1, 2007, which is 18 days from the date of our first quarter 2007 preliminary earnings release, which we made on May 14, 2007. In addition, the common shares outstanding will increase and be available for sale when certain option holders receive our common shares if they exercise their share options upon vesting, subject to volume, holding period and other restrictions as applicable under Rule 144 and Rule 701 under the Securities Act. Any or all of these shares may be released prior to expiration of the lock-up period at the discretion of the joint lead underwriters in our initial public offering. To the extent shares are released before the expiration of the lock-up period and these shares are sold into the market, the market price of our common shares could decline.

Your right to participate in any future rights offerings may be limited, which may cause dilution to your holdings.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to you in the United States unless we register the rights and the securities to which the rights relate under the Securities Act or an exemption from the registration requirements is available. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

Our articles of continuance contain anti-takeover provisions that could adversely affect the rights of holders of our common shares.

We adopted an amendment to our articles of continuance that became effective immediately upon the closing of our initial public offering. We have included certain provisions in our amended articles of continuance that would limit the ability of others to acquire control of our company, and deprive our shareholders of the opportunity to sell their shares at a premium over the prevailing market price by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transactions.

We have included the following provisions in our amended articles of continuance that may have the effect of delaying or preventing a change of control of our company:

> Our board of directors has the authority, without approval by the shareholders, to issue an unlimited number of preferred shares in one or more series. Our board of directors may establish the number of shares to be included in each such series and may fix the designations, preferences, powers and other rights of the shares of a series of preferred shares.
>
> Our board of directors shall fix and may change the number of directors within the minimum and maximum number of directors provided for in our articles. Our board of directors may appoint one or more additional directors, who shall hold office for a term expiring no later than the close of the next annual meeting of shareholders, subject to the limitation that the total number of directors so appointed may not exceed one-third of the number of directors elected at the previous annual meeting of shareholders.

You may have difficulty enforcing judgments obtained against us.

We are a corporation organized under the laws of Canada and substantially all of our assets are located outside of the United States. Substantially all of our current operations are conducted in the PRC. In addition, most of our directors

and officers, are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. courts, judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, most of whom are not residents in the United States and the

Table of Contents

substantial majority of whose assets are located outside of the United States. In addition, we have been advised by our Canadian counsel that a monetary judgment of a U.S. court predicated solely upon the civil liability provisions of U.S. federal securities laws would likely be enforceable in Canada if the U.S. court in which the judgment was obtained had a basis for jurisdiction in the matter that was recognized by a Canadian court for such purposes. We cannot assure you that this will be the case. It is unlikely that an action could be brought in Canada in the first instance for civil liability under U.S. federal securities laws. There is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state. In addition, it is uncertain whether such PRC courts would be competent to hear original actions brought in the PRC against us or such persons predicated upon the securities laws of the United States or any state.

We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. holders of our common shares.

Based on the price of our common shares and the composition of our income and assets and our operations, we believe we were not a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our taxable year ended December 31, 2006. However, we must make a separate determination each year as to whether we are a PFIC (after the close of each taxable year). Accordingly, we cannot assure you that we will not be a PFIC for our current taxable year ending December 31, 2007 or any future taxable year. A non-U.S. corporation will be considered a PFIC for any taxable year if either (1) at least 75% of its gross income is passive income or (2) at least 50% of the value of its assets is attributable to assets that produce or are held for the production of passive income. The market value of our assets is generally determined by reference to the market price of our common shares, which may fluctuate considerably. If we were treated as a PFIC for any taxable year during which a U.S. person held a common share, certain adverse U.S. federal income tax consequences could apply to such U.S. person. See Item 10. Additional Information E. Taxation United States Federal Taxation Passive Foreign Investment Company.

We incur increased costs as a result of being a public company.

As a public company, we incur a significantly higher level of legal, accounting and other expenses than we did as a private company. In addition, the Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the Securities and Exchange Commission, or the SEC, and the Nasdaq, have required changes in corporate governance practices of public companies. We expect these new rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. We are currently evaluating and monitoring developments with respect to these new rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

ITEM 4. *Information on the Company*

A. History and Development of the Company

We were incorporated pursuant to the laws of the Province of Ontario in October 2001. We changed our jurisdiction by continuing under the Canadian federal corporate statute, the Canada Business Corporations Act, or CBCA, effective June 1, 2006. As a result, we are governed by the CBCA.

In November 2001, we established CSI Solartronics (Changshu) Co., Ltd., or CSI Solartronics, which is our wholly owned subsidiary located in Changshu, China. Through CSI Solartronics, we focus primarily on the production of specialty solar modules and products. In addition to CSI Solartronics, we also currently have five other wholly owned subsidiaries: (i) CSI Solar Manufacture Inc., or CSI Solar Manufacturing, located in Suzhou, China, which we incorporated in January 2005, through which we focus primarily on the production of standard solar modules; (ii) CSI

Solar Technologies Inc., or CSI Solar Technologies, also located in Suzhou, China, which we incorporated in August 2003, through which we focus on solar module product development; (iii) CSI Central Solar Power Co., Ltd., or CSI Luoyang, in Luoyang, China, which we incorporated in February 2006, through which we intend to manufacture solar module products; (iv) CSI Cells Co., Ltd, or CSI Cells, formerly known as CSI Solarschip International Co., Ltd., which we incorporated in June 2006 and completed the first cell production

Table of Contents

line in the first quarter of 2007, through which we manufacture solar cells; and (v) Changshu CSI Advanced Solar Inc., or CSI Advanced, which was incorporated in August 2006 and through which we intend to manufacture solar modules. We have injected full amounts of registered capital into all the above subsidiaries after our initial public offering in November 2006. CSI Luoyang and CSI Advanced have not begun manufacturing operations and are currently in the construction and preparatory phase. In May 2007, we set up a representative office in Phoenix, Arizona, to enhance our sales and marketing efforts in the U.S. market. See C. Organizational Structure.

Our principal executive offices are located at Xin Zhuang Industry Park, Changshu, Suzhou, Jiangsu, 215562, People s Republic of China. Our telephone number at this address is (86-512) 6269-6010 and our fax number is (86-512) 5247-7589. Our registered address in Canada is The Exchange Tower, Suite 1600, P.O. Box 480, 130 King Street West, Toronto, Ontario MSX 1J5. Our mailing address in Canada is 675 Cochrane Drive, East Tower, 6th Floor, Markham, Ontario, L3R OB8. Our telephone number at this mailing address is (1-905) 530-2334 and our fax number is (1-905) 530-2001.

You should direct all inquiries to us at the address and telephone number of our principal executive offices set forth above. Our website is *www.csisolar.com.* The information contained on our website does not form part of this annual report on Form 20-F.

B. Business Overview

Overview

We design, manufacture and sell solar cell and module products that convert sunlight into electricity for a variety of uses. We are incorporated in Canada and conduct all of our manufacturing operations in China. Our products include a range of standard solar modules built to general specifications for use in a wide range of residential, commercial and industrial solar power generation systems. We also design and produce specialty solar modules and products based on our customers requirements. Specialty solar modules and products consist of customized modules that our customers incorporate into their own products, such as solar-powered bus stop lighting, and complete specialty products, such as solar-powered car battery chargers. Our products are sold primarily under our own brand name and also produced on an OEM basis for our customers. We also implement solar power development projects, primarily in conjunction with government organizations to provide solar power generation in rural areas of China.

We currently sell our products to customers located in various markets worldwide, including Germany, Spain, Canada and China. We currently sell our standard solar modules to distributors and system integrators. We sell our specialty solar modules and products directly to various manufacturers who either integrate these solar modules into their own products or sell and market them as part of their product portfolio.

We proactively manage our supply chain, which consists of silicon feedstock, ingots, wafers and solar cells, to secure a cost-effective supply of solar cells, the key component of our solar module products. We do this primarily by directly sourcing silicon feedstock, which consists of high-purity silicon and reclaimable silicon. Under toll manufacturing arrangements, we provide the silicon feedstock to manufacturers of ingots, wafers and cells, which in turn convert these silicon raw materials ultimately into the solar cells that we use for our production of solar modules. We believe we were one of the first solar module companies to process reclaimable silicon, which consists primarily of broken wafers and scrap silicon, for reuse in the solar power supply chain. Today, we believe we operate a large-scale and cost-efficient silicon reclamation program. We believe that the substantial industry and international experience of our management team has helped us foster strategic relationships with suppliers throughout the solar power industry value chain. We also take advantage of our flexible and low-cost manufacturing capability in China to lower our manufacturing and operating costs.

We have grown rapidly since March 2002, when we sold our first solar module products. Our net revenues increased from $9.7 million in 2004 to $68.2 million in 2006. We sold 2.2 MW, 4.1 MW and 14.9 MW of our solar module products in 2004, 2005 and 2006, respectively.

Table of Contents

Our Products

We currently design, develop, manufacture and sell solar cell and module products, which consist of standard solar modules and specialty solar modules and products.

Standard Solar Modules

Our standard solar modules are an array of interconnected solar cells encased in a weatherproof frame. We produce a wide variety of standard solar modules, currently ranging from 0.2 W to 300 W in power and using multi-crystalline and mono-crystalline solar cells. These products are built to general specifications for a wide range of residential, commercial and industrial solar power generation systems. Our standard solar modules are designed to be durable under harsh weather conditions and easy to transport and install. We primarily sell our standard solar modules under our own CSI brand and also on an OEM basis branded with our customers names.

Specialty Solar Modules and Products

We collaborate with our customers to design and manufacture specialty solar modules and products based on our customers specifications and requirements. Our specialty solar modules and products consist of:

customized solar modules; and

complete specialty products.

Our customized solar modules are solar modules that we design and manufacture for customers who incorporate our customized solar modules as a component of their own products. For example, we have manufactured a customized array of six solar modules assembled onto a curved canopy for a customer who incorporated it into its bus stop shelter products. We design and manufacture our complete specialty products, which combine our solar modules with various electronic components that we purchase from third party suppliers. Presently, this has consisted primarily of car battery chargers for a major automotive maker.

Our specialty solar modules and products have been used primarily in the automotive sector as well as the LED lighting sector. We focus on these and other industries, such as the telecommunications sectors, that have off-grid applications that can be powered by solar power. In the future, we intend to increasingly focus on the LED lighting industry. As LED technology advancements continue to create higher quality lighting with less power at increasingly economical prices, we believe that solar power will become a major power source in the LED lighting industry. In addition to specialty solar modules and products used in bus stop signs, our car battery chargers and LED lighting, we have also produced security sensors, signaling systems and mobile phone chargers in the past. We will continue to work closely with our customers to design and develop specialty solar modules and products that meet their specific requirements. We expect sales of these products, which typically have higher margins than our standard solar modules, to increase as we go forward.

Solar Cells

The first solar cell production line with an annual capacity of 25 MW was completed in the first quarter of 2007. We target to install a second solar cell production line before the end of the second quarter of 2007 and the third and fourth lines by the end of 2007. We expect the annual solar cell production capacity from these production lines to reach 100 MW by the end of 2007. Currently, we intend to use all of our solar cells in the manufacturing of our own solar module products.

Our solar cells are currently made on mono-crystalline silicon wafers, and we plan to make solar cells on multi-crystalline silicon wafers beginning in the third quarter of 2007, in our wafer fab through multiple manufacturing steps, including surface texturization, diffusion, plasma-enhanced chemical vapor deposition and surface metalization. A functional solar cell generates a flow of electricity when exposed to light. The metal on the cell surface collects and carries away the current to the external circuitry.

Table of Contents

Solar Power Development Projects

We also implement solar power development projects, primarily in conjunction with government organizations, to provide solar power generation in rural areas of China. In conjunction with the Canadian International Development Agency, or CIDA, we implemented a C$1.8 million Solar Electrification for Western China project between 2002 and June 2005. As part of this project, we installed many demonstration projects and conducted three solar power forums in Beijing, Xining and Suzhou.

To date, our solar power development projects have consisted of government-related assistance packages. Going forward, we will continue to secure and implement large-scale solar power development projects in conjunction with CIDA, the World Bank, the Asian Development Bank, provincial and city governments and other organizations, and we will explore more commercial transactions, which are becoming more prevalent.

Supply Chain Management

Our business depends on our ability to obtain solar wafers and cells. There is presently a shortage of solar wafers and cells as a result of a shortage of high-purity silicon due to the rapid growth of and demand for solar power. Beginning in early 2005, we began managing our supply chain to secure a reliable and cost-effective supply of solar cells. This has allowed us to partially mitigate the effects of the industry-wide shortage of high-purity silicon, while reducing margin pressure. We secure our supply of solar wafers and cells primarily through our sourcing of silicon raw materials and toll manufacturing arrangements with suppliers of ingots, wafers and cells and through the direct purchase of cells, in addition to producing our own solar cells, which we recently began to produce. We minimize costs and reduce margin pressure primarily through our silicon reclamation program.

