

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarter ended September 30, 2003

OR

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

COMMISSION FILE NUMBER 000-31687

**EVERGREEN SOLAR, INC.**  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

**DELAWARE**  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

**04-3242254**  
(I.R.S. EMPLOYER  
IDENTIFICATION NUMBER)

**259 Cedar Hill Street**  
**Marlboro, Massachusetts 01752**  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

**(508) 357-2221**  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes ☒ No ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 1, 2003 there were 11,647,583 shares of common stock outstanding.

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**EVERGREEN SOLAR, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2003**

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## PART I. FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

**Evergreen Solar, Inc.**  
**Condensed Consolidated Balance Sheets**  
(in thousands, except share data)  
(unaudited)

	September 30, 2003	December 31, 2002
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,977	\$ 1,194
Marketable securities	20,535	7,289
Accounts receivable, net of allowance for doubtful accounts of \$254 and \$140 at September 30, 2003 and December 31, 2002, respectively	2,376	2,848
Interest receivable	295	57
Inventory	1,945	2,194
Other current assets	611	1,012
Total current assets	29,739	14,594
Restricted cash	414	464
Fixed assets, net	21,355	16,905
Total assets	\$ 51,508	\$ 31,963
<b>Liabilities, convertible preferred stock and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 1,275	\$ 861
Accrued employee compensation	488	569
Accrued warranty	410	326
Other accrued expenses	282	294
Total current liabilities	2,455	2,050
<b>Convertible preferred stock</b>		
Series A, \$.01 par value, 26,227,668 and 0 shares authorized, 26,004,454 and 0 issued and outstanding at September 30, 2003 and December 31, 2002, respectively	30,232	—
<b>Stockholders' equity:</b>		
Common stock, \$.01 par value, 70,000,000 and 30,000,000 shares authorized, 11,647,583 and 11,410,826 issued and outstanding at September 30, 2003 and December 31, 2002, respectively	116	114
Additional paid-in capital	70,031	71,508
Accumulated other comprehensive income (loss)	(32)	7
Accumulated deficit	(51,141)	(41,356)
Deferred compensation	(153)	(360)
Total stockholders' equity	18,821	29,913
Total liabilities, convertible preferred stock and stockholders' equity	\$ 51,508	\$ 31,963

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

**Evergreen Solar, Inc.**  
**Condensed Consolidated Statements of Operations**  
(in thousands, except per share data)  
(unaudited)

	Three months ended September 30, 2003		Nine months ended September 30, 2003	
	2003	2002	2003	2002
Revenues:				
Product revenues	\$ 2,642	\$ 1,461	\$ 6,368	\$ 3,448
Research revenues	463	641	1,352	1,084
Total revenues	3,105	2,102	7,720	4,532
Operating expenses:				
Cost of product revenues	4,061	3,041	10,969	8,861
Research and development expenses, including costs of research revenues	1,087	935	2,872	2,776
Selling, general and administrative expenses	1,301	991	3,821	3,108
Total operating expenses	6,449	4,967	17,662	14,745
Operating loss	(3,344)	(2,865)	(9,942)	(10,213)
Interest income, net	83	133	157	585
Net loss	(3,261)	(2,732)	(9,785)	(9,628)
Accretion and dividends on Series A convertible preferred stock	(747)	—	(12,802)	—
Net loss attributed to common stockholders	(4,008)	(2,732)	(22,587)	(9,628)
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities	22	(46)	(39)	47
Comprehensive loss	\$ (3,986)	\$ (2,778)	\$ (22,626)	\$ (9,581)
Net loss per common share (basic and diluted)	\$ (0.35)	\$ (0.24)	\$ (1.97)	\$ (0.84)
Weighted average shares used in computing basic and diluted net loss per common share	11,497	11,408	11,440	11,403

