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CSIQ - Q2 2019 Canadian Solar Inc Earnings Call

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## OVERVIEW:

Co. reported 2Q19 net revenue of \$1,036.3m, net income attributable to Co.'s shareholders of \$62.7m, or \$1.04 per diluted share. Expects 2019 total revenue to be \$3.5-3.8b and 3Q19 revenue to be \$780-810m.



## CORPORATE PARTICIPANTS

### Ed Job

**Huifeng Chang** *Canadian Solar Inc. - Senior VP & CFO*

**Xiaohua Qu** *Canadian Solar Inc. - Chairman, President & CEO*

**Yan Zhuang** *Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions*

## CONFERENCE CALL PARTICIPANTS

**Colin William Rusch** *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

**Mark Wesley Strouse** *JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst*

**Philip Shen** *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

## PRESENTATION

### Operator

Ladies and gentleman, thank you for standing by. Welcome to the Canadian Solar Second Quarter 2019 Earnings Conference Call. My name is Leslie, and I will be your operator for today. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the call over to Ed Job, Managing Director of Canadian Solar's IR Department. Please go ahead, sir.

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### Ed Job

Thank you, operator, and welcome all to Canadian Solar's Second Quarter 2019 Earnings Conference Call. On a personal note, I had a great and productive time working with the entire Canadian Solar team in my previous stint coordinating our Investor Relations program. And after a restful sabbatical, I am happy to be back, and I look forward to working with all of you.

Joining us today on the call are Dr. Shawn Qu, Chairman and Chief Executive Officer; Yan Zhuang, Acting Chief Executive Officer; and Dr. Huifeng Chang, Senior Vice President and Chief Financial Officer. On this call, Shawn will provide a brief introduction; followed by Yan, who will reveal the execution of our business strategy; and Huifeng, who will go over our financial results. We will then open the call to your questions.

Before we begin, may I remind our listeners that management's prepared remarks today as well as their answer to your questions will contain forward-looking statements, which are subject to risks and uncertainties. Therefore, the company claims the protection of the safe harbor for forward-looking statements that is contained in the Private Securities Litigation Reform Act of 1995. Actual results may differ from management's current expectations. Any projection of the company's future performance represent management's estimates as of today. Canadian Solar assumes no obligation to update these projections in the future, unless otherwise required by applicable law. A more detailed discussion of risks and uncertainties can be found in the company's annual report on Form 20-F filed in the Securities and Exchange Commission. Management's prepared remarks will be presented within the requirements of SEC Regulation G regarding generally acceptable -- accepted accounting principles, or GAAP. Some financial information presented during the call will be provided on both GAAP and non-GAAP basis. By disclosing certain non-GAAP information, the management intends to provide investors with additional information to allow further analysis of the company's performance and the underlying trends. Management uses non-GAAP measures to better assess operating performance and establish operational goals. Non-GAAP information should not be viewed by investors as a substitute for prepared -- for data prepared in accordance to GAAP.

At this time, I would like to turn the call over to Canadian Solar's Chairman and CEO, Dr. Shawn Qu. Shawn, please go ahead.



**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Thanks, Ed, and welcome everyone. I'm excited to join today's earnings call. Before Yan and Huifeng speak to you about our strong Q2 results, I have a few personal words to share. Since the accident I endured in May, the outreach to me and my family from all corners of the world, within and outside the solar industry, have been comforting and encouraging. Thank you so much for the kind prayers and thoughtful support. I'm still rehabilitating and making progress every day. I have been communicating with our managers and engaging in the company's business on a daily basis over important and strategic decisions.

Regarding our Q2 results, first, Yan, our Acting CEO, has led the team to accomplish more than what I expected. Once again, Canadian Solar has demonstrated the robustness and resilience of its long-term strategy with a differentiated business model. I have full confidence in Yan's leadership and the strength of our seasoned team, who will continue to execute and deliver solid results in the coming quarters.