The following chart illustrates our management of the solar power supply chain:

Silicon Raw Materials

Silicon feedstock, which consists of high-purity silicon and reclaimable silicon, is the building block of the entire solar power supply chain.

We have entered into a five-year supply agreement with Luoyang Poly in China from 2006 to 2010. This agreement provides us specified minimum levels of high-purity silicon. We have entered into a 10-year strategic partnership agreement with Kunical International from 2006 to 2015 to supply us reclaimable silicon and other silicon raw materials. We also have a four-year agreement with LDK from 2007 to 2010 for specified quantities of solar wafers and a toll manufacturing arrangement to convert our reclaimed silicon feedstock into wafers. In January

Table of Contents

2007, we entered into a twelve-year supply agreement with Deutsche Solar, a subsidiary of SolarWorld AG of Germany for supply of multi-crystalline silicon wafers. We have also concluded a number of other annual silicon wafer and solar cell supply agreements.

We believe these silicon raw materials agreements will, through toll manufacturing arrangements, enable us to secure solar wafers and cells sufficient for a major portion of our estimated 2007 production output. In anticipation of increased demand for solar power products, we are currently in discussions with other China-based suppliers to secure additional silicon feedstock supply. We incorporated CSI Luoyang in 2006 to give us more direct access to major silicon feedstock suppliers located in Luoyang.

Silicon Reclamation Program

We believe that we were one of the first solar cell and module companies to process reclaimable silicon to ultimately produce solar wafers and cells. We recycle the reclaimable silicon that we source and process it through our reclaiming facilities for reuse in the solar supply chain. Our processes recycle silicon from pot scraps, broken or unused silicon wafers, and the top and tail discarded portions of silicon ingots. Our factory in Changshu includes reclamation workshops where our employees sort the reclaimable silicon into reprocessing categories. We believe that our access to relatively inexpensive labor in China for this process that involves a substantial amount of labor gives us a significant competitive advantage compared to international solar module manufacturers.

Toll Manufacturing Arrangements

We primarily engage in toll manufacturing arrangements to source silicon wafers and solar cells. Manufacturers of ingots, wafers and cells are facing over-capacity due to shortages of high-purity silicon and are looking for ways to obtain silicon feedstock. Through our toll manufacturing arrangements, we provide the silicon feedstock in return for ingots, wafers and cells.

Solar Wafers. We currently purchase solar wafers through these toll manufacturing arrangements from international and local suppliers, including LDK in China and Green Energy Technology Inc.

Solar Cells. We currently purchase solar cells from over five international and local suppliers, including Del Solar Co., Ltd., Motech Industries Inc. and Neo Solar S.L.L.

Direct Solar Cell Purchasing and Expansion into Solar Cell Manufacturing

In 2006, in addition to toll manufacturing arrangements that we have with our solar cell suppliers, we directly purchased solar cells from some of the above-listed solar cell suppliers and Q-Cells AG, China Electric and Equipment Group and Sharp Solar.

We intend to continue our toll manufacturing arrangements and direct purchase for our supply of solar cells. As we grow our business, we will seek to diversify our cell supply channel mix to ensure flexibility in adapting to future changes in the supply of, and demand for, solar cells. We completed our first solar cell production line in the first quarter of 2007. We target to install a second solar cell production line before the end of the second quarter of 2007 and the third and fourth lines by the end of 2007. We expect the annual solar cell production capacity from these production lines to reach 100 MW by the end of 2007. We currently intend to use our solar cells products for use in our own solar module manufacturing. When installing the production lines, we apply stringent criteria in selecting our vendors, including the requirement that they demonstrate at least two successful implementations of the same equipment for well-known solar cell manufacturers in Asia.

Our solar cells are currently made on mono-crystalline silicon wafers, and we plan to make solar cells on multi-crystalline silicon wafers beginning in the third quarter of 2007, in our wafer fab through multiple manufacturing steps, including surface texturization, diffusion, plasma-enhanced chemical vapor deposition and surface metalization.

Table of Contents

A typical solar cell manufacturing process is illustrated as follows:

Solar Module Manufacturing

We assemble our solar modules by interconnecting multiple solar cells through taping and stringing into a desired electrical configuration. The interconnected cells are laid out, laminated in a vacuum, cured by heating and then packaged in a protective light-weight anodized aluminum frame. Our solar modules are sealed and weatherproofed and are able to withstand high levels of ultraviolet radiation, moisture and extreme temperatures.

The diagram below illustrates our solar module manufacturing process:

(1) Laser cutting is only necessary for smaller-sized modules.

We work closely with our customers during the design and manufacture of our specialty solar modules and products. For our customized modules, we collaborate with the customer to make certain that our product is compatible for incorporation into that customer s product. For our complete specialty products, we work with the customer and typically provide sample products to the customer for testing before the product is manufactured on a larger scale.

We selectively use automation to enhance the quality and consistency of our finished products and to improve efficiency in our manufacturing processes. Key equipment in our manufacturing process includes automatic laminators, simulators and solar cell testers. The current design of our assembly lines gives us flexibility to adjust the ratio of manufacturing equipment to skilled labor for quality and efficiency control. We use manufacturing equipment purchased primarily from Chinese solar power equipment suppliers. The location of our manufacturing operations in China gives us the advantage of proximity to these Chinese manufacturers, who typically sell solar power manufacturing equipment at more competitive prices compared to similar machinery offered by international solar power equipment manufacturers. We source critical testing equipment from international manufacturers. The manufacturing of solar module products remains a labor intensive process, and we leverage China s competitive labor costs by using labor in our manufacturing process when it proves to be more efficient and cost-effective than using equipment.

Since we began selling our solar module products in March 2002, we have increased our annual production capacity from 2 MW to 50 MW as of December 2006. By June 2007, we expect our total production capacity to

Table of Contents

reach 120 MW through our three module manufacturing facilities in Changshu, Suzhou and Luoyang. The nature of our flexible manufacturing process allows us to increase capacity at low cost within a short period of time to ramp up production for increased demand for standard solar modules or for new solar module products as necessary. We may not, however, utilize our production facilities to their full capacity. Overall production output depends in part on the product mix and sizes of the solar modules produced by each laminator and is affected by the timing of customer orders and requested completion dates. Our production output is also constrained by the availability of solar cells and silicon raw materials and demand for our solar module products. Although there is a gap between our production capacity and production output, it is important for manufacturers of solar module products to maintain additional production capacity to handle surges in customer demand and quick changes in the product mix and timing of completion demanded by customers. Due to the relatively inexpensive cost of solar module manufacturing equipment, it is generally cost-efficient to maintain additional production capacity.

Our manufacturing facilities can be easily reset, allowing us to quickly ramp up production for increased orders or new solar module products as necessary. We currently operate our manufacturing lines in two factories in China and typically operate these lines 24 hours a day by rotating shifts of employees to operate the lines. We currently produce a higher volume of standard solar modules in our factory located in Suzhou and manufacture most of our specialty solar modules and products, which tend to be lower volume, at our Changshu facilities. We expect our new solar module manufacturing facility through CSI Luoyang to commence commercial production in May 2007. Our employees are trained to work on different types of solar module products. This gives us the flexibility to quickly increase our manufacturing capacity and lines with additional employees in order to meet increases in demand.

Quality Control and Certifications

Our quality control was set up according to the quality system requirements of ISO 9001:2000 and ISO:TS 16949 standards. The latter originated from QS 9000 and VDA quality systems and is now the world-wide quality system standard for the automotive industry. Our quality systems are reviewed and certified by TUV Rheinland Group, a leading international service company that documents the safety and quality of products, systems and services. Our quality control focuses on incoming inspection through which we ensure the quality of the components and raw materials that we source from third parties and includes the use of simulators and solar cell testers. We focus on in-process quality control by examining our manufacturing processes and on output quality control by inspecting finished products and conducting reliability and other tests.

We have obtained IEC 61215 and TUV Class II safety European standards for sales in Europe. We have also obtained certifications of CAN ORD-UL 1703 and UL 1703 in March 2007, which allow us to sell products in North America.

Markets and Customers

We currently sell our standard solar modules primarily to distributors and system integrators. Our distributor customers include companies that are exclusive solar power distributors and engineering and design firms that include our standard solar modules in their system installations. Our system integrator customers typically design and sell complete, integrated systems that include our standard solar modules along with other system components. We sell our specialty solar modules and products to various manufacturers who either integrate these products into their own products or sell and market them as part of their product portfolio. Our standard solar module customers include leading solar power distributors and system integrators such as ProSolar Energ Tetecnik GmbH, Bihler Maschinenfhbrik GmbH & Co. and Schüco International KG. Our specialty solar modules and products customers include automotive customers such as Audi, for whom we make car battery chargers, and various manufacturers, such as Carmanah Technologies, who incorporate our customized modules in their bus stop, road lighting and marine lighting products.

As we expand our manufacturing capacity and enhance our brand name, we anticipate developing additional customer relationships in other markets and geographic regions to decrease our market concentration and dependence. In 2006 and in the near future, we have aimed, and will continue to aim, to increase our sales to customers located in several markets such as Germany, Spain, China, the United States and Canada. These solar

Table of Contents

power markets have been significantly influenced by past and current government subsidies and incentives, or, in the case of Canada, by intended future government subsidies and incentives. While we expect to expand our markets, we expect that Germany will continue to remain our major market in the near future.

Germany. The renewable energy laws in Germany require electricity transmission grid operators to connect various renewable energy sources to their electricity transmission grids and to purchase all electricity generated by such sources at guaranteed feed-in tariffs. Additional regulatory support measures include investment cost subsidies, low-interest loans and tax relief to end users of renewable energy. Germany s renewable energy policy has had a strong solar power focus, which contributed to Germany surpassing Japan as the leading solar power market in terms of annual megawatt additions in 2004. According to Solarbuzz, Germany grew 16% to 968 MW, or 56% of the world s total solar power production in 2006. Germany s feed-in tariff remains one of the highest in the world. Our products are used for large-size ground mounted solar power field, commercial rooftop and residential rooftop installations. According to Solarbuzz, the feed-in tariffs for rooftop applications less than 30 KwH and between 30 KwH and 100 KwH was 51.8 and 49.28 (US$68.36 and $65.03) per KwH, respectively, in 2006. Our major customers located in Germany in 2006 are ProSolar, Schüco, Bihler, Iliotec and Maas.

Spain. In Spain, the incentive regime includes a national net metering program and favorable interest loans, and the actual feed-in tariff for solar power energy is fully guaranteed for 25 years and guaranteed at 80% subsequently. According to Solarbuzz, the feed-in tariff for applications less than 100 KwH was 0.44 (US$0.58) per KwH in 2006. Spain was our second largest market after Germany in 2006 and is expected to remain at such position in 2007. We sell products in Spain both under our own CSI brand name and as an OEM for a major Spanish solar company.

China. China passed the Renewable Energy Law in February 28, 2005, which went into effect on January 1, 2006. The Renewable Energy Law authorizes relevant authorities to set favorable prices for the purchase of on-grid solar power-generated electricity, and provides other financial incentives for the development of renewable energy projects. In January 2006, China s National Development and Reform Commission further promulgated two implementation rules of the Renewable Energy Law, and other implementation rules are expected in the future.

China finances its off-grid solar installations through the now completed township program and the current village program. The current five-year plan from 2006 to 2010 is targeted to provide electricity to 29,000 villages, mainly in Western China. The Ministry of Construction has recently promulgated directives encouraging the development and use of solar power energy in both urban and rural areas. Various local authorities have also introduced initiatives to encourage the adoption of renewable energy including solar power energy. Furthermore, in October 2005, the Shanghai municipal government endorsed the 100,000 M Project , the goal of which is to install solar energy heating systems onto 100,000 Mrooftops in Shanghai in the coming years.

We believe that we will be well-positioned to take advantage of growth opportunities in the Chinese solar power energy market, which is potentially one of the fastest growing markets for solar power.

United States. There are now six states that offer significant incentives, with California offering the most preferential incentives. In January 2006, the California Public Utilities Commission enacted the California Solar Initiative, a $2.9 billion program that will subsidize solar power systems by $2.80 per watt. Due to excessive demand, this subsidy has been reduced to the current $2.50 per watt. Combined with federal tax credits for solar power usage, the subsidy may account for as much as 50% of the cost of a solar power system. The program will last from 2007 to 2017 and is expected to dramatically increase the use of solar power for

on-grid applications in California. We have recently built up our U.S. sales team and set up a representative office in Phoenix, Arizona, to enhance our sales and marketing efforts in the U.S.

Canada. In March 2006, the province of Ontario, Canada s largest province, announced a solar power subsidy, by which a fixed price of C$0.42 per KwH is offered for solar power transferred to the electrical grid starting in the fall of 2006. The program will last 20 years and is expected to substantially increase the market for solar power in Ontario.