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

**Evergreen Solar, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
(in thousands)  
(unaudited)

	Nine Months Ended September 30,	
	2003	2002
Cash flows from operating activities:		
Net loss	\$ (9,785)	\$ (9,628)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	1,544	1,476
Bad debt expense	114	—
Amortization of bond premiums	216	233
Write-off of fixed assets	—	43
Issuance of stock options to consultants	37	—
Compensation expense associated with employee stock options	207	215
Changes in operating assets and liabilities:		
Inventory	249	(1,563)
Interest receivable	(238)	190
Accounts receivable	358	(2,012)
Other current assets	401	(82)
Accounts payable	414	56
Accrued expenses	75	200
Net cash used in operating activities	(6,408)	(10,872)
Cash flows from investing activities:		
Purchases of fixed assets	(5,994)	(1,454)
Restricted cash	50	—
Purchases of marketable securities	(22,201)	(9,475)
Proceeds from sale and maturity of marketable securities	8,700	20,180
Net cash provided by (used in) investing activities	(19,445)	9,251
Cash flows from financing activities:		
Issuance of Series A convertible preferred stock	29,375	—
Financing costs on issuance of Series A convertible preferred stock	(849)	—
Proceeds from issuance of common stock warrant	100	—
Proceeds from exercise of stock options and shares purchased under Employee Stock Purchase Plan	10	14
Net cash flow provided by financing activities	28,636	14
Net increase (decrease) in cash and cash equivalents	2,783	(1,607)
Cash and cash equivalents at beginning of period	1,194	2,554
Cash and cash equivalents at end of period	\$ 3,977	\$ 947
Supplemental cash flow information:		
Taxes paid	13	36
Non-cash Series A convertible preferred stock dividends earned	1,114	—
Non-cash conversion of Series A convertible preferred stock to common	257	—

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

## EVERGREEN SOLAR, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Basis of Presentation

The accompanying condensed consolidated interim financial statements of Evergreen Solar, Inc. ("Evergreen Solar" or the "Company") are unaudited and have been prepared on a basis substantially consistent with the Company's audited financial statements for the year ended December 31, 2002. The condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Consequently, these statements do not include all disclosures normally required by generally accepted accounting principles for annual financial statements. These condensed consolidated interim financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2002, which are contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, which was filed with the Securities and Exchange Commission on March 27, 2003. The unaudited condensed consolidated interim financial statements, in the opinion of management, reflect all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the financial position at September 30, 2003, the results of operations for the three and nine month periods ended September 30, 2003 and 2002, and the cash flows for the nine month periods ended September 30, 2003 and 2002. The balance sheet at December 31, 2002 has been derived from audited financial statements as of that date. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for any other interim period or for the full fiscal year ending December 31, 2003.

The Company's preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reported periods. Estimates are used when accounting for the collectibility of receivables, valuing deferred tax assets, provisions for warranty claims and inventory obsolescence.

The Company has historically financed operations and met capital expenditures requirements primarily through sales of capital stock and, to a lesser extent, research and product revenues. The first of the Marlboro facility's two manufacturing lines became operational in 2001. As more fully described in Note 8 "Stockholders' Equity," on May 15, 2003, the Company consummated the private placement transaction contemplated by the purchase agreement entered into on March 21, 2003 with certain investors to raise \$29,475,000 through the issuance of 26,227,668 shares of Series A convertible preferred stock and the sale of a warrant to purchase 2,400,000 shares of common stock. The proceeds to the Company, net of financing expenses of approximately \$849,000, were approximately \$28.6 million. The Company expects to use the net proceeds from this transaction to fund the construction of the second manufacturing line and other operations of the Company. The Company expects portions of the second manufacturing line to become operational in late 2003 and that it will be completed in 2004. As of September 30, 2003, our outstanding commitments for capital expenditures were approximately \$3.3 million. Nearly all of its commitments for capital expenditures are associated with infrastructure improvements and equipment purchases for its manufacturing facility. In addition to the current capital commitments, substantial further capital expenditures will be required over the next twelve to eighteen months to increase the capacity at its manufacturing facility to its target level of 10 to 14 megawatts for both lines.

The Company may need additional financing to execute its business plan if the Company needs to respond to business contingencies such as the need to enhance its operating infrastructure, respond to competitive pressures and acquire complementary businesses or necessary technologies. The Company does not know whether it will be able to raise additional financing on favorable financing terms. If adequate funds are not available or are not available on acceptable terms, the Company's ability to fund its operations, develop and expand its manufacturing operations and distribution network, or otherwise respond to competitive pressures would be significantly limited.