Second, I'm incrementally more positive in our outlook for the second half of 2019 based on healthier demand for our differentiated products and services in key markets, in improvement in our cost structure, higher capacity utilization rate and solid execution within the Energy group. As my trouble is now reduced, I have more time to read reports and articles and to deliberate on a strategy for the company and the future of the solar industry. Further, stepping back from daily operations gives me more time to strategically review the fundamentals of our business model such as how to optimize the structure of the Module and System Solutions group and the Energy group. My priority remains unchanged, which is to increase the value for the company and our shareholders.

With that, I would like to pass the line to Yan. Yan, please go ahead.

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**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Thank you, Shawn. We're very glad that you're joining us on today's call. The key takeaways from Q2 are: one, we achieved strong results for the second quarter, with solar module shipments, revenue and gross margin all above expectations. We greatly improved our profitability through solid execution across all aspects of our businesses.

Two, we strengthened the executive team to help accelerate efforts to enhance shareholders' value. Specifically, Ismael Guerrero Arias rejoined the company to further sharpen the performance of the Energy business. Ed Job has also returned to bolster an engagement with our shareholders and the investor community.

Three, we continue to strengthen Canadian Solar's leadership position through targeted and high-ROI R&D investments.

Four, we remain on track to monetize the majority of the 3.6 gigawatts late-stage project pipeline in 2020 or later.

And five, as Shawn mentioned, we are incrementally more positive in the outlook for the second half of 2019. We are firmly on track in our business execution and timing.

Now let me go through results for the second quarter. Our strong Q2 results were due to solid execution across the MSS and Energy groups, including the many synergies between the 2 businesses. For Q2, revenue from the MSS business was \$673.1 million, gross margin was 22.8% and operating income was \$58.4 million. The better-than-expected gross margin benefited from a lower blended module manufacturing cost and a stabilized average module selling price.

Canadian Solar continues to differentiate and drive value through its premium brand, global sales channels and reliability of quality products. During the quarter, we signed a multiyear module supply agreement with EDF Renewables North America to deliver 1.8 gigawatts of high-efficiency BiHiKu and HiKu modules to EDF's projects in the U.S., Canada and Mexico. This is the largest module supply agreement in Canadian Solar's 18-year history.



In addition, we signed a 500-megawatt supply -- module supply agreement with Solarcentury for its solar-powered projects in Spain. A big reason why Canadian Solar is winning is that our products not only provide customers with the best ROI but also the most favorable financing options from financial institutions. Most recently, Canadian Solar was ranked #1 by Bloomberg New Energy Finance in terms of bankability. 100% of the respondents surveyed by BNEF considered Canadian Solar's modules bankable. We are proud of this achievement and the superior recognition from the industry.

We're also encouraged by Canadian Solar's ongoing R&D leadership and innovation. We expect to complete the transition of all our cell capacity into PERC by end of August 2019. This will give Canadian Solar a further competitive advantage as we expand bifacial capacity to meet increasing global demand. Further, we're pleased with the results of the EPC and O&M businesses. We now have 966 megawatts of EPC projects under execution and a growing O&M portfolio of over 2.9-gigawatts projects contracted globally.

Canadian Solar also continues to achieve strong results in the Energy business. In Q2, we completed the sale of 228-megawatt solar projects globally. This includes 134 megawatts in the U.S., 68 megawatts in Mexico, 20 megawatts in China and 6 megawatts in Namibia. Last week, we completed the sale of around 30% of Brazil's 482.6-megawatt late-stage project portfolio. We expect to complete the sale of the remaining Brazilian projects in the coming months. In addition to project sales, we successfully energized the 100 megawatts Cafayate projects in Argentina in July. This is now the country's largest operational solar power plant.

In line with our strategy, we will continue to redeploy capital into attractive opportunities to replenish and expand Canadian Solar's late-stage project pipeline. For example, in July, we were awarded a power purchase agreement of 25.6 megawatts of electricity in Brazil's latest government auction. We also signed a 32 megawatts power purchase agreement for the largest solar project in Alberta, Canada. Both projects will use Canadian Solar's high-efficiency bifacial modules.