Table of Contents

Japan. According to Solarbuzz, the Ministry of Land, Infrastructure and Transport of Japan recorded that there was new construction initiated in 2006 for approximately 1.3 million residential units including solar power systems, a 4.4% increase from 2005 and the fourth consecutive year of increases. The Japanese government has implemented a series of incentive programs, including the Solar Power 2030 Roadmap designed to generate up to 100 GW of solar power electricity by 2030, as well as provide government subsidies for research and development. Solar power energy is becoming increasingly competitive and self-sustained in Japan. Historically, the Japanese solar power market has been relatively closed to non-Japanese solar power players. There have been signs, however, that this market is beginning to open up to international players.

Sales and Marketing

Standard Solar Modules

We market and sell our standard solar module products worldwide through a direct sales force. We have direct sales personnel or representatives that cover our markets in Europe, North America and Asia. Our marketing programs include conferences and technology seminars, sales training, trade show exhibitions, public relations and advertising. We sell our products primarily under two types of arrangements, supply contracts and OEM manufacturing arrangements.

Sales contracts. In early 2007, we entered into a number of annual sales and distribution agreements with most of our customers and deliver standard solar modules according to a pre-agreed monthly schedule. We also typically require full payment of the contract price by letters of credit or telex money transfers prior to shipping. We also occasionally use credit term sales to creditworthy customers and may increase these sales when expanding our U.S. market.

OEM manufacturing arrangements. From time to time, to address solar cell shortage issues, we enter into OEM arrangements with our customers.

Under these arrangements, we purchase or obtain on a consignment basis silicon cells from the customer and then sell solar module products back to the customer who sell these products under their own brands. In addition, we have recently began using our own solar cells in certain services we provide to a limited number of strategic partners with the finished solar module products branded with their labels.

Specialty Solar Modules and Products

In addition to the above efforts, we target our sales and marketing efforts of our specialty solar modules and products at companies in selected industry sectors, including the automotive, telecommunications and LED lighting sectors. As standard solar modules increasingly become commoditized and technology advancements allow for greater usage of solar power in off-grid applications, we will continue to expand our sales and marketing focus on our specialty solar modules and products and capabilities. Our sales and marketing team works with our specialty solar modules and products development team to make certain that we take the changing customer preferences and demands into account in our product development and that our sales and marketing team is able to effectively communicate to customers our product development changes and innovations. To further enhance this communication we will enter into cooperative agreements with our customers to share solar power technical and management expertise in our respective areas of expertise. For example, we entered into a cooperative agreement with Carmanah Technologies in April 2006 to supply solar modules and add special value for some of Carmanah s lighting products. We intend to establish additional relationships in other market sectors as the specialty solar modules and products market expands.

Solar Power Development Projects

To date, our solar power development projects have consisted of government grants. Going forward, we will continue to secure and implement large-scale solar power development projects in conjunction with CIDA, the World Bank, the Asian Development Bank, and other government and non-governmental organizations. We will also explore more commercial solar power development projects, which are becoming more prevalent. We seek to

Table of Contents

participate in a mix of solar power development projects that provide us a continuous, steady source of revenue. These projects will also allow our personnel to further develop project management skills. In addition, we also provide solar power forums, demonstration projects and presentations as part of these solar power development projects, because we believe they generate significant goodwill and publicity for us.

Customer Support and Service

We provide customers with after-sales support, including product return and warranty services. Our standard solar modules are typically sold with a two-year guarantee for defects in materials and workmanship and a 10-year and 25-year warranty against declines of more than 10.0% and 20.0%, respectively, of the initial minimum power generation capacity at the time of delivery. Our specialty solar modules and products are typically sold with a one-year guarantee against defects in materials and workmanship and may, depending on the characteristics of the product, contain a limited warranty of up to ten years, against declines of the minimum power generation capacity specified at the time of delivery.

Competition

The market for solar module products is competitive and continually evolving. We compete with international companies such as BP Solar, Sharp Solar and SolarWorld and companies located in China such as Suntech Power Holdings Co., Ltd. While crystalline technology currently accounts for 94.0% of the solar power market, many of our competitors are also developing or currently producing products based on alternative solar technologies such as thin film photovoltaic materials that may ultimately have costs similar to, or lower than, our projected costs. For example, solar modules produced using thin film materials, such as amorphous silicon and cadmium telluride, are generally less efficient, with conversion efficiencies ranging from 5% to 10% according to Solarbuzz, but require significantly less silicon to produce than crystalline silicon solar modules, such as our products, and are less susceptible to increases in silicon costs. Some of our competitors have also become vertically integrated, from upstream silicon wafer manufacturing to solar system integration. We may also face competition from semiconductor manufacturers, several of which have already announced their intention to start production of solar modules. In addition, the solar power market in general competes with other sources of renewable and alternative energy and conventional power generation. We believe that the key competitive factors in the market for solar module products include:

- supply chain management;
- strength of supplier relationships;
- manufacturing efficiency;
- power efficiency and performance;
- price;
- customer relationships and distribution channels;
- brand name and reputation; and
- aesthetic appearance of solar module products.

In the immediate future, because of the growing demand for solar module products and the shortage of high-purity silicon, we believe that the ability to compete in our industry will continue to depend on the ability to effectively

manage the supply chain and form strategic relationships. Consolidation of the segments of the solar power supply chain is already occurring and is expected to continue in the near future. In the fourth quarter of 2006 and the first quarter of 2007, some smaller solar module producers cleared their inventory prior to their exits of the market and caused periodic price instability in the short time. We, however, believe consolidation of the industry will benefit our company in the long term. We believe that as the supply of high-purity silicon stabilizes, the key to competing successfully will shift to more traditional sales and marketing activities. We believe that the strong relationships that we are building now with both suppliers and customers will support us in that new competitive environment when the time arrives.

Table of Contents

Insurance

We maintain property insurance policies with reputable insurance companies for covering our equipment, facilities, buildings and their improvements, office furniture and inventory. These insurance policies cover losses due to fire, floods and other natural disasters. Insurance coverage for our property assets in China amounted to approximately $64.0 million as of December 31, 2006. We also maintain product liability insurance with an aggregate coverage amount of approximately C$10 million (US$8.7 million), which covers general commercial and product liability. We have increased the insurance coverage for our properties in China to approximately $107.1 million as of April 15, 2007 in light of our rapid business expansion. We have purchased key-man life insurance for our chairman and chief executive officer, Dr. Shawn Qu and four other senior executive officers. We do not maintain business interruption insurance or insurance relating to marine, air and inland transit risks for the export of our products. We consider our insurance coverage to be adequate. However, significant damage to any of our manufacturing facilities, whether as a result of fire or other causes, could have a material adverse effect on our results of operation. We paid an aggregate of approximately $355,000 in insurance premiums for 2006 coverage.

Environment Matters

We believe we have obtained all environmental permits necessary to conduct the business currently carried on by us at our existing manufacturing facilities. We are in the process of obtaining a final environmental assessment and permit according to government procedures for our newly established manufacturing facility for CSI Cells. We have conducted environmental studies in conjunction with our solar power development projects to assess and reduce the environmental impact of our facilities. We believe that our manufacturing processes do not generate any material levels of noise, waste water, gaseous wastes and other industrial wastes and believe that our manufacturing processes are environmentally friendly. We will also continue to devote efforts to ensure that our products comply with the European Union s Restriction of Hazardous Substances Directive, which takes effect in July 2006, by reducing the amount of lead and other restricted substances used in our solar module products. Our operations are subject to regulation and periodic monitoring by local environmental protection authorities. If we fail to comply with present or future environmental laws and regulations, we could be subject to fines, suspension of production or a cessation of operations.

The Chinese Customs have recently increased their scrutiny on the import of scrap silicon over a concern that the recycling process for certain types of scrap silicon may cause environmental damage if not performed in a fully licensed factory and have subjected certain importations of recyclable silicon by some China-based companies, including us. See Item 3D. Risk Factors If we are unable to secure an adequate and cost effective supply of solar cells or reclaimable silicon, our revenue, margins and profits could be adversely affected and Compliance with environmental regulations can be expensive and noncompliance with these regulations may result in adverse publicity and potentially significant monetary damages, fines and suspensions of our business operations.

Government regulation

This section sets forth a summary of the most significant regulations or requirements that affect our business activities in China or our shareholders right to receive dividends and other distributions from us.

Renewable Energy Law and Other Government Directives

In February 2005, China enacted its Renewable Energy Law, which became effective on January 1, 2006. The Renewable Energy Law sets forth policies to encourage the development and use of solar energy and other non-fossil energy. The renewable energy law sets forth the national policy to encourage and support the use of solar and other

renewable energy and the use of on-grid generation. It also authorizes the relevant pricing authorities to set favorable prices for the purchase of electricity generated by solar and other renewable power generation systems.

The law also sets forth the national policy to encourage the installation and use of solar energy water-heating system, solar energy heating and cooling system, solar photovoltaic system and other solar energy utilization systems. It also provides financial incentives, such as national funding, preferential loans and tax preferences for the development of renewable energy projects. In January 2006, China s National Development and Reform Commission promulgated two implementation directives of the Renewable Energy Law. These directives set forth

Table of Contents

specific measures in setting prices for electricity generated by solar and other renewal power generation systems and in sharing additional expenses occurred. The directives further allocate the administrative and supervisory authorities among different government agencies at the national and provincial levels and stipulate responsibilities of electricity grid companies and power generation companies with respect to the implementation of the renewable energy law.

China s Ministry of Construction also issued a directive in June 2005, which seeks to expand the use of solar energy in residential and commercial buildings and encourages the increased application of solar energy in different townships. In addition, China s State Council promulgated a directive in July 2005, which sets forth specific measures to conserve energy resources.

Environmental Regulations

We believe that our manufacturing processes do not generate any material levels of noise, waste water, gaseous wastes and other industrial wastes and believe that our manufacturing processes are environmentally benign. We are subject to a variety of governmental regulations related to the storage, use and disposal of hazardous materials. The major environmental regulations applicable to us include the Environmental Protection Law of the PRC, the Law of PRC on the Prevention and Control of Water Pollution, Implementation Rules of the Law of PRC on the Prevention and Control of Water Pollution, the Law of PRC on the Prevention and Control of Air Pollution, the Law of PRC on the Prevention and Control of Solid Waste Pollution, and the Law of PRC on the Prevention and Control of Noise Pollution.

Restriction on Foreign Businesses

The principal regulation governing foreign ownership of solar power businesses in the PRC is the Foreign Investment Industrial Guidance Catalogue (effective as of January 1, 2005). Under the regulation, the solar power business belongs to permitted foreign investment industry.

Tax

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles. In accordance with Income Tax of China for Enterprises with Foreign Investment and Foreign Enterprises, or the Income Tax Law, and the related implementing rules, foreign invested enterprises incorporated in the PRC are generally subject to an enterprise income tax at the rate of 30% on taxable income and local income tax at the rate of 3% of taxable income. The Income Tax Law and the related implementing rules provide certain favorable tax treatments to foreign invested enterprises. For instance, a foreign invested manufacturing enterprise with an operation term of no less than 10 years would be eligible for an enterprise income tax holiday of two-year exemption followed by a three-year 50% reduction from the enterprise income tax starting from the first profit making year of the enterprise after its application of previous years operating losses carried forward for a maximum period of five years.

The effective income tax rate applicable to us in China depends on various factors, such as tax legislation, the geographic composition of our pre- tax income and non-tax deductible expenses incurred. In 2006, the consolidated effective tax rate applicable to us was 5%. On March 16, 2007, the National People s Congress, the Chinese legislature, passed a new enterprise income tax law, which is scheduled to take effect on January 1, 2008. The new law applies a uniform 25% enterprise income tax rate to both foreign invested enterprises and domestic enterprises. An enterprise registered under the laws of a jurisdiction outside China may be deemed a Chinese tax resident if its place of effective management is in China and it will consequently be subject to the enterprise income tax on its worldwide income. Existing companies are required to transition to the new enterprise income tax rate over a five year period starting January 1, 2008. The new Enterprise Income Tax Law empowers the PRC State Council to promulgate detailed implementation rules. Since the implementation rules are not yet promulgated, there may be some uncertainty

as to how the new enterprise income tax law will be interpreted or implemented.

Once the non-Chinese company is deemed as a Chinese Tax residence by following the managed or controlled concept, the Chinese withholding income tax currently exempted for dividends distributed to overseas shareholders under the current PRC income tax laws could be imposed and applied to the dividends distributed from the deemed

Table of Contents

Chinese tax resident to overseas shareholders. A 20% withholding tax on gross income could be imposed, although a 10% rate is likely subject to the detailed implementation rules of the PRC new EIT law. Our management carefully monitors these legal developments and will timely adjust our effective income tax rate when necessary.