### 2. Net Loss per Common Share

The Company computes net loss per common share in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS 128"), and SEC Staff Accounting Bulletin No. 98 ("SAB 98"). Under the provisions of SFAS 128 and SAB 98, basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding during the period. The calculation of diluted net loss per common share for the three and nine month periods ended September 30, 2003 and 2002 does not include 30,042,944 and 1,557,511 potential shares of common stock equivalents outstanding at September 30, 2003 and 2002, respectively, as their inclusion would be antidilutive.

### 3. Inventory

A summary of inventories is as follows:

	September 30, 2003	December 31, 2002
Raw materials	\$1,318,000	\$1,236,000
Work-in-process	30,000	148,000
Finished goods	597,000	810,000
	<u>\$1,945,000</u>	<u>\$2,194,000</u>

### 4. Cash and Investments

Cash and cash equivalents consist of cash and highly liquid investments with maturities of three months or less from the date of purchase and whose carrying amount approximates fair value.

The Company's investments are classified as available-for-sale. At September 30, 2003 and December 31, 2002 the Company held US government agency bonds, treasury notes, municipal bonds, corporate bonds and commercial paper. The investments generally mature within one year from the date of purchase and are carried at market value. Cash and investments have increased significantly since December 31, 2002 due to the Company's Series A convertible preferred stock and warrant financing that closed on May 15, 2003.

### 5. Fixed Assets

Fixed assets consisted of the following at September 30, 2003 and December 31, 2002 (in thousands):

	Useful Life	September 2003	December 2002
Laboratory and manufacturing equipment	3-7 years	\$11,764	\$10,997
Computer and office equipment	3-7 years	258	245
Leasehold improvements	Lesser of 15 to 20 years or lease term	6,584	6,273
Assets under construction		7,672	2,769
		<u>26,278</u>	<u>20,284</u>
Less accumulated depreciation		<u>(4,923)</u>	<u>(3,379)</u>
		<u>\$21,355</u>	<u>\$16,905</u>

Fixed assets have increased significantly since December 31, 2002 due to the Company's current production capacity expansion program. The Company expects portions of the second manufacturing line to become operational in late 2003 and that it will be completed in 2004. As of September 30, 2003, the Company's outstanding commitments for capital expenditures were approximately \$3.3 million. Nearly all of its commitments for capital expenditures are associated with infrastructure improvements and equipment purchases for its manufacturing facility. In addition to the current capital commitments, substantial further capital expenditures will be required over the next twelve to eighteen months to increase the capacity at our manufacturing facility to our target level of 10 to 14 megawatts for both lines.

### 6. Guarantor Arrangements

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45") "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34." FIN 45 requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken by issuing the guarantee. The accounting requirements for the initial recognition of guarantees are applicable on a prospective basis for guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for all guarantees outstanding, regardless of when they were issued or modified, during the first quarter of fiscal 2003. The adoption of FIN 45 did not have a material effect on the Company's consolidated financial statements. The following is a summary of the Company's agreements that are within the scope of FIN 45.



### *Product Warranty*

The Company provides for the estimated cost of product warranties at the time revenue is recognized. Given the Company's limited operating history, the Company uses historical industry solar panel failure rates as the basis for the accrued warranty costs during the period. While the Company engages in product quality programs and processes, including monitoring and evaluating the quality of component suppliers, its warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting a product failure. If the Company's actual product failure rates, material usage or service delivery costs differ from these estimates, accrued warranty costs would be adjusted in the period that such events or costs become known. Since the Company has a limited operating history and its manufacturing process differs from industry standards, its experience may be different from the industry data used as a basis for its estimate. While the Company's methodology takes into account these uncertainties, adjustments in future periods may be required as its products mature. The following table summarizes the activity regarding the Company's warranty accrual during the first nine months of 2003:

Balance at December 31, 2002	\$326,000
Accruals for warranties issued during the period	84,000
Settlements made during the period	—
	<hr/>
Balance at the end of the period	\$410,000
	<hr/>

### *Indemnification Agreements*

The Company enters into standard indemnification agreements in its ordinary course of business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally our business partners, directors and officers. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements under certain circumstances may be unlimited. However, the Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. Furthermore, the Company has a director and officer insurance policy pursuant to which the Company may recover all or a portion of amounts it pays to directors and officers under their indemnification agreements. As a result of the Company's insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal. The Company believes the estimated fair value of agreements with parties other than its directors and officers is minimal as well.