In the U.S., we're working with PG&E to update power purchase agreements previously signed in 2017 for a portion of the Gaskell West 2 project. This collaboration with PG&E will support California's commitment to 100% carbon-free electricity while also enhancing the overall value of the project. The investor community has responded favorably to these proposed updates.

Our portfolio of late-stage utility-scale solar project projects, including those under construction, was over 3.6 gigawatts as of July 31. Projects in operation totaled 796 megawatts as of July 31, with an estimated resale value of approximately \$1 billion. The company's strategy is to opportunistically sell projects at various stages including pre-NTP or COD, based on market conditions. Given the typical development cycle, we expect to realize sales for the majority of our current 3.6-gigawatts late-stage project pipeline in 2020 or later. This timing is unchanged from what we have previously discussed.

Now let me comment on guidance for Q3 2019. We currently expect total Q3 module shipments to be in the range of 2.2 gigawatts to 2.3 gigawatts, including 160 megawatts of shipments to the company's owned utility-scale solar projects. Revenue is expected to be in the range of \$780 million to \$810 million. Gross margin is expected to be between 24% to 26%. This reflects the positive impact of planned higher gross margin project sales, primarily in Japan and the U.S. The aforementioned revenue forecast does not include the potential sales of a project that may be completed in the third quarter. If the transaction is closed in time, total revenue for the third quarter is expected to be in the range of \$970 million to 1 -- not -- sorry, the range of \$970 million to \$1 billion and gross margin between 27% and 29%.

For the full year 2019, the company now raises its guidance for total module shipments to be in the range of approximately 8.4 gigawatts to 8.5 gigawatts from the previous guidance of 7.4 to 7.8 gigawatts. Total revenue for the year is expected to be in the range of \$3.5 billion to \$3.8 billion. Canadian Solar remains committed to increase -- to increasing shareholder value by executing on our strategy for the MSS and Energy businesses while strengthening our balance sheet. In addition, we intend to improve shareholder communications to help enhance the investors -- the investor community's understanding of the strength of Canadian Solar's business model, strategy and performance track record. We look forward to further engage with you.

Let me now turn the call over to Huifeng for a more detailed review of results for the second quarter. Huifeng, please go ahead.



**Huifeng Chang** - Canadian Solar Inc. - Senior VP & CFO

Thank you, Yan. At the end of the -- Q2 results were above expectations. We achieved better-than-expected shipments, gross margin and revenue. The improved profitability reflects the benefits of low-cost, high-ASP, higher earnings contribution from our unconsolidated investees such as our J-REIT based in Japan and a net gain of foreign exchange. Q2 versus Q1 operating expense dropped from 20.8% of revenue to 11.8% of revenue, which resulted mainly from significantly higher sales turnover. Meanwhile, we reduced the inventory by \$47.3 million and improved days sales outstanding by 50 days. Importantly, we generated a \$225.8 million cash from operations, which allowed us to further lower total debt and then strengthen the balance sheet.

Now allow me to go over the financial numbers in detail. In Q2, total solar module shipments were 2,143 megawatts compared to 1,575 megawatts in Q1. Net revenue for Q2 was \$1,036.3 million, up 113.8% sequentially from Q1 and up 69.3% year-over-year. Net revenue for Q2 was comprised of \$673.1 million from the MSS business and \$375 million from the Energy business. Gross profit in Q2 was \$182.6 million compared to \$107.4 million in Q1 and \$159.4 million in Q2 last year. Gross margin Q2 was 17.6% compared to 22.2% in the first quarter of 2019 and a 24.5% in the second quarter of 2018. These numbers, except of Q1 2019, include antidumping and countervailing duty true-up benefits, which were \$21.6 million in Q2 2019 and a \$25.8 million in Q2 last year.