Pursuant to the Provisional Regulation of China on Value Added Tax and their implementing rules, all entities and individuals that are engaged in the sale of goods, the provision of repairs and replacement services and the importation of goods in China are generally required to pay VAT at a rate of 17.0% of the gross sales proceeds received, less any deductible VAT already paid or borne by the taxpayer. Further, when exporting goods, the exporter is entitled to a portion of or all the refund of VAT that it has already paid or borne. In the case of CSI Solar Manufacturing, our imported raw materials that are used for manufacturing export products are imported into China under bonded condition with an exemption on import VAT.

Foreign Currency Exchange

Foreign currency exchange regulation in China is primarily governed by the following rules:

- Foreign Currency Administration Rules (1996), as amended, or the Exchange Rules; and
- Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules;

Currently, the Renminbi is convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. Conversion of Renminbi for most capital account items, such as direct investment, security investment and repatriation of investment, however, is still subject to the approval of the PRC State Administration of Foreign Exchange, or SAFE.

Under the Administration Rules, foreign-invested enterprises may buy, sell and/or remit foreign currencies only at those banks authorized to conduct foreign exchange business after providing valid commercial documents and, in the case of most capital account item transactions, obtaining approval from the SAFE. Capital investments by foreign-invested enterprises outside of China are also subject to limitations, which include approvals by the Ministry of Commerce, the SAFE and the State Reform and Development Commission.

Dividend Distribution

The principal regulations governing distribution of dividends paid by wholly foreign owned enterprises include:

- Wholly Foreign Owned Enterprise Law (1986), as amended; and
- Wholly Foreign Owned Enterprise Law Implementation Rules (1990), as amended.

Under these regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, a wholly foreign owned enterprise in China is required to set aside at least 10.0% of their after-tax profit based on PRC accounting standards each year to its general reserves until the accumulative amount of such reserves reach 50.0% of its registered capital. These reserves are not distributable as cash dividends. The board of directors of a foreign-invested enterprise has the discretion to allocate a portion of its after-tax profits to staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation.

Table of Contents

C. Organizational Structure

The following diagram illustrates our company s organizational structure, and the place of formation, ownership interest, affiliation and the operation focus of each of our subsidiaries.

D. Property, Plant and Equipment

The following is a summary of our properties, including information on our manufacturing facilities and office buildings:

We have manufacturing facilities and offices in Suzhou that occupy approximately 6,050 square meters under a lease that will expire in March 2008 and 4,048 square meters under a lease that will expire in April 2010. We have the right to renew the leases on three-months or six-month s prior written notice if the terms we offer are not less favorable than terms offered by other prospective tenants. We also rent offices with an aggregate of approximately 40 square meters in Suzhou for our research and development and certain administrative personnel under a lease expiring in September 2008. In Changshu, we rent our facilities of approximately 4,500 square meters under a three-year lease expiring in September 2007.

CSI Luoyang has obtained the land use rights certificate for a piece of land of approximately 35,345 square meters, on which we are in the process of constructing the manufacturing facility of approximately 4,627.5 square meters for module manufacturing together with an office building of approximately 1,915 square meters.

CSI Cells has obtained the land use rights certificate for a piece of land of approximately 65,661 square meters. We recently built a solar cell facility in Suzhou and completed our first solar cell production line in the first quarter of 2007. The manufacturing facility has approximately 10,000 square meters and we are building an office building of approximately 3,900 square meters on the same land.

CSI Advanced is applying for the land use rights certificate for a piece of land of approximately 40,000 square meters, on which we expect to commence the construction of a manufacturing facility of approximately 30,000 square meters that is designed for module manufacturing. We are targeting to open this facility in the first quarter of 2008. We are applying for the construction permit required to establish the facility.

We believe our current facilities and our planned facilities will meet our future needs and are consistent with our business plans.

Table of Contents

ITEM 4A. ***Unresolved Staff Comments***

Not Applicable.

ITEM 5. ***Operating and Financial Review and Prospects***

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Item 3. Key Information D. Risk Factors or in other parts of this annual report on Form 20-F.

A. Operating Results

The most significant factors that affect our financial performance and results of operations are:

availability and price of solar cells and silicon raw materials;

industry demand;

government subsidies; and

product mix and pricing.

Availability and Price of Solar Cells, Wafers and Silicon Raw Materials. We produce solar modules, which are an array of interconnected solar cells encased in a weatherproof frame, and products that use solar modules. Solar cells are the most important component for making solar modules. Our solar cells are currently made on mono-crystalline wafers, and we plan to make solar cells on multi-crystalline silicon wafers in the third quarter of 2007, in our wafer fab through multiple manufacturing steps, including surface texturization, diffusion, plasma-enhanced chemical vapor deposition and surface metalization. Solar wafers are the most important material for making solar cells. There is presently a shortage of solar cells and wafers as a result of a shortage of high-purity silicon caused primarily by the recent expansion of, and increased demand in, the solar power and semiconductor industries. The shortage of high-purity silicon has also contributed to significant price increases for solar cells and wafers. For example, according to Solarbuzz, the average long term silicon feedstock contracted price increased from approximately $28-32 per kilogram in 2004 to $60-65 per kilogram in 2007. In addition, according to Solarbuzz, spot prices of silicon feedstock through stock purchases or short-term contracts went as high as $300 per kilogram in the third quarter of 2006 before decreasing by 10% from this peak by the first quarter of 2007. According to Solarbuzz, the average selling price of solar cells increased from the fourth quarter of 2004 to the fourth quarter of 2005 by approximately 20% to 25%, depending on the size of the solar cells and the type of technology; mainstream multicrystalline silicon cell prices increased from the first quarter of 2006 to the first quarter of 2007 by an average of 8%, while monocrystalline silicon PV cell prices increased by a similar proportion. Based on our experience, we believe that the average prices of high-purity silicon, solar wafers and solar cells will remain high for the near future until the industry-wide high-purity silicon shortage eases. Any increase in demand from the semiconductor industry will compound the shortage. Increases in the prices of high-purity silicon, solar wafers and solar cells have in the past increased our production costs and may continue to impact our cost of revenues and net income in the future. In addition, we have experienced late delivery and supply shortages, which have affected our production.

Beginning in early 2005, we began managing our supply chain through toll manufacturing arrangements and our silicon reclamation program to secure a cost-effective supply of solar cells. This has allowed us to mitigate the effects of the industry-wide shortage of high-purity silicon, while reducing margin pressure. Currently, we secure our supply of solar cells and wafers at a large percentage through our sourcing of silicon raw materials and toll manufacturing arrangements with suppliers of ingots, wafers and cells. We also purchase solar wafers and solar cells directly from our suppliers. In the past, we have been able to achieve cost savings through our toll manufacturing arrangements primarily because of our silicon reclamation processes.

Table of Contents

We believe our current silicon raw material supply agreements and toll manufacturing arrangements will enable us to secure solar cells and wafers sufficient for a major portion of our estimated 2007 production output. However, as we grow our business and as high-purity silicon becomes more readily available, we plan to diversify our solar wafers and cell supply channel mix to ensure flexibility in adapting to the future changes in the supply of and demand for solar wafers and cells. We plan to enter into long-term supply contracts and commence in-house manufacture of solar cells. We completed our first solar cell production line in the first quarter of 2007. Despite our plans to have a balanced and diversified solar cell supply channel mix, we cannot assure you that we will be able to secure sufficient quantities of solar wafers, cells and silicon raw materials to grow our revenues as planned or that we will be able to successfully develop a cost-effective solar cell manufacturing capability. See Item 3. Key Information D. Risk Factors Risks Related to Our Company and Our Industry The current industry wide shortage of high-purity silicon may constrain our revenue growth and decrease our gross margins and profitability and Item 3. Key Information D. Risk Factors Risks Related to Our Company and Our Industry We may not succeed in developing a cost-effective solar cell manufacturing capability.

Given the current state of the industry, suppliers of solar wafers, cells and silicon raw materials typically require customers to make prepayments well in advance of their shipment. While we also sometimes require our customers to make partial prepayments, there is typically a lag between the time of our prepayment for solar wafers, cells and silicon raw materials and the time that our customers make prepayments to us. As a result, the purchase of solar wafers, cells and silicon feedstock, and other silicon raw materials through toll manufacturing arrangements, has required, and will continue to require, us to make significant working capital commitments beyond that generated from our cash flows from operations to support our estimated production output.

Industry and Seasonal Demand. Our business and revenue growth depends on demand for solar power. Although solar power technology has been used for several decades, the solar power market has grown significantly in the past several years. We believe growth in the near term will be constrained by the limited availability of high-purity silicon, but is expected to accelerate after 2007. See Item 4. Information on the Company Business Overview Our Industry for a more detailed discussion on the factors driving the growth of the solar power industry and the challenges that it faces. In addition, we believe that industry demand may be affected by seasonality. Demand tends to be lower in the winter quarter than in the subsequent warmer quarters, primarily because of adverse weather conditions in our key markets, such as Germany, that complicate the installation of solar power systems. For example, our sales to Germany slowed down in the fourth quarter of 2006 and the first quarter of 2007 due primarily to such changes in seasonal demands and partially to the inventory clearing efforts by some smaller solar module producers exiting the market.

See Item 3. Key Information D. Risk Factors Risks Related to Our Company and Our Industry If solar power technology is not suitable for widespread adoption, or sufficient demand for solar power products does not develop or takes longer to develop than we anticipate, our revenues may not continue to increase or may even decline, and we may be unable to sustain our profitability.

Government Subsidies. We believe that the near-term growth of the market for on-grid applications depends in large part on the availability and size of government subsidies and economic incentives. Today, the cost of implementing and operating a solar power system substantially exceeds the cost of purchasing power provided by the electric utility grid in many locations. As a result, federal, state and local governmental bodies in many countries, most notably Germany, Spain, the United States, Japan and China, have provided subsidies and economic incentives to reduce dependency on conventional sources of energy. These have come in the form of rebates, tax credits and other incentives to end users, distributors, system integrators and manufacturers of solar power products, to promote the use of solar energy in on-grid and, to a lesser extent, off-grid applications. The demand for our solar module products, in particular our standard solar modules, is affected significantly by these government subsidies and economic incentives. Any reductions or eliminations in government subsidies and economic incentives could reduce demand for

our products and affect our revenues.

Product Mix and Pricing. We began selling our solar module products in March 2002 and all of our net revenues in 2002 and 2003 were generated from sales of specialty solar modules and products. We did not begin selling standard solar modules until 2004. By the end of 2004, the sale of standard solar modules represented 72.5% of our net revenues for the year. In 2005 and 2006, that percentage increased to 76.9% and 96.8%, respectively,

Table of Contents

excluding silicon materials sales. In 2006, approximately 74% of our solar module product net revenues consisted of standard solar module sales. Approximately 14% were from sales of specialty solar modules and products. The remaining balance was primarily generated from sales of silicon materials. Our specialty solar modules and products generally generate higher margins compared with those generated by our standard solar modules, primarily because of the higher average selling price. We are able to charge a higher average selling price because of the greater complexity of design, the higher labor cost to design and manufacture specialty solar modules and products and the cost, if any, of purchasing additional components to complete the product. For example, the average selling price per watt of our standard solar modules was $3.97 for the year ended December 31, 2006, as compared to $5.27 per watt for our specialty solar modules and products over that same time period. While we expect sales of standard solar modules to drive our net revenues in the near future, we expect to increase sales of both our standard solar modules and our specialty solar modules and products going forward.

Our standard solar modules are priced based on the number of watts of electricity they can generate as well as overall demand in the solar power industry. We price our standard solar modules based on the prevailing market price at the time we enter into sales contracts with our customers, taking into account the size of the contract, the strength and history of our relationship with each customer and our solar wafers, cells and silicon raw materials costs. Over the past few years, the average selling prices for standard solar modules have risen year-to-year across the industry primarily because of high demand. Correspondingly, the average selling price of our standard solar module products increased from $3.62 per watt in 2004 to $3.92 per watt in 2005, and to $3.97 per watt in 2006. This increasing trend began reversing at the end of 2006. We believe the average price for solar modules to decline in 2007 as the market matures, manufacturing cost decreases and the competition increases. Beginning in 2007, we generally enter into annual sales and distribution contracts with our customers, some of which are subject to quarterly adjustments. We believe such short-term arrangements enable us to reduce our exposure to market fluctuation.

The price for our specialty solar modules and products is determined on a product-by-product basis, taking into account the complexity of design, direct labor costs in designing and manufacturing the product and the cost of purchasing additional components, if any, to complete the product. Specialty solar modules and products have shorter product life cycles, and product designs and customer preferences change more rapidly for specialty solar modules and products than for standard solar modules. As a result, the prices that we charge for these products are not directly comparable from year to year because our customers typically order these products for limited time periods. When a customer order ends, we may not be able to replace the customer order with orders for similarly-sized and -priced solar modules from that same customer or other customers. In addition, because we have a relatively small number of customers of specialty solar modules and products, sales of these products are susceptible to significant fluctuations. We sold 0.4 MW, 0.7 MW and 0.4 MW of these products in 2004, 2005 and 2006, respectively.