The Company agreed to indemnify, defend and hold harmless each of the purchasers participating in the Company's Series A private placement financing transaction, their affiliates and their respective officers, directors, agents, employees, subsidiaries, partners, members and controlling persons to the fullest extent permitted by law from and against any and all losses, claims or written threats thereof, damages, expenses (including reasonable fees, disbursements and other charges of counsel) resulting from or arising out of the Company's breach of any representation or warranty, covenant or agreement in the purchase agreement. The Company believes the estimated fair value of this indemnification agreement is minimal.

## **7. Deferred Compensation and Equity Related Charges**

Prior to December 31, 2000, the Company recorded total cumulative deferred compensation of approximately \$1.3 million, representing the difference between the fair market value of the Company's common stock and the exercise price on the option grant date. These amounts were presented as a reduction of stockholders' equity and are being amortized ratably over the vesting period of the options, which is generally four years. The amortization resulted in charges to operations of \$207,000 and \$215,000 for the nine months ended September 30, 2003 and 2002, respectively.

## **8. Stock Based Compensation**

The Company applies the accounting provisions of Accounting Principles Board ("APB") Opinion 25 and related interpretations and has elected the disclosure-only alternative permitted under Statement of Financial Accounting Standards Board ("SFAS") No. 123, "Accounting for Stock-Based Compensation." The Company has disclosed herein pro forma net loss using the fair value based method. All stock-based awards to non-employees are accounted for at their fair market value, as calculated using the Black-Scholes model in accordance with SFAS No. 123.

Had compensation expense for the employee stock option plan been determined based on the fair value at the grant dates for options granted under the plan consistent with the method of SFAS No. 123, net loss would have been as follows (in thousands, except per share data):

	Three Months Ended			
	September 30, 2003		September 30, 2002	
	Net Loss Attributable To Common Stockholders	Net Loss Per Common Share	Net Loss Attributable To Common Stockholders	Net Loss Per Common Share
Net loss attributed to common stockholders, as reported	\$(4,008)	\$(0.35)	\$(2,732)	\$(0.24)
Add: Stock-based employee compensation expense included in reported results	69	0.01	72	0.01
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all awards	(289)	(0.03)	(294)	(0.03)
Pro forma net loss attributed to common stockholders	\$(4,228)	\$(0.37)	\$(2,954)	\$(0.26)

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Nine Months Ended			
	September 30, 2003		September 30, 2002	
	Net Loss Attributable To Common Stockholders	Net Loss Per Common Share	Net Loss Attributable To Common Stockholders	Net Loss Per Common Share
Net loss attributed to common stockholders, as reported	\$(22,587)	\$(1.97)	\$(9,628)	\$(0.84)
Add: Stock-based employee compensation expense included in reported results	207	0.02	215	0.02
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all awards	(857)	(0.07)	(867)	(0.08)
Pro forma net loss attributed to common stockholders	\$(23,237)	\$(2.02)	\$(10,280)	\$(0.90)

## 9. Segment Information

The Company operates as one operating segment. The following table summarizes the Company's concentration of total revenue:

	Nine Months Ended September 30,	
	2003	2002
<b>By geography:</b>		
U.S. distributors	22%	29%
U.S. Government (research revenue)	18%	24%
Germany	56%	36%
Japan	0%	4%
All other	4%	7%
	100%	100%
<b>By customer:</b>		
European distributor #1	40%	33%
European distributor #2	10%	0%
National Institute of Industry Standards (research revenue)	8%	13%
National Renewable Energy Laboratory (research revenue)	9%	11%
All other	33%	43%
	100%	100%

## **10. Stockholders' Equity**

The Company has two classes of capital stock: common and preferred. In May 2003, the Company increased the number of authorized shares of common stock to 70,000,000. At September 30, 2003, 7,650,000 shares of common stock were authorized for issuance under the Company's 2000 Stock Option Plan and 40,000,000 shares were reserved for issuance upon conversion of Series A convertible preferred stock sold to several purchasers and upon exercise of a warrant issued to Beacon Power Corporation.