Excluding these benefits, non-GAAP gross margin would have been 15.5% in Q2 2019 and a 20.5% in Q2 2018. Total operating expenses were \$121.9 million in Q2 compared to \$100.8 million in Q1 and \$105.5 million in Q2 2018. Income from operations was \$60.7 million in Q2 compared to \$6.6 million in Q1 and \$53.9 million in Q2 of last year. Operating margin was 5.9% in Q2 compared to 1.4% in Q1 and 8.3% in Q2 over the prior year. Foreign exchange gain in Q2 was \$16.4 million compared to a loss of \$12.6 million in Q1 and a loss of \$2.5 million in Q2 of the prior year. We recorded a loss on the change in fair value of derivatives of \$12.5 million in Q2 compared to a loss of \$1.3 million in Q1 and a loss of \$7.6 million in Q2 2018.

Income tax expense was \$14 million compared to income tax benefits of \$7.5 million in Q1 and an income tax expense of \$7.8 million in Q2 2018. Net income attributable to Canadian Solar shareholders for Q2 was \$62.7 million or \$1.04 per diluted share. This compares to a net loss of \$17.2 million or \$0.29 per diluted share in Q1 2019 and a net income of \$15.6 million or \$0.26 per diluted share in Q2 2018. Net income attributable to Canadian Solar on a non-GAAP basis for Q2 2019 was \$14.4 million (sic) [\$46.4 million] or \$0.77 per diluted share. This excludes the AD/CVD true-up of \$21.6 million net of income tax effect.

Moving on to the balance sheet. At the end of Q2, Canadian Solar increased its balance of cash, and cash equivalents was \$438.5 million compared to \$370.2 million at the end of Q1. The restricted cash balance was \$542.5 million (sic) [\$525.8 million] at the end of Q2 compared to \$542.2 million at the end of Q1. Inventories at the end of Q2 were \$337.8 million compared to \$385.1 million at the end of Q1. Inventory turnover was 40 days in Q2 compared to 81 days in Q1. Short-term borrowings and a current portion of long-term borrowings on project assets at the end of Q2 totaled \$1.3 billion compared to \$1.4 billion at the end of Q1. Long-term borrowings at the end of Q2 were \$462.9 million compared to \$433.5 million at the end of Q1. Total debt at the end of Q2 was \$1.86 billion, of which \$430.8 million was nonrecourse. Short-term borrowings and the long-term borrowings directly related to utility-scale projects, which includes \$398.2 million of nonrecourse borrowing, totaled \$640.5 million at the end of Q2 compared to \$735 million at the end of Q1.

Finally, I would like to welcome Ed Job back to Canadian Solar team. Ed is a veteran in Investor Relations. He has deep knowledge and experience in strategic development, corporate finance and the solar industry. Ed will work closely with the analyst and investor community to improve the understanding of our business and enhance shareholder value.

With that, I would now like to open the call to your questions. Operator?

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We have the first question from the line of Brian Lee.

**Unidentified Analyst**

This is Alex on for Brian. Just a couple of quick ones from our side. I was wondering if you could provide a little more color on the Gaskell project. Just potentially why you decided to take the voluntary cuts? And what you think the valuation impact will be?

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**Huifeng Chang** - *Canadian Solar Inc. - Senior VP & CFO*

Alex, this is Huifeng. First of all, the size of that Gaskell West project is 60 megawatts. So relative to our late-stage pipeline, multiple gigawatts is not significant. And second, that agreement with PG&E, about 10% reduction in the PPA price, is subject to the backup support and the CPUC approval. Now in that negotiation, we will get a delay on the delivery of the project. Exactly, I don't have the details, but it will be a couple of years. So that will allow us to reduce the cost building this project. Now overall, we believe the project coming out of all these negotiation will remain viable, not only for us but for the future permanent owner of the assets. So everything included, I think this will be amicable conclusion of this PG&E [modifier] this page and then eventually, we will deliver the upside, and then we will find a buyer that will make the project profitable.