Overview of Financial Results

We evaluate our business using a variety of key financial measures.

Net Revenues

We generate revenues primarily from the sale of solar module products, consisting of standard solar modules and specialty solar modules and products. Solar module products accounted for 92.3%, 97.7% and 87.6% of our net revenues in 2004, 2005 and 2006, respectively. We also generate revenues from the implementation of solar power development projects, primarily in conjunction with government organizations, to provide solar power generation in rural areas of China. To date, these have consisted of government-related assistance packages. In the fourth quarter of 2006, we began generating revenues from the resales to third parties of our excessive inventory of silicon materials. Going forward, we believe that revenues from the resales of silicon materials will be on a relatively small scale and may occur from time to time. Main factors affecting our net revenues include average selling prices per watt, unit

volume shipped, product demand and product mix. Our net revenues are net of business tax, value-added tax and returns and exchanges.

Table of Contents

A small number of customers have historically accounted for a major portion of our net revenues. In 2004, 2005 and 2006, our top five customers during those periods collectively accounted for approximately 64.0%, 62.1% and 53.5% of our net revenues, and sales to our largest customer accounted for 16.3%, 36.8% and 14.3%, respectively. Our largest customers have changed from year to year, primarily because of the short product life cycles of our specialty solar modules and products, our recent entry into the standard solar module business and the rapid expansion of our business and operation. Changes in our product mix and strategic marketing decisions have also resulted in changes in our market concentration from year to year. The following table sets forth certain information relating to our total net revenues derived from our customers categorized by their geographic location for the periods indicated:

	Year Ended December 31,							
	2003		2004		2005		2006	
Region	Total Net Revenues	%	Total Net Revenues	%	Total Net Revenues	%	Total Net Revenues	%
	(In thousands of US$, except percentages)							
Europe								
Germany	$ 20	0.5%	$ 6,499	67.1%	$ 13,801	75.3%	$ 38,788	56.8%
Spain			85	0.8	445	2.4	5,226	7.7
Others			42	0.4	1,018	5.6	7,967	11.7
Europe Total	20	0.5	6,625	68.4	15,264	83.3	51,981	76.2
China	271	6.6	109	1.1	504	2.8	14,091(2)	20.6
North America	3,798	92.3	2,853	29.5	2,556	13.9	2,031	3.0
Others	25	0.6	97	1.0	(1)	0.0	109	0.2
Total net revenues	$ 4,113	100.0%	$ 9,685	100.0%	$ 18,324	100.0%	$ 68,212	100.0%

(1) Less than a thousand.

(2) $8.3 million of the $14.1 million net revenues was generated from a one-time silicon materials sales that took place in the fourth quarter of 2006.

Cost of Revenues

Our cost of revenues consists primarily of the costs of:

solar cells;

other materials for the production of solar modules such as glass, aluminum frame and polymer backing;

production labor, including salaries and benefits for manufacturing personnel;

warranty costs;

since the second quarter of 2006, share-based compensation expenses for options and restricted shares granted to our manufacturing employees and suppliers; and

other materials, such as electronic components, used for the production of our specialty solar modules and products.

Solar cells make up the major portion of our cost of revenues. We purchase some of our solar cells directly from cell suppliers. The costs of solar cells that we directly purchase are the price that we pay to our suppliers. A major portion of our solar cells is obtained through toll manufacturing arrangements through which we source and provide silicon feedstock to suppliers of ingots, wafers and cells. These suppliers ultimately convert these silicon raw materials into the solar cells that we use for our production of solar modules. The costs of solar cells that we obtain through these toll manufacturing arrangements comprise of: (i) the costs of purchasing the silicon feedstock; (ii) labor costs incurred in inventory management; (iii) labor costs incurred in sorting the reclaimable silicon as part of our silicon reclamation program; and (iv) tolling fees charged by our suppliers under the tolling arrangements. The payments we make to our suppliers for the solar cells and the payment our suppliers make to us for the silicon

Table of Contents

feedstock that we source are generally settled separately. We do not include payments we receive for providing silicon feedstock as part of these toll manufacturing arrangements in our net revenues.

We also recently began to produce solar cells for use in the manufacturing of our solar modules. Where solar cells are manufactured by our own solar cell manufacturing facility, the cost of solar cells consists of: (i) the costs of purchasing the solar wafer, (ii) labor costs incurred in manufacturing solar cells at our own facility, (iii) other materials and utilities we use for manufacturing the solar cells and (iv) depreciation charges incurred for our solar cell manufacturing facility, equipment and building.

Our cost of revenues also includes warranty costs. We accrue 1.0% of our net revenues as warranty costs at the time revenues are recognized. Our standard solar modules are typically sold with a two-year guarantee for defects in materials and workmanship and a 10-year and 25-year warranty against declines of more than 10.0% and 20.0%, respectively, of the initial minimum power generation capacity at the time of delivery. Our specialty solar modules and products are typically sold with a one-year guarantee against defects and may, depending on the characteristics of the product, contain a limited warranty of up to ten years, against declines of the minimum power generation capacity specified at the time of delivery. We have not had any warranty claims to date. Our cost of revenues has historically increased as we increased our net revenues. We expect cost of revenues to increase as we increase our production volume.

Gross Profit/ Gross Margin

Our gross profit is affected by a number of factors, including the average selling prices for our products, product mix and our ability to cost-effectively manage our supply chain.

Our gross margin decreased from 42.3% in 2003 to 33.2% in 2004, primarily as a result of the change in product mix focus from specialty solar modules and products to standard solar modules in 2004 and the rising cost of solar cells due to high industry demand for solar power and shortages of silicon raw materials. Our specialty solar modules and products generally have higher margins compared to our standard solar modules. The primary reason for this is the higher average selling price per watt that we are generally able to charge for our specialty solar modules and products due to their more complex design.

Our gross margin increased from 33.2% in 2004 to 38.8% in 2005 as we initiated our supply chain management strategy in 2005. Our gross margin decreased from 38.8% for 2005 to 18.0% for 2006, primarily as a result of our changing product mix as we completed one of our large specialty solar module product contracts in 2005. Specialty solar modules and products, which tend to have higher margins than our standard solar modules, accounted for 23.1% and 3.2% of our net revenues (excluding silicon material sales) for 2005 and 2006, respectively. The decrease in gross margin is also attributable to the higher costs of solar cells and silicon materials in 2006 and the substantial completion of one of our CIDA projects in 2005. A major component of our supply chain management involves the purchase of reclaimable silicon and processing it for reuse at a lower cost. This provides a significant cost advantage over the purchase of high-purity silicon. Our ability to select cost-effective suppliers for solar cells also provides us with cost savings. The successful use of reclaimed silicon requires extensive experience, know-how and additional quality control measures from both the provider of reclaimed silicon and the toll manufacturers. We must continue to maintain the consistency and quality of the reclaimed silicon from our silicon reclamation program at an acceptable level in order to continue receiving the cost advantages of recycling silicon through our silicon reclamation program. The decrease in gross margin from 2005 to 2006 was also attributable to a decrease in average selling prices for standard solar modules in the fourth quarter of 2006 as a result of lower-than-anticipated market demand.

We believe that we will face some margin compression in the sale of standard solar modules in 2007 comparing to 2006 because we expect the decrease in the price for high-purity silicon lags the decrease in average selling price of

our products. On the other hand, we also believe this will be partially offset by an increase in our business volume, which will result in improvement of economies of scale, cost savings through the continuous research and development as well as in-house manufacturing of solar cells. In addition, we expect expansion of our specialty solar modules and product businesses will be a key driver of our gross margin increase in the future.

Table of Contents

Operating Expenses

Our operating expenses include selling expenses, general and administrative expenses and research and development expenses. Our operating expenses have decreased in recent years as a percentage of our net revenues primarily due to economies of scale that we have achieved in connection with our revenue growth. We expect this trend to continue as our net revenues grow in the future.

Selling Expenses

Selling expenses consist primarily of salaries, sales commissions for sales and marketing personnel, advertising, promotional and other sales and marketing expenses. Since the second quarter of 2006, selling expenses have included share-based compensation expenses for options and restricted shares granted to our sales and marketing personnel. We have incurred only limited selling expenses to date as we have relied primarily on sales of standard solar modules in 2004, 2005 and 2006, which have become increasingly commoditized. As we expand our business, we will increase our sales and marketing efforts and target companies in selected industry sectors in response to the evolving industry trend. We expect our selling expenses to increase in the near term as we increase our sales efforts, hire additional sales personnel, target more markets and initiate additional marketing programs to reach our goal of building a leading global brand. However, assuming our net revenues increase at the rate we expect, over time we anticipate that our selling expenses will decrease as a percentage of our net revenues.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries and benefits for our administrative and finance personnel, consulting and professional service fees, government and administration fees, exchange gain or loss, insurance fees and provisions for bad debt and inventory write-off. Since the second quarter of 2006, our general and administrative expenses have included share-based compensation expenses for options and restricted shares granted to our general and administrative personnel, directors and consultants. We expect our general and administrative expense to increase as we hire additional personnel, upgrade our information technology infrastructure and incur expenses necessary to fund the anticipated growth of our business. We also expect general and administrative expenses to increase to support our operations as a public company, including compliance-related costs. However, assuming our net revenues increase at our anticipated rate, we expect our general and administrative expenses will increase for a short period of time as a percentage of our net revenue immediately after we became publicly listed in November 2006, while, over time we anticipate that our general and administrative expenses will decrease as a percentage of our net revenues.

Research and Development Expenses

Research and development expenses consist primarily of costs of raw materials used in our research and development activities, salaries and benefits for research and development personnel and prototype and equipment costs related to the design, development, testing and enhancement of our products and silicon reclamation program. Since the second quarter of 2006, our research and development activities have included share-based compensation expenses for options and restricted shares granted to our research and development employees. We expense our research and development costs as incurred. To date, our research and development expenses have been minor. A significant portion of our research and development activities have been in connection with our implementation of solar power development projects, primarily in conjunction with government organizations, to provide solar power generation in rural areas of China. We have recorded the expenditures in connection with these solar power development projects in our cost of revenues.

After becoming a public company, we have devoted and expect to devote more efforts to research and development and expect that our research and development expenses will increase in the near future as we hire additional research and development personnel, expand and promote innovation in our specialty solar modules and products portfolio, devote more resources towards using new technologies and materials in our silicon reclamation program as well as expanding into solar cell manufacturing.

Table of Contents

Share-based Compensation Expenses

We adopted our 2006 share incentive plan effective March 2006 and have granted a total of 1,370,488 options to purchase our common shares and 566,190 restricted shares as of December 31, 2006. For a description of the options and restricted shares granted, including the exercise prices and vesting periods, see Item 6. Directors, Senior Management and Employees B. Compensation of Directors and Executive Officers 2006 Share Incentive Plan. Under Statement of Financial Accounting Standards (SFAS) No.123 (revised 2004), Share-Based Payment, (SFAS123R), we are required to recognize share-based compensation as compensation expense in our statement of operations based on the fair value of equity awards on the date of the grant, with the compensation expense recognized over the period in which the recipient is required to provide service in exchange for the equity award.

As required by SFAS 123R, we have made an estimate of expected forfeitures and is recognizing compensation cost only for those equity awards expected to vest. We estimate our forfeitures based on past employee retention rates, our expectations of future retention rates, and we will prospectively revise our forfeiture rates based on actual history. Our share option and restricted share compensation charges may change based on changes to our actual forfeitures. In addition, a portion of the options were granted with exercise prices that were dependent upon the price of our initial public offering. Such exercise prices are now fixed, either at $15.0, the price of our initial public offering in November 2006, or at 80% of $15.0. We measured the fair value of these option awards on the date of our initial public offering when the exercise prices became known.

For the year ended December 31, 2006, we recorded share-based compensation expenses of approximately $6,144,879. We have categorized these share-based compensation expenses in our (i) cost of revenues; (ii) selling expenses; (iii) general and administrative expenses; and (iv) research and development expenses, depending on the job functions of grantees to whom we granted the options or restricted shares. The following table sets forth the allocation of our share-based compensation expenses both in absolute amount and as a percentage of total share-based compensation expenses.

	Years Ended December 31,		
	2004	2005	2006
	(In thousands of US$, except for percentages)		
Share-based compensation expenses included in:			
Cost of revenues		169	2.8%
Selling expenses		1,945	31.7
General and administrative expenses		3,942	64.15
Research and development expenses		89	1.4
Total share-based compensation expenses		6,145	100.0%

We expect to incur additional share-based compensation as we expand our operations. For example, we anticipate that research and development expenses will increase as we hire additional research and development personnel to further enhance our technology platform and meet the expected growth of our operations.