In May 2003, the Company increased the number of authorized shares of preferred stock to 27,227,668, of which 26,227,668 shares were designated Series A convertible preferred stock. On May 15, 2003, the Company consummated the transaction contemplated by a Stock and Warrant Purchase Agreement which was entered into on March 21, 2003 with Perseus 2000, L.L.C., Nth Power Technologies Fund II, LP, Nth Power Technologies Fund II-A, LP, RockPort Capital Partners, L.P., RP Co-Investment Fund, I, Micro-Generation Technology Fund, LLC, UVCC Fund II, UVCC II Parallel Fund, L.P., Caisse de depot et placement du Quebec, CDP Capital - Technology Ventures U.S. Fund 2002 L.P., Beacon Power Corporation, Massachusetts Technology Park Corporation, Zero Stage Capital VII, L.P., Zero Stage Capital (Cayman) VII, L.P., Zero Stage Capital SBIC VII, L.P., IMPAX Environmental Markets plc, Merrill Lynch New Energy Technology Plc, MLIIF New Energy Fund, PNE Invest Limited, Odyssey Fund, SAM Private Equity Energy Fund LP, SAM Sustainability Private Equity LP and SAM Smart Energy. As a result of the consummation of this transaction, the Company issued 26,227,668 shares of Series A convertible preferred stock at a per share purchase price of \$1.12. Additionally, Beacon Power Corporation purchased a warrant to purchase 2,400,000 shares of common stock at a per share exercise price equal to \$3.37, for \$100,000. A total of \$29,475,000 was raised as a result of the consummation of the transaction. The proceeds to the Company, net of financing expenses of approximately \$849,000, were approximately \$28.6 million for the

transaction. The shares of Series A convertible preferred stock were initially convertible into shares of common stock on a 1-to-1 basis which is subject to adjustment to account for the payment of dividends, to take into account certain changes to the Company's capital structure and to account for future dilutive issuances. As a condition to the obligation of the purchasers to consummate the financing transaction, the Company agreed to register for resale the shares of common stock issuable upon the conversion of the Series A convertible preferred stock and the exercise of the warrant.

As a result of the Series A convertible preferred stock and warrant financing, accretion and dividends of \$12.8 million was recorded for the nine-month period ended September 30, 2003. \$11.7 million of this charge was recognized immediately (during the second quarter) since the holders of shares of the Series A convertible preferred stock are entitled to convert their shares into common stock at any time. The sources of the discounts on issuance requiring this accretion charge and dividends are summarized in the following table:

Beneficial conversion feature	\$10,314,000
Proceeds allocated to the fair value of common stock warrant	525,000
Financing costs	849,000
Preferred stock dividend through September 30, 2003	1,114,000
	<hr/>
Total preferred stock accretion and dividends	\$12,802,000
	<hr/>

The difference between the issuance price of the Series A convertible preferred stock and the fair value of the Company's common stock on the date of issuance of the Series A convertible preferred stock resulted in a beneficial conversion feature totaling approximately \$10.3 million, which was calculated in accordance with EITF 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*.

#### *Liquidation Preference of Series A Convertible Preferred Stock*

In the event of voluntary or involuntary liquidation under applicable bankruptcy or reorganization legislation, dissolution or winding up, the holders of shares of Series A convertible preferred stock will be paid in cash for each share of Series A convertible preferred stock held thereby, out of the Company's assets legally available for distribution to stockholders, before any payment or distribution is made to any other class or series of the Company's capital stock, an amount equal to the greater of (i) the sum of (x) the Accreted Value of each share of Series A convertible preferred stock as of such date, plus (y) all dividends accrued since the previous Compounding Date, or (ii) the aggregate amount then payable with respect to the number of shares of common stock into which such share of Series A convertible preferred stock is convertible immediately prior to such liquidation event. The liquidation preference of the Series A convertible preferred stock initially will be the purchase price per share paid by the purchasers for the Series A convertible preferred stock of \$1.12, subject to adjustment.