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**Unidentified Analyst**

Okay. Great. Appreciate the additional insight there. I guess to change gears a little, can you provide information on which project is potentially being sold in the third quarter?

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**Huifeng Chang** - *Canadian Solar Inc. - Senior VP & CFO*

That will be a project in Japan.

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**Yan Zhuang** - *Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions*

The 3 projects, one of them is in China, one in Japan, the other one is in U.S.

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**Huifeng Chang** - *Canadian Solar Inc. - Senior VP & CFO*

Yes. But the major portion of the potential -- like we provided the 2 numbers for the Q3 revenue guidance, and that difference is mainly for the project in Japan. Other projects, we believe, most likely will be closed in Q3. But for the project in Japan, we think we maybe, very likely, able to close it in Q3, but there's a probability it may slip into Q4.

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**Operator**

We have the next question from the line of Philip Shen.

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**Philip Shen** - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

First ones are around guidance. I think you took your full year module shipments up by roughly 10%, but revenues are expected to be the same. Can you address why? And then also on your Q4 call, you guys gave guidance for net income in 2019 to be lower than 2018. What are your thoughts on this now especially with the higher shipments? And then which projects are expected -- I'll just leave it there on the guidance.

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**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

So the first question, actually, we have higher shipment, but then we have less project sales as planned. So that's why you see a 10% up on shipment but revenue, not much change. That's the first [view]. Second question, you said something about Q4?

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**Philip Shen** - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Yes. That's right, Yan. On your Q4 call, you guys gave guidance for the full year. 2019 net income will be lower than 2018. What's your updated view on that now?

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Philip, this is Shawn speaking. Our -- the 2019 guidance, which we provided in Q4 2018 call is more or less in line with the 2018 number rather than lower. So the new number is also more or less in line with the 2018 number rather than lower than the 2018 numbers. But as Yan said, for the project business, our second half, some of the project sales will -- maybe will happen in 2019. Therefore, for the whole year, the module shipment number is up, but we kept the revenue number more or less the same as before. But let's see. Maybe we'll have a pleasant surprise in Q4.

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**Philip Shen** - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Great. Secondly, in terms of China, I know you guys don't depend too much on the market but it is important for the industry, and marginally or incrementally, it is important. We know that Q4 looks like it's going to be strong. What are your expectations for how China develops in Q1 and Q2 of next year? And when do you think the 2020 policy could be released? And we've heard that potentially could be Q1, maybe early April, but what are your thoughts on those topics?

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Well, Philip, you know my view. My view is -- has always been conservative on China. So we talked about it in Q1. At that time, I was conservative on the Q2, Q3 result in China. And I think the actual result in the China market more or less reflected my prediction. Now Yan, do you have more to add on?

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**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Well, I think the 2 things worth to notice, first of all, is the project that's supposed to be connected by year-end, and it's slipping to Q1. So you will see some residue volume transfer from 2019 to early 2020. And secondly is you also see some carryover demand for U.S., see proper module from Southeast Asia, that will compete on the same source of wafer. And thirdly is -- important is the Tier 1. Actually in today's market, Tier 1 suppliers are actually receiving more and more volume, more and more share of the demand from market. That continue to grow. That trend continue to grow. So we will see -- next year, we will see, compared to this year, overall demand is flat. I'm not seeing a dramatic demand up, but for Tier 1, players should be the better product. I think we are cautiously optimistic.

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**Philip Shen** - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Okay. If I can squeeze in one more. Can you share what the megawatt shipments were to the U.S. in Q2? And what do you expect that to be for the full year?



**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Q2 for U.S., we see an increasing trend. The shipment to U.S., now starting from Q2, is going up. We see Q2 total volumes about 140, 150 megawatts, but Q3 is stronger. It's going to be higher.

**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Greater volume.

**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Yes. It's like up to 300 megawatts in Q3. So that's the number, roughly.

**Operator**

We have the next question from the line of Mark Strouse.