Interest Expenses

Interest expenses consist primarily of interest expenses with respect to our short-term loans and the accrued interest and non-cash charges on the convertible notes that we issued to HSBC HAV2 (III) Limited, or HSBC, and JAFCO Asia Technology Fund II, or JAFCO, which reference includes any affiliate to which it transferred shares issued upon conversion of the notes. HSBC and JAFCO were entitled to receive cash interest at 2% per annum. If the notes matured without being converted, HSBC and JAFCO would be entitled to receive a premium at redemption equal to 10% per annum on the principal amount of the notes from their issue date to redemption. Discounts against the debt portion of the convertible notes were amortized over the maturity of the convertible notes using the straight-line method, which is not materially different from the effective interest rate method. We accrued non-cash charges in connection with the premium at redemption equal to 10% per annum on the principal amount of the notes from their issue date to redemption assuming the convertible notes had matured without being converted and amortization of discounts against the debt portion. Our non-cash charges of $134,666 and $706,320 in 2005 and 2006,

Table of Contents

respectively, consisted primarily of the amortization of discount on debt and the charges we incurred in connection with this premium. All of our outstanding convertible notes were converted into 5,542,005 common shares on July 1, 2006.

Loss on Change in Fair Value of Derivatives

Loss on change in fair value of derivatives is associated with the convertible notes that we issued to HSBC and JAFCO. Prior to March 2006, at any time after the occurrence of a predefined event of default upon written demand from the note holders, the note holders were entitled to receive a premium of the higher of 12% per annum internal rate of return to the note holders or a market value-based return assuming full conversion of all convertible notes. Since the market value-based return created a net settlement provision, we were required to bifurcate the compound embedded derivatives and record them as derivatives or derivative financial instruments, which are stated at fair value on the issuance date and each financial reporting period thereafter. Changes in fair value of the compound embedded derivatives were recorded in profits and losses as non-cash charges. The fair value of the convertible notes, excluding the compound embedded derivative liabilities, were determined with reference to a valuation conducted by American Appraisal. These non-cash charges amounted to $316,000 and $6,997,000 million in 2005 and 2006, respectively. In March 2006, this feature was eliminated such that an event of default entitles the note holders to receive a premium of 18% per annum internal rate of return to the note holders, effectively removing the net settlement provision. As a result, since March 2006, we no longer incurred this charge.

Loss on Financial Instruments Related to Convertible Notes

In addition to the compound embedded derivatives which arose as part of the issuance of our convertible notes, our convertible notes also included freestanding financial instrument liabilities associated with the obligation to issue the second tranche of convertible notes to the investors and the investors option to subscribe for a third tranche of convertible notes. These financial instruments do not meet the definition of derivative instruments under U.S. GAAP. However, the investors option to subscribe to the third tranche of convertible notes represents our written option which was required to be marked to market on the date of issuance and each financial reporting period thereafter. The changes in the fair value of the marked to market financial instrument was reported in profits and losses as a non-cash charge. These non-cash charges amounted to $263,089 in 2005 and $1,189,500 in 2006, all of which was incurred during the first quarter of 2006. We issued the second tranche convertible notes together with the convertible notes pursuant to the investors option in March 2006. As a result, since March 2006, we no longer incurred this charge.

Income Tax Expense

We recognize deferred tax assets and liabilities for temporary differences between financial statement and income tax bases of assets and liabilities. Valuation allowances are provided against deferred tax assets when management cannot conclude that it is more likely than not that some portion or all of the deferred tax asset will be realized.

We are incorporated in Canada and are subject to Canadian federal and provincial corporate income taxes. As a Canadian controlled private corporation, we enjoyed preferential tax rates for active business income carried on in Canada up to an annual limit. Since the listing of our common shares on the Nasdaq, we are no longer eligible for these preferential tax rates.

Under current PRC laws and regulations, an FIE in China is typically subject to EIT, at the rate of 30% on taxable income, and local income tax at the rate of 3% on taxable income. The PRC government has provided various incentives to FIEs, such as each of our PRC subsidiaries, to encourage the development of foreign investments. Such incentives include reduced tax rates and other measures. FIEs that are determined by PRC tax authorities to be manufacturing companies with authorized terms of operation of more than ten years, are eligible for: (i) a two-year

exemption from EIT from their first profitable year; and (ii) a reduced EIT of 50% for the succeeding three years. CSI Solartronics is entitled to a preferential EIT rate of 24%, as it is a manufacturing enterprise located in a coastal economic development zone in Changshu. CSI Solartronic s first profitable year was 2002 and it is currently paying an EIT rate of 12% until the end of 2006. CSI Solartronics, as an advanced

Table of Contents

technology company, is currently applying for a 50% EIT holiday extended for a 3-year period, to which advanced technology companies are generally entitled. If this application is approved, CSI Solartronics will be entitled to enjoy a 50% EIT holiday until 2009. CSI Solar Manufacturing is entitled to a preferential EIT rate of 15%. CSI Solar Manufacturing s first profitable year was 2005 and it is exempt from EIT until 2006. Starting from 2007, CSI Solar Manufacturing is entitled to a preferential EIT of 7.5% until the end of 2009. CSI Solar Technologies, CSI Luoyang, CSI Cells and CSI Advanced have not yet made a profit and have therefore not applied for preferential tax treatment. If these subsidiaries become profitable, they will apply for preferential tax rates and tax holidays. However, with the effectiveness of the new Enterprise Income Tax Law on January 1, 2008, a foreign invested enterprise currently enjoying a lower tax rate will be subject to gradual increases to the uniform standard rate of 25% over a five-year transition period. Foreign invested enterprises currently enjoying preferential treatment in the form of enterprise income tax reduction or exemption may continue to enjoy such treatment until the end of the preferential treatment period. For enterprises which have yet to enjoy preferential treatment due to lack of profitability, commencement of the preferential treatment period will coincide with the year the new EIT law comes into effect, i.e. January 1, 2008. At the current stage, in the absence of the detailed implementation rules of the new EIT law, it is uncertain what the applicable tax rate during the 3-year 50% reduction period will be over the transition period.

As these tax benefits expire, the effective tax rate of our PRC subsidiaries may increase significantly.

Critical Accounting Policies

We prepare financial statements in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect (i) the reported amounts of our assets and liabilities, (ii) the disclosure of our contingent assets and liabilities at the end of each fiscal period and (iii) the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

When reviewing our financial statements, you should consider (i) our selection of critical accounting policies, (ii) the judgment and other uncertainties affecting the application of such policies, (iii) the sensitivity of reported results to changes in conditions and assumptions. We believe the following accounting policies involve the most significant judgment and estimates used in the preparation of our financial statements.

Revenue Recognition

We record sales of our solar module products when the products are delivered and title has passed to our customers. We only recognize revenues when prices to the seller are fixed or determinable and collection is reasonably assured. We also recognize revenues from reimbursements of shipping and handling costs of products sold to customers. Our sales contracts typically contain our customary product warranties but do not contain post-shipment obligations or any return or credit provisions. A majority of our contracts provide that products are shipped under the term of free on board, or FOB, Ex-works, or cost, insurance and freight, or CIF. Under FOB, we fulfill our obligation to make delivery when the goods have passed over the ship s rail at the named port of shipment. From that point on, the customer has to bear all costs and risks of loss or damage to the goods. Under Ex-works, we fulfill our obligation to make delivery when we have made the goods available at our premises to the customer. The customer bears all costs and risks involved in transporting the goods from our premises to their desired destination. Under CIF, we must pay the costs, marine insurance and freight necessary to bring the goods to the named port of destination but the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have

been delivered on board the vessel, is transferred to the customer when the goods pass the ship s rail at the port of shipment. Sales are generally recorded when the risk of loss or damage is transferred from us to the customers.

Table of Contents

We also generate revenues from our implementation of solar power development projects, consisting primarily of government related assistance packages for our demonstration, promotion and feasibility projects and studies. The revenue is recognized when the service is completed and accepted by the customers.

Warranty Cost

It is customary in our business and industry to warrant or guarantee the performance of our solar module products at certain levels of conversion efficiency for extended periods. Our standard solar modules are typically sold with a two-year guarantee for defects in materials and workmanship and a 10-year and 25-year warranty against declines of more than 10.0% and 20.0%, respectively, of the initial minimum power generation capacity at the time of delivery. Our specialty solar modules and products are typically sold with a one-year guarantee against defects in materials and workmanship and may, depending on the characteristics of the product, contain a limited warranty of up to ten years, against declines of the minimum power generation capacity specified at the time of delivery. We therefore maintain warranty reserves (recorded as accrued warranty costs) to cover potential liabilities that could arise from these guarantees and warranties. We accrue 1.0% of our net revenues as warranty costs at the time revenues are recognized and include that amount in our cost of revenues. Due to limited warranty claims to date, we accrue the estimated costs of warranties based primarily on an assessment of our competitors accrual history. Through our relationships with, and management s experience working at, other solar power companies and on the basis of publicly available information regarding other solar power companies accrued warranty costs, we believe that accruing 1.0% of our net revenues as warranty costs is within the range of industry practice and is consistent with industry-standard accelerated testing, which assists us in estimating the long-term reliability of solar modules, estimates of failure rates from our quality review and other assumptions that we believe to be reasonable under the circumstances. However, although we conduct quality testing and inspection of our solar module products, our solar module products have not been and cannot be tested in an environment simulating the up to 25-year warranty periods. We have not experienced any material warranty claims to date in connection with declines of the power generation capacity of our solar modules. As is typical in the industry, however, we have experienced some claims concerning other defects or workmanship. We will prospectively revise our actual rate to the extent that actual warranty costs differ from the estimates.

Impairment of Long-lived Assets

We evaluate our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, we measure impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, we will recognize an impairment loss based on the fair value of the assets.

Allowance for Doubtful Accounts

We conduct credit evaluations of customers and generally do not require collateral or other security from our customers. We establish an allowance for doubtful accounts primarily based upon the age of the receivables and factors surrounding the credit risk of specific customers. With respect to advances to suppliers, our suppliers are primarily suppliers of solar cells and silicon raw materials. We perform ongoing credit evaluations of our suppliers financial conditions. We generally do not require collateral or security against advances to suppliers. However, we maintain a reserve for potential credit losses.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined by the weighted average method. Cost of inventories consists of costs of direct materials, and where applicable, direct labor costs, tolling costs and any overhead that we incur in bringing the inventories to their present location and condition.

Adjustments are recorded to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecast demand.

Table of Contents

We outsource portions of our manufacturing process, including converting silicon into ingots, cutting ingots into wafers, and converting wafers into solar cells, to various third-party manufacturers. These outsourcing arrangements may or may not include transfer of title of the raw material inventory (silicon, ingots or wafers) to the third-party manufacturers. Such raw materials are recorded as raw materials inventory when purchased from suppliers.

For those outsourcing arrangements in which the title is not transferred, we maintain such inventory on our balance sheet as raw materials inventory while it is in physical possession of the third-party manufacturer. Upon receipt of the processed inventory, it is reclassified to work-in-process inventory and a processing fee is paid to the third-party manufacturer.

For those outsourcing arrangements, which are characterized as sales, in which title (including risk of loss) transfer to the third-party manufacturer, we are constructively obligated, through raw materials sales contracts and processed inventory purchase contracts which have been entered into simultaneously with the third-party manufacturers, to repurchase the inventory once processed. In this case, the raw material inventory remains classified as raw material inventory while in physical possession of the third-party manufacturer and cash is received, which is classified as advances from suppliers and customers on the balance sheet and not as revenue or deferred revenue. Cash payments for outsourcing arrangements, which require prepayment for repurchase of the processed inventory are classified as advances to suppliers on the balance sheet. There is no right of offset for these arrangements and accordingly, advances from suppliers and customers and advances to suppliers remain on the balance sheet until the processed inventory is repurchased.

Fair value of derivative and freestanding financial instruments

Valuations for derivative and freestanding financial instruments are typically based on the following hierarchy: (i) prices quoted on an organized market, (ii) prices obtained from other external sources such as brokers or over-the-counter third parties and (iii) valuation models and other techniques usually applied by market participants. Because our convertible notes and common shares were not publicly traded, we had relied solely on valuation models in determining these values.

We used a binomial model to value the conversion option and early redemption put option. The binomial model requires the input of assumptions, some of which are subjectively determined, such as the fair values of the common shares and the underlying notes, life of the option, the risk free interest rate over the period of the option, a standard derivation of expected volatility, and expected dividend yields. We determined the fair value of the underlying common shares based on valuations by American Appraisal. For a more detailed discussion on the assumptions involved in determining the fair value of our common shares, see Overview of Financial Results Share-based Compensation Expenses.