In the event of the merger, consolidation or sale of all or substantially all of the Company's assets or in the event of certain other change of control transactions, the holders of shares of Series A convertible preferred stock will be paid for each share of Series A convertible preferred stock held thereby, before any payment or distribution is made to any other class or series of our capital stock, an amount equal to the greater of (i) the sum of the Accreted Value of each share of Series A convertible preferred stock as of such date, plus all dividends accrued since the previous Compounding Date, or (ii) the aggregate amount payable in the applicable change of control transaction with respect to the number of shares of our common stock into which a share of Series A convertible preferred stock is convertible immediately prior to the consummation of the change of control transaction. If the assets available for distribution to the holders of shares of Series A convertible preferred stock are insufficient to permit payment in full to the holders thereof of the amount described above, then all of the assets available for distribution to holders of shares of Series A convertible preferred stock will be distributed among and paid to those holders ratably in proportion to the amounts that would be payable to those holders if such assets were sufficient to permit payment in full. Any liquidation payment due upon a change of control transaction will be paid in the form of consideration paid in such change of control transaction on the closing date of the transaction.

"Accreted Value" means, as of any date, with respect to each share of Series A convertible preferred stock, the purchase price paid for such share, plus the amount of dividends that have accrued and compounded and have been added thereto to such date pursuant to the terms of the Certificate of the Powers, Designations, Preferences and Rights of the Series A Convertible Preferred Stock. "Compounding Date" means March 31, September 30, September 30 or December 31 of each year, each of which is a date upon which holders of shares of Series A convertible preferred stock are entitled to receive cumulative dividends quarterly in arrears.

### *Dividend Rights of Series A Convertible Preferred Stock*

Shares of Series A convertible preferred stock pay a compounding dividend of 10% per annum, paid quarterly, in cash, or at the Company's election, to be added to the liquidation preference of the Series A convertible preferred stock on a quarterly basis, which would result in an increase in the number of shares of common stock issuable upon conversion of the Series A convertible preferred stock. To date, a total of \$1,114,000 in dividends has accrued on the outstanding Series A convertible preferred stock, which the Company elected to add to the liquidation preference of the Series A convertible preferred stock. Subject to changes in business conditions, the Company presently anticipates that the dividend will be added to the liquidation preference for the foreseeable future.

### *Conversion of Series A Convertible Preferred Stock*

The holders of shares of Series A convertible preferred stock are entitled to convert their shares into common stock at any time. The number of shares of common stock issuable upon the conversion of a share of Series A convertible preferred stock is equal to the product of (x) the number of shares of Series A convertible preferred stock to be converted and (y) the quotient obtained by dividing the sum of the Accreted Value, plus all dividends accrued since the previous Compounding Date by the conversion price per share of the Series A convertible preferred stock, which conversion price initially was \$1.12.

The applicable conversion price is subject to adjustment for stock splits, stock dividends, combinations, and other similar structural events. Additionally, the Series A convertible preferred stock provides for full-ratchet anti-dilution protection, subject to standard exceptions, with respect to the issuance of the Company's capital stock at a purchase price per share which is below the conversion price of the Series A convertible preferred stock then in effect. If, on any date after May 15, 2005, the average market price for a share of common stock for the trailing 180 consecutive trading days is at least \$7.50 (subject to adjustment for stock splits, stock dividends, combinations, and other similar structural events), then the Company may elect, at its option, to convert all, but not less than all, of the outstanding shares of Series A convertible preferred stock into the number of shares of common stock as is equal to the product of (x) the number of shares of Series A convertible preferred stock to be converted and (y) the quotient obtained by dividing the sum of (i) \$1.12 and (ii) all accrued and unpaid dividends on such shares by the then applicable conversion price.