**Mark Wesley Strouse** - JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst

So it looks like you took up your year-end planned module capacity by about 1 gigawatt or so. Can you just provide some color behind that? Is -- should we assume that most of that is in bifacial? Or any color there?

**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Well, so I think the incremental volume is mainly in the second half. The strong demand come from 3 different sources. One is the U.S. safe harbor is going to be quite strong in [Q2, 4]. And China's new policy came actually after our annual guidance, and there -- that also caused a strong demand up in second half, particularly in Q4. And the third source of growth is the emerging market is getting strong. So that's why. I think this is why we are -- our total earning shipment is going up by gigawatts.

**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Mark, this is Shawn. Yes, I will add a few words. The new capacity, new module capacity, 1 gigawatt capacity, going into the all -- all of those capacities are going to be bifacial-compatible, and also, all of those capacities will support our new module format. We have a -- we released a new module. We call it HiKu. Basically, use a new standard of -- new standard size of the wafer, the 6.5-inch wafers, which provide significant higher per module output -- power output, therefore, reduce the installation cost. So only 1 gigawatt will be new factories and support these new module products.

**Mark Wesley Strouse** - JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst

Okay. That's helpful. And then just one quick follow-up. The below the line items, the equity and earnings of unconsolidated investees in 2Q was a lot higher than it's been in the past. Can you just go back to what drove that? And how we should think about that line item for the remainder of the year?



**Huifeng Chang** - Canadian Solar Inc. - Senior VP & CFO

Okay. First of all -- this is Huifeng. The income from the unconsolidated investee from 2 sources. One is from our listed vehicle in Japan, the J-REIT. That's several million U.S. dollars for Q2. And the other one is that we received a significant proceed for our road project in Texas, which is a joint venture between us and Southern Company. We own 49%. And then remember that about 3 years ago, there was -- when we were building that project, there was a hailstorm and -- actually 2. And then there was some damage or delay to the project. And now we got the insurance claim payment, and we shared that 41% deduct tax and so on. Overall, there's another significant income from there.

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**Operator**

(Operator Instructions) We have the next question from the line of Colin Rusch.

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**Colin William Rusch** - Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

Shawn, with the strategic work that you're doing, what can you tell us about the evolution of the technology serving the residential market, not just on the AC module side but the actual cell technology? And your expectations or cadence on how you can creep up efficiencies for that market?

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

So Colin, are you asking me? Or are you asking someone else?

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**Colin William Rusch** - Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

I'm asking you, Shawn.

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

All right, all right. So now, we are a module company, but we also provide complete kits. The total solution for some market, for example, the Japan market and now also to U.S. market and the South American market. So we have experience, strong experience in module but also some experience in the total solutions. On a module side, clearly, people want to have high-efficiency modules, so we have a product specifically designed for that. Recall that HiDM product. HiDM pretty much means high-density modules, something like that. So that's one product. And also, the residential customer pay a lot of attention to the cosmetic effect. Therefore, we are doing a lot in order to give a customer a perfect module, either perfect black or perfect blue, whatever you want.

Now on the systems side, we're introducing our own residential inverters and -- which got pretty good response from market. So -- and also the brand name support along. The brand name support either our module product and our total solution product. However, business model-wise, we rely on the distributor's network rather than doing sales ourselves. So we still see ourselves as a solutions provider rather than a distributor. So that's different from some of our competitors.

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**Colin William Rusch** - Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

That's really helpful. And I'll have a follow-up with you off-line on the inverter design if that's okay. And then can you give us an update in terms of how you see the development business evolving? Obviously, you're moving into some new geographies and working with some corporate customers. How do you see that business changing over the next, call it, 2 to 4 years in terms of where you're going to be able to work from a geographic perspective? And what sort of customer base -- your customer base -- or what the customer base actually looks like over time as you weave in some of these larger corporate customers?