In determining the fair value of the freestanding note option, we used the Black-Scholes option pricing model. The option-pricing model requires the input of assumptions, some of which are subjectively determined, such as the fair value of the underlying convertible note, the exercise price of the option, the life of the option, the risk free rate over the period of the option, and a standard derivation of expected volatility.

In determining the fair value of the freestanding forward instrument, we used the fair value of the convertible note less the subscription price and interest forgone by not exercising the forward, discounted for the expected time the forward would be outstanding.

Changes to any of the assumptions used in the valuation model could materially impact the valuation results. A more detailed discussion on fair value calculations is reflected in Note 2(r) and Note 9 to our consolidated financial

statements included elsewhere in this annual report.

Income Taxes

Deferred income taxes are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, net operating loss carry forwards and credits by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in our opinion, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Table of Contents

Current income taxes are provided for in accordance with the laws of the relevant taxing authorities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on the characteristics of the underlying assets and liabilities.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) released Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and a measurement attribute for tax positions taken, or expected to be taken, in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for the fiscal years beginning after December 15, 2006, and has been applicable to us since the first quarter of fiscal 2007. The cumulative effect of implementation of FIN 48 is approximately a $0.6 million increase in the liability for unrecognized tax benefits, which we have accounted for as a decrease in the January 1, 2007 balance of retained earnings.

In June 2006, Emerging Issues Task Force (EITF) issued consensus on Issue No. 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation) (EITF No. 06-03). We have been required to adopt the provisions of EITF No. 06-03 beginning in the first quarter of fiscal 2007. We do not expect the provisions of EITF No. 06-03 to have a material impact on our financial position, cash flows or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim period within those fiscal years, with early adoption permitted. SFAS No. 157 will be applicable to us in the first quarter of fiscal 2007. We do not anticipate that the adoption of this statement will have a material effect on our financial position, cash flow or results of operations.

Table of Contents

Results of Operations

The following table sets forth a summary, for the periods indicated, of our consolidated results of operations and each item expressed as a percentage of our total net revenues. Our historical results presented below are not necessarily indicative of the results that may be expected for any future period.

	Years Ended December 31,					
	2004		2005		2006	
	(In thousands of US$, except percentages)					
Net revenues:						
Solar modules	$ 8,941	92.3%	$ 17,895	97.7%	$ 68,144	99.9%
Others	744	7.7	429	2.3	68	(1)
Total net revenues	9,685	100.0%	18,324	100.0%	68,212	100%
Cost of revenues						
Solar modules	5,894	60.9	10,885	59.4	55,804	81.8
Others	571	5.9	326	1.8	68	(1)
Total cost of revenues	6,465	66.8	11,211	61.2	55,872	81.9
Gross profit	3,220	33.2	7,113	38.8	12,340	18.1
Operating expenses						
Selling expenses	269	2.8	158	0.9	2,909	4.3
General and administrative expenses	1,069	11.0	1,708	9.3	7,923	11.6
Research and development expenses[(2)]	41	0.4	16	0.1	398	0.6
Total operating expenses	1,379	14.2	1,882	10.3	11,230	16.5
Income from operations	1,840	19.0	5,231	28.5	1,110	1.6
Interest expenses			(239)	(1.3)	(2,194)	(3.2)
Interest income	11	0.1	21	0.1	363	0.5%
Loss on change in fair value of derivatives related to convertible notes			(316)	(1.7)	(6,997)	(10.3)
Loss on financial instruments relating to convertible bonds			(263)	(1.4)	(1,190)	(1.7)
Other gain/(loss) net	(31)	(0.4)	(25)	(0.1)	(90)	(0.1)
Income before taxes	1,820	18.7	4,409	24.1	(8,998)	(13.2)
Income tax expense	(363)	(3.7)	(605)	(3.3)	(432)	(0.6)
Minority interests						
Income/(loss) before extraordinary gain	1,457	15.0	3,804	20.8	(9,430)	(13.8)
Extraordinary gain						

Net income/(loss)	$ 1,457	15.0%	$ 3,804	20.8%	$ (9,430)	(13.8)

(1) Less than 0.1.

(2) We also conduct research and development activities in connection with our implementation of solar power development projects. These expenditures are included in our cost of revenues. See Item 4. Information on the Company B. Business Overview Solar Power Development Projects.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net Revenues. Our total net revenues increased by more than three times from $18.3 million in 2005 to $68.2 million in 2006. The significant increase was primarily due to a sizable increase in net revenues generated from the sale of solar module products from $17.9 million in 2005 to $59.8 million in 2006. Included in our total net

Table of Contents

revenue for 2006 was $8.3 million generated from silicon material sales. The volume of our solar module products sold increased from 4.1 MW in 2005 to 14.9 MW in 2006. Among our solar module product categories, the major increase was driven primarily by the sales of our standard solar modules. Net revenues from the sale of standard solar modules increased from $13.7 million in 2005 to $57.6 million in 2006 with an increase in volume from 3.4 MW in 2005 to 14.5 MW in 2006.

The significant increase in the overall volume of our products sold was driven primarily by a significant increase in market demand for our standard solar modules, in particular in Germany and elsewhere in Europe. The average selling price of our standard solar modules rose from $3.62 per watt in 2005 to $3.97 per watt in 2006. The average selling price of our specialty solar modules and products remained stable at $5.27 per watt in 2005 and 2006.

Cost of Revenues. Our cost of revenues increased significantly from $11.2 million in 2005 to $55.9 million in 2006. The increase in our cost of revenues was due primarily to a significant increase in our expenditures on silicon feedstock and solar cells. This was caused by a significant increase in the quantity of solar cells needed to produce an increased output of our standard solar modules and the rising prices of silicon feedstock and solar cells due to the industry-wide shortage of high-purity silicon. As a percentage of our total net revenues, however, cost of revenues showed a substantial increase from 61.2% in 2005 to 81.9% in 2006 primarily because we did not achieve as much cost savings advantage as we had achieved mostly through our silicon reclamation program in 2005 due to a global silicon supply shortage and increased competition for reclaimable silicon mateials.

Gross Profit. As a result of the foregoing, our gross profit increased by 42% from $7.1 million in 2005 to $12.3 million in 2006. Our overall gross margin in percentage decreased from 38.8% in 2005 to 18.1% in 2006.

Operating Expenses. Our overall operating expenses increased by $9.3 million, from $1.9 million in 2005 to $11.2 million in 2006. Of this amount, $5.98 million related to share-based compensation expense recorded in 2006 whereas we had no share-based compensation expense for 2005. The remaining $3.32 million increase related to increase in personnel cost and fees for professional services. As a percentage of our total net revenue, operating expenses increased by 6.2%, from 10.3% in 2005 to 16.5% in 2006. Share-based compensation expense accounted for 8.8% of this increase, indicating that our remaining operating expenses effectively decreased as a percentage of total revenues mainly due to a much higher level of sales as compared to 2005, achievement of increases in economies of scale and controlled spending.

Selling Expenses. Our selling expenses increased by $2.75 million from $157,763 in 2005 to $2.9 million in 2006. The increase in our selling expenses in 2006 was primarily due to share-based compensation expenses of $1.9 million incurred for our sales and marketing personnel, as a result of our tying a portion of sales commissions related to product sales by granting either options to purchase our common shares or by granting restricted shares.

General and Administrative Expenses. Our general and administrative expenses increased from $1.7 million in 2005 to $7.9 million in 2006, of which $3.9 million related to share-based compensation expenses for our general and administrative personnel as we achieved greater economies of scale in 2006.

Research and Development Expenses. We have increased the level of our research and development activities in 2006 in connection with the expansion of our operations. Our research and development expenses increased from $16,381 in 2005 to $397,859 in 2006. In addition we incurred $88,764 in share-based compensation charge for our research and development personnel.

Interest Expenses. We incurred interest expenses of approximately $2.2 million in 2006, compared to $239,225 in 2005. The increase in our interest expenses in 2006 were primarily attributable to interest expense accrued in connection with the convertible notes that we issued to HSBC and JAFCO in November 2005 and March 2006, all of

which were converted into our common shares in July 2006 and, to a lesser extent, to interest on short-term borrowings.

Loss on Change in Fair Value of Derivatives Related to Convertible Notes. We recorded a charge of $316,000 in 2005 compared to $7.0 million in 2006. The loss on change in fair value of derivatives related to convertible notes, the non-cash interest charge mentioned above and the loss on financial instruments related to Convertible Notes mentioned below were one-time charges incurred in connection with an increase in the option value of the

Table of Contents

convertible notes that we issued to HSBC and JAFCO in November 2005. These notes were converted into common shares in early July 2006.

Loss on Financial Instruments Related to Convertible Notes. We recorded a non-cash charge of $1.19 million in 2006, compared to $263,089 in 2005.

Income Tax Expense. Our income tax expense was $605,402 in 2005, as compared to $431,994 in 2006.

Net Income. As a result of the cumulative effect of the above factors, we recorded a net loss of $9.4 million in 2006, compared to $3.8 million of net income in 2005. The difference of $13.2 million was due to share-based compensation expenses of $6.1 million and non-cash charges related to the convertible notes of $8.9 million, offset by $1.8 million income from operations in 2006.

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

Net Revenues. Our total net revenues increased significantly from $9.7 million in 2004 to $18.3 million in 2005. The increase was due primarily to a significant increase in net revenues generated from the sale of solar module products from $8.9 million in 2004 to $17.9 million in 2005. This was offset in part by a decrease in other net revenues generated from our implementation of solar power development projects from $743,601 in 2004 to $428,417 in 2005. The volume of our solar module products sold increased from 2.2 MW in 2004 to 4.1 MW in 2005. Among our solar module product categories, the increase was driven primarily by sales of our standard solar modules. Net revenues from the sale of standard solar modules increased from $6.5 million in 2004 to $13.7 million in 2005 with an increase in volume from 1.8 MW in 2004 to 3.4 MW in 2005. Net revenues from the sale of specialty solar modules and products increased to a lesser extent from $2.3 million in 2004 to $3.7 million in 2005 with an increase in volume from 0.4 MW to 0.7 MW in 2005.

The significant increase in the volume of our products sold was driven primarily by a significant increase in market demand for our standard solar modules, in particular in Germany and elsewhere in Europe. The average selling price of our standard solar modules rose from $3.62 per watt in 2004 to $3.92 per watt in 2005. The average selling price of our specialty solar modules and products decreased from $5.23 per watt in 2004 to $5.13 per watt in 2005. The decrease was primarily due to a change in our product mix from 2004 to 2005 as the orders on one of our specialty solar modules and products from 2004 ended in mid-2005. In addition, a larger percentage of the specialty solar modules and products that we sold in 2005 consisted of smaller-sized modules sold to Chinese domestic customers that were less complex and commanded a lower average selling price per watt. The prices that we charge for specialty solar modules and products are not directly comparable from period to period, nor between different products. See Product Mix and Pricing.

Cost of Revenues. Our cost of revenues increased significantly from $6.5 million in 2004 to $11.2 million in 2005. The increase in our cost of revenues was due primarily to a significant increase in our expenditures on silicon feedstock and solar cells. This was caused by a significant increase in the quantity of solar cells needed to produce an increased output of our standard solar modules and the rising prices of silicon feedstock and solar cells due to the industry-wide shortage of high-purity silicon. As a percentage of our total net revenues, however, cost of revenues decreased from 66.8% in 2004 to 61.2% in 2005 primarily because of the cost savings we achieved largely through our silicon reclamation program in 2005, which allowed us to purchase more lower-cost reclaimable silicon for use in our toll manufacturing arrangements with ingot, wafer and cell suppliers. The decrease was also due in part to the economies of scale achieved through an increase in our production volume.

Gross Profit. As a result of the foregoing, our gross profit increased significantly from $3.2 million in 2004 to $7.1 million in 2005. Our gross margin increased from 33.2% in 2004 to 38.8% in 2005.

Operating Expenses. Our operating expenses increased by 36.5% from $1.4 million in 2004 to $1.9 million in 2005. Operating expenses as a percentage of our total net revenue decreased from 14.2% in 2004 to 10.3% in 2005. The increase in our operating expenses was due primarily to an increase in our general and administrative expenses, offset by decreases in our selling expenses and research and development expenses.

Selling Expenses. Our selling expenses decreased by 41.4% from $268,994 in 2004 to $157,763 in 2005. Selling expenses as a percentage of our total net revenues, decreased from 2.8% in 2004 to 0.9% in 2005. The

Table of Contents

decrease in our selling expenses was due primarily to a significant decrease in sales commissions. In 2005 we negotiated a reduction of our cash sales commissions with our sales and marketing personnel. We intend to prospectively tie a portion of sales commissions related to future product sales by granting either options to purchase our common shares or by granting restricted shares. The decrease was offset in part by an increase in salaries and benefits as we hired additional sales personnel to handle our increased sales volume.