### *Voting Rights of Series A Convertible Preferred Stock*

Holders of the Series A convertible preferred stock will have the right to vote on all matters that the holders of common stock vote on, voting together with the holders of common stock as single class. Each share of Series A convertible preferred stock will be entitled to the number of votes as is equal to the number of shares of the Company's common stock into which it is convertible. However, the maximum number of votes to which a share of Series A convertible preferred stock will be entitled is capped at 0.7417, subject to adjustment to reflect stock splits, stock dividends, recapitalizations and the like.

### *Preemptive Rights of Series A Convertible Preferred Stock*

For so long as 5,350,000 of the shares of Series A convertible preferred stock remain outstanding, subject to adjustment to reflect stock splits, stock dividends, recapitalizations and the like, the purchasers will have preemptive rights for any private placement of equity securities by the Company.

## **11. Warrants**

In connection with the Series A convertible preferred stock financing transaction (described in Note 8), Beacon Power Corporation purchased a warrant for \$100,000, which is exercisable for 2,400,000 shares of the Company's common stock at an exercise price of \$3.37 per share. The warrant issued to Beacon Power Corporation is exercisable in whole (and not in part) at any time prior to May 14, 2006 and may not be exercised on a cashless basis. Additionally, Beacon Power Corporation purchased 892,857 shares of Series A convertible preferred stock for \$1,000,000. The total proceeds of \$1.1 million from Beacon Power Corporation were allocated between the Series A convertible preferred stock (\$475,000) and the warrant (\$625,000) based on their relative fair values. The fair value of the warrant was calculated using the Black-Scholes pricing model with the following assumptions: dividend yield of zero percent; expected volatility of 90%; risk free interest rate of 2% and a term of three years. The difference between the proceeds allocated to the relative fair value of the warrant, \$625,000, and the amount paid for the warrant, \$100,000, or \$525,000 was included in the accretion charge of \$12.8 million for the nine-month period ended September 30, 2003.

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

We caution readers that statements in this Quarterly Report on Form 10-Q that are not strictly historical statements, including, but not limited to: statements reflecting our expectations regarding the timing, cost, and success of our manufacturing scale-up at our facility in Marlboro, Massachusetts and future manufacturing expansion and production, as well as related financing requirements; future financial performance; our technology and product development, cost and performance; our current and future strategic relationships and future market opportunities; and our other business and technology strategies and objectives, constitute forward-looking statements which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements may be identified with such words as "we expect", "we believe", "we anticipate" or similar indications of future expectations. These statements are neither promises nor guarantees and involve risks and uncertainties, which could cause our actual results to differ materially from such forward-looking statements. Such risks and uncertainties may include, among other things, those risks and uncertainties described in this Quarterly Report and in our other filings with the Securities and Exchange Commission, copies of which may be accessed through the SEC's Web Site at <http://www.sec.gov>. We caution readers not to place undue reliance on any forward-looking statements contained in this Quarterly Report, which speak only as of the date of this Quarterly Report. We disclaim any obligation to publicly update or revise any such statements to reflect any change in our expectations, or events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in such forward-looking statements.

### **Overview**

We develop, manufacture and market solar power products for the global marketplace. Solar cells are semiconductor devices that convert sunlight into electricity and form the building block for all solar power products. To date, our product sales have been primarily solar panels, which have been used to generate electricity for on-grid and off-grid applications. Off-grid applications have included the electrification of rural homes, lighting for small, rural schools and power supplies for water pumping. More recently, the majority of our products have been used by on-grid customers as a clean, renewable source of alternative or supplemental electricity.