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Right. For our Energy group, our important business, our main focus is the G20 countries because we are very risk-averse. So you may get high hidden tariff or high-priced PPA from some of the emerging market, but those PPA's are 20 years PPA. At some point, something may happen. So our -- see, our key focus in Energy business are still U.S., Canada, Japan and some of the countries in South America. So I still see our main focus in those countries, but we're also paying attention to some developing countries. And we have some breakthrough in some developing countries, too. Now Yan, do you have any comment to add?

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**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

I think, in particular in Japan, we see a strong trend of the big profit, self-consumption business model. And we have some well-known large profit that has a strong demand from module side for their own self-consumption projects with the big body. So that's pretty strong in Japan as well.

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**Operator**

(Operator Instructions) As there are no -- I'm sorry, we do have a question. We have a question from the line of Philip Shen.

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**Philip Shen** - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

We've seen cell ASPs decline meaningfully in recent weeks. How do you expect that to impact your margins ahead? I can imagine they're positive. But in general, can you also speak about how you expect module ASPs to trend in Q3 and in Q4?

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**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Actually, in terms of ASP, at least for us,, we do not see ASP erosion. Actually, for -- in some markets for some products, high-efficiency product, we see ASP moving up slightly, not dramatically. Overall, I will say it's very stable. ASP trend is very much stabilized. And into Q4, there is a high chance that there might be some upside opportunity. So this is what we observe.

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**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Well, Philip, we are seeing another interesting phenomena, which is the imbalance of the supply chain, imbalance on every step of the supply chain. We don't see much price movement on the polysilicon side. Well, the -- only the price for the casting, multicrystalline casting purpose of the polysilicon, that price dropped a little bit. But for the model, the polysilicon price remain pretty much flat, and we don't see much change on the wafer price either, but we see a significant change on the solar cell price. And what we heard -- what I heard is that on the wafer side, some of the major mono wafer companies were not able to produce as the nameplate capacity, either due to some ramp-up issues or due to the electricity supply. Some of the mono wafer suppliers choose to build their factories in a remote region to get the incentive of the electricity, but sometimes, the grid in those remote areas are not that reliable. This is what I heard.

And on the solar cell side, obviously, there's quite some over building on the over expansion of the solar cell capacity. And since the China capacity didn't take off as people expected, so this is what you'll see, the solar cell price dropped a lot. And it looks like the solar cell price drop have caused some module price drop inside China. But we pretty much sell to international market. So as Shawn -- as Yan said, we haven't seen much price change in our channel.

**Philip Shen** - Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst

Great. That's really helpful. In terms of your margin guidance, you guys have been providing this segment breakout, which has been very helpful for us, and your margin guidance is for the overall company. In Q2, your MSS business had almost 23% gross margin, Energy had about 6%. Can you comment on what you expect the margins to be by segment for Q3? And then longer term, can we expect a better gross margin out of the Energy business in the coming years?

**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Well -- sorry, Shawn. Go ahead.

**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Yes. I don't think so. If you read our Q3 guidance, you'll pretty much figure that for Q3, the Energy business gross profit have improved a lot. As I commented before, the project business are sometimes lumpy, and we sold some of the high-profit project in 2018. Therefore, there are some low-profit projects to be sold this year. So this is what you see in Q2. But overall, the average profit for our project pipeline is reasonably good.

**Yan Zhuang** - Canadian Solar Inc. - Acting CEO, Senior VP, Chief Commercial Officer and President of Modules & Systems Solutions

Our Q3 number, I think, our margin on project side is significantly higher than Q2. So it's, which segment? So it's -- so we guided overall profit -- overall margin for Q3 is more, 28%. So project margin is higher than that.

**Operator**

At this time, there are no further questions. I'd like to hand the call back to the speakers for any closing remarks.

**Xiaohua Qu** - Canadian Solar Inc. - Chairman, President & CEO

Hi, this is Shawn. Thank you for joining today's call and for your continued support. If you have any further follow-up questions, please contact our Investor Relations team, and have a great day.

**Operator**

Thank you, sir. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.

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