General and Administrative Expenses. Our general and administrative expenses increased by 59.7% from $1.1 million in 2004 to $1.7 million in 2005. The increase in our general and administrative expenses was due primarily to increases in salaries and benefits for our administrative and finance personnel as we hired additional personnel in connection with the growth of our business. The increase was also due to foreign exchange losses as a result of the fluctuations of the Euro, which was the currency that most of our sales contracts were denominated in prior to mid-2005, against the U.S. dollar. However, general and administrative expenses as a percentage of our total net revenues decreased from 11.0% in 2004 to 9.3% in 2005, primarily as a result of the greater economies of scale we achieved in 2005.

Research and Development Expenses. Our research and development expenses decreased by 59.7%from $40,623 in 2004 to $16,381 in 2005.

Interest Expenses. We incurred interest expenses of approximately $239,225 in 2005 compared to none in 2004. Our interest expenses in 2005 were primarily attributable to the non-cash charges that we accrued in connection with the convertible notes that we issued to HSBC and JAFCO in November 2005 and, to a lesser extent, to interest on short-term borrowings.

Loss on Change in Fair Value of Derivatives Related to Convertible Notes. We recorded a charge of $316,000 in 2005 compared to none in 2004. The loss on change in fair value of derivatives related to convertible notes was recorded in connection with an increase in the option value of the convertible notes that we issued to HSBC and JAFCO in November 2005.

Loss on Financial Instruments Related to Convertible Notes. We recorded a non-cash charge of $263,089 in 2005 compared to none in 2004.

Income Tax Expense. Our income tax expense increased by 66.8% from $362,882 in 2004 to $605,402 in 2005, primarily because of increased profitability, offset by the tax benefit from an increase in accrued warranty costs, which were recorded as deferred tax assets under U.S. GAAP.

Net Income. As a result of the cumulative effect of the above factors, net income increased significantly from $1.5 million in 2004 to $3.8 million in 2005. Our net margin increased from 15.0% in 2004 to 20.8% in 2005.

B. Liquidity and Capital Resources

Cash Flows and Working Capital

To date, we have financed our operations primarily through cash flows from operations, short-term borrowings, convertible note issuances, as well as equity contributions by our shareholders. As of December 31, 2006, we had $40.9 million in cash and cash equivalents. Our cash and cash equivalents primarily consist of cash on hand, demand deposits and liquid investments with original maturities of three months or less that are outstanding and placed with banks and other financial institutions. As of December 31, 2006, we did not have any convertible notes outstanding. All of our convertible notes previously issued were converted into our common shares in July 2006. See Item 7. Major Shareholders and Related Party Transactions Issuance, Sale and Conversion of Convertible Notes.

We have significant working capital commitments because our suppliers of solar wafers, cells and silicon raw materials require us to make prepayments in advance of their shipment. Our suppliers typically require us to make prepayments in cash of 20% to 30% of the purchase price and require us to pay the balance of the purchase price by letters of credit or additional cash payments prior to delivery. In a long term supply contract, customary with the current industry practice, we agreed to make large amounts of prepayments in cash to our supplier in advance of the planned delivery with the prepayments being proportionally off-set at deliveries from the supplier during the contract term. Due to the industry-wide shortage of high-purity silicon, working capital and access to financings to

Table of Contents

allow for the purchase of silicon feedstock are critical to growing our business. Advances to suppliers increased significantly from $4.7 million as of December 31, 2005 to $13.5 million as of December 31, 2006. While we also require some of our customers to make prepayments, there is typically a lag between the time of our prepayment for solar cells and silicon raw materials and the time that our customers make prepayments to us.

We expect that accounts receivable and inventories, two of the principal components of our current assets, will continue to increase as our net revenues increase. We require prepayments in cash of 20% to 30% of the purchase price from some of our customers, and require many of them to pay the balance of the purchase price by letters of credit prior to delivery. These prepayments are recorded as our current liabilities under advances from suppliers and customers, and amounted to $273,231 as of December 31, 2004, $2.8 million as of December 31, 2005 and $3.2 million as of December 31, 2006. Until the letters of credit are drawn in accordance with their terms, the balance purchase price is recorded as accounts receivable. As the market demand changes and we continue to diversify our geographical markets, we have increased and may continue to increase credit term sales to our creditworthy customers after careful review of the customers credit standings. Inventories have also increased significantly due to our toll manufacturing arrangements and the rapid growth of our operation and business. We do not record the silicon feedstock and other silicon raw materials that we source and provide to toll manufacturers in our net revenues. We account for the silicon feedstock as consigned inventory and for payments received from our toll manufacturers as advances from suppliers and customers. Because of the prepayment and the letters of credit payment requirements that we impose on our customers, our allowance for doubtful accounts has not been significant in prior years. Allowance for doubtful accounts was nil for 2006. While we plan to increase credit term sales in 2007 to selected creditworthy customers, we cannot assure you that the allowance for doubtful accounts will remain at zero in the future.

The following table sets forth a summary of our cash flows for the periods indicated:

	Year Ended December 31,			
	2003	2004	2005	2006
	(In thousands of US$)			
Net cash provided by (used in) operating activities	$ 1,752	$ 440	$ (4,670)	$ (46,276)
Net cash used in investing activities	(441)	(252)	(646)	(7,770)
Net cash provided by financing activities			9,330	88,307
Net increase (decrease) in cash and cash equivalents	1,283	180	4,221	34,631
Cash and cash equivalents at the beginning of the year	596	1,879	2,059	6,280
Cash and cash equivalents at the end of the year	$ 1,879	$ 2,059	$ 6,280	$ 40,911

Operating Activities

Net cash used in operating activities increased from $4.7 million in 2005 to $46.3 million in 2006, primarily due to our solar cell and silicon materials purchase advance payments as well as the rapid growth of our solar module operation and business. The increase in cash outflow in 2006 mainly resulted from a significant increase in the level of our inventories (particularly silicon feedstock) due to the increase in our toll manufacturing arrangements in 2006 and advances to suppliers and accounts receivable at the end of 2006 compared to the end of 2005. Net cash used in operating activities in 2005 was $4.7 million, compared to net cash provided by operating activities in 2004 of $439,550. The change from cash inflow to cash outflow in 2005 was mainly a result of a significant increase in the level of our inventories, in particular silicon feedstock, due to the increase in our toll manufacturing arrangements in 2005, advances to suppliers and accounts receivable at the end of 2005 compared to the end of 2004. This was partially offset by a higher net income in 2005 and a significant increase in accounts payable as at the end of 2005 compared to the end of 2004.

Investing Activities

Net cash used in investing activities increased from $645,997 in 2005 to $7.7 million in 2006, primarily due to the construction and installation of our new solar cell manufacturing facility. Net cash used in investing activities increased from $252,249 in 2004 to $645,997 in 2005, primarily as a result of an increase in our purchase of

Table of Contents

property, plant and equipment for our silicon reclamation program, as well as the expansion of our assembly lines for the production of solar module products.

Financing Activities

Net cash provided by financing activities increased from $9.3 million in 2005 to $88.3 million in 2006, primarily as a result of the proceeds from our initial public offering in November 2006. Net cash provided by financing activities amounted to $9.3 million in 2005, representing the net proceeds received from a $1.3 million short-term borrowing and a $8.1 million convertible note issuance. We did not raise any funds through financing activities in 2004.

We believe that our current cash and cash equivalents, anticipated cash flow from operations and planned commercial bank borrowings will be sufficient to meet our anticipated cash needs, including our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional cash due to changing business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our existing cash is insufficient to meet our requirements, we may seek to sell additional equity securities or debt securities or borrow from lending institutions. We cannot assure you that financing will be available in the amounts we need or on terms acceptable to us, if at all. The sale of additional equity securities, including convertible debt securities, would dilute our shareholders. The incurrence of debt would divert cash for working capital and capital expenditures to service debt obligations and could result in operating and financial covenants that restrict our operations and our ability to pay dividends to our shareholders. If we are unable to obtain additional equity or debt financing as required, our business operations and prospects may suffer.

Capital Expenditures

We made capital expenditures of $253,570, $560,793 and $7.1 million in 2004, 2005 and 2006, respectively. In the past, our capital expenditures were used primarily to purchase equipment for our silicon reclamation program and for the expansion of our assembly lines for the production of solar modules. Our capital expenditures in 2006 have been used primarily to purchase manufacturing equipment for the expansion of our solar module assembly lines and for the establishment of a solar cell plant.

Restricted Net Assets

Our PRC subsidiaries are required under PRC laws and regulations to make appropriations from net income as determined under accounting principles generally accepted in the PRC, or PRC GAAP, to non-distributable reserves which include a general reserve and a staff welfare and bonus reserve. The general reserve is required to be made at not less than 10% of the profit after tax as determined under PRC GAAP. The staff welfare and bonus reserve is determined by our board of directors. The general reserve is used to offset future extraordinary losses. Our PRC subsidiaries may, upon a resolution of the board of directors, convert the general reserve into capital. The staff welfare and bonus reserve is used for the collective welfare of the employees of the PRC subsidiaries. These reserves represent appropriations of the retained earnings determined under PRC law. In addition to the general reserve, our PRC subsidiaries are required to obtain approval from the local government authorities prior to distributing any registered share capital. Accordingly, both the appropriations to general reserve and the registered share capital of the our PRC subsidiaries are considered as restricted net assets. These restricted net assets amounted to $851,516, $4.6 million and $51.6 million as of December 31, 2004, 2005, and 2006, respectively.

C. Research and Development, Patents and Licenses, Etc.

As of December 31, 2006, we had 14 research and product development employees. We currently have approximately 34 technical and engineering employees. Our research and development efforts have focused on the following areas:

(a) silicon reclamation and technologies which allow manufacturing of solar cells using low-cost silicon feedstock; (b) improving the conversion efficiency of solar cells; (c) improving manufacturing yield and reliability of solar modules and reducing manufacturing costs; and (d) designing and developing new and efficient specialty solar modules and products to meet customer requirements. Our research and development team works closely with our manufacturing team, our suppliers, our partners and our customers.

Table of Contents

Our senior management, led by Dr. Qu, our founder, chairman and chief executive officer, Mr. Genmao Chen, our director of research and development, Dr. Lingjun Zhang, our general manager of CSI Cells, and Mr. Chengbai Zhou, our principal technical fellow for solar modules, all have extensive experience in the solar power industry. We have also established collaborative research and development relationships with a number of universities and research institutes, including the University of Toronto in Canada and Tsinghua University in China.

Going forward, we will focus on the following research and development initiatives, which, among other projects, we believe will contribute to our competitiveness:

Silicon materials and reclamation technologies. We will seek to improve our technologies and know-how to increase the efficiency of our silicon reclamation program, including increasing the yields on our recovery of scrap silicon. We are developing new technologies and designing equipment for refining certain scrap silicon materials and expanding on the type of materials that can be utilized to manufacture solar cells. We are also developing technologies which allow us to use partial or 100% of low-cost silicon feedstock for manufacturing of solar cells.

Solar module manufacturing technologies. We intend to focus on developing state-of-the-art testing and diagnostic techniques that improve solar module production yield and efficiency. We are also studying light transmission and reflection technologies inside the solar module to find ways to increase the light absorption of solar cells for the purpose of improving power output.

Product development of specialty solar modules and products. We will seek to improve our product development capabilities for specialty solar modules and products to position ourselves for the expected growth in this area of the solar power market. For example, we are collaborating with a research institute in China to develop a concentrator module technology and a glass curtain wall company based in China to develop a building-integrated photovoltaic, or BIPV, technology. We expect our first BIPV project will be installed in the City of Luoyang, China by the end of the second quarter of 2007.

Solar cell manufacturing. As we expand into solar cell manufacturing, we have invested both manpower and equipment in the development of process technologies to increase the conversion efficiencies of our solar cells.

D. Trend Information

Other than as disclosed elsewhere in this annual report on Form 20-F, we are not aware of any trends, uncertainties, demands, commitments or events that are reasonably likely to have a material adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

E. Off-balance Sheet Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder s equity, or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or that engages in leasing, hedging or research and development services with us.

Table of Contents

F. Tabular Disclosure of Contractual Obligations

Contractual Obligations and Commercial Commitments

The following table sets forth our contractual obligations and commercial commitments as of December 31, 2006:

	Payment Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	(In thousands of US$)				
Short-term debt obligations	$ 3,311	$ 3,311	$	$	$
Interest related to short-term debt[1]	32	32			
Operating lease obligations	318	222	96		
Purchase obligations[2]	19,900	12,400	3,750	3,750	
Other long-term liabilities reflected on the company s balance sheet	875				875
Total	$ 24,436	$ 15,965	$ 3,846	$ 3,750	$ 875