### **Financing Transaction**

On May 15, 2003, we consummated a private placement financing transaction with Perseus 2000, L.L.C., Nth Power Technologies Fund II, LP, Nth Power Technologies Fund II-A, LP, RockPort Capital Partners, L.P., RP Co-Investment Fund, I, Micro-Generation Technology Fund, LLC, UVCC Fund II, UVCC II Parallel Fund, L.P., Caisse de depot et placement du Quebec, CDP Capital - Technology Ventures U.S. Fund 2002 L.P., Beacon Power Corporation, Massachusetts Technology Park Corporation, Zero Stage Capital VII, L.P., Zero Stage Capital (Cayman) VII, L.P., Zero Stage Capital SBIC VII, L.P., IMPAX Environmental Markets plc, Merrill Lynch New Energy Technology Plc, MLIIF New Energy Fund, PNE Invest Limited, Odyssey Fund, SAM Private Equity Energy Fund LP, SAM Sustainability Private Equity LP and SAM Smart Energy. As a result of the consummation of this transaction, on May 15, 2003, we issued 26,227,668 shares of Series A convertible preferred stock at a per share purchase price of \$1.12. Additionally, Beacon Power Corporation purchased a warrant to purchase 2,400,000 shares of common stock at an exercise price equal to \$3.37 per share. A total of \$29,475,000 was raised as a result of the consummation of the transaction. The proceeds to us, net of financing expenses of approximately \$849,000, were approximately \$28.6 million. The shares of Series A convertible preferred stock were initially convertible into shares of common stock on a 1-to-1 basis which is subject to adjustment to account for the payment of dividends, to take into account certain changes to our capital structure and to account for future dilutive issuances. As a condition to the obligation of the purchasers to consummate the financing transaction, we agreed to register for resale the shares of common stock issuable upon the conversion of the Series A convertible preferred stock and the exercise of the warrant.

### **Results of Operations**

There were no material changes in the our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2002.

**Product revenues.** Product revenues consist of revenues from the sale of solar cells, panels and systems. Product revenues represented 82% of total revenues for the nine- month period ended September 30, 2003 and 76% of total revenues for the nine- month period ended September 30, 2002. International product sales accounted for approximately 74% of total product revenues for the nine-month periods ended September 30, 2003, and 2002.

Product sales to a German distributor accounted for approximately 49% and 44% of total product revenue for the nine-months ended September 30, 2003 and 2002, respectively. Product sales to a second German distributor accounted for approximately 12% and 0% of total product revenue for the nine-months ended September 30, 2003 and 2002, respectively. Product sales to a U.S. distributor accounted for 0% and 11% of total product revenue for the nine-months ended September 30, 2003 and 2002, respectively. We anticipate that international sales will continue to account for a significant portion of our product revenues for the foreseeable future. Currently, all product revenues are denominated in United States dollars. Foreign exchange rate fluctuations have impacted the relative competitiveness of our products in other markets, but we have not had any direct foreign exchange exposure relating to our sales. However, market conditions in the future may require us to denominate a portion of our sales in local currencies, which could further expose us to foreign exchange gains or losses. As we expand our manufacturing operations and distribution network internationally, our exposure to fluctuations in currency exchange rates may increase.

**Research revenues.** Research revenues consist of revenues from various state and federal government agencies to fund our ongoing research, development, testing and enhancement of our products and manufacturing technology. Our current intention is not to pursue contracts that are not part of our ongoing research activities. We recognize research revenues as services are rendered.

**Cost of product revenues.** Cost of product revenues consists primarily of salaries and related personnel costs, materials expenses, depreciation expenses, maintenance, rent, royalties on licensed technology, warranty costs, and other support expenses associated with the manufacture of our solar power products. We expect to continue to experience costs in excess of product revenues unless we are able to achieve greater manufacturing efficiencies, higher yields, and higher production levels.

**Research and development expenses, including cost of research revenues.** Research and development expenses, including cost of research revenues, consist primarily of salaries and related personnel costs, consulting expenses, and prototype costs related to the design, development, testing and enhancement of our products and manufacturing technology. We expense our research and development costs as incurred. We believe that research and development is critical to our strategic objectives of enhancing our technology, reducing manufacturing costs and meeting the changing requirements of our customers. As a result, we expect that our total research and development expenses will increase in the future. We currently have two active research contracts with total estimated revenues of approximately \$5.0 million, \$3.5 million of which has been authorized by the sponsoring agencies and \$3.4 million of which has been recorded as revenue as of September 30, 2003. We have fully recognized all revenue associated with our contract that expires on October 31, 2003, and we expect the remaining \$1.6 million of revenue will be recognized somewhat ratably over the remaining life of the second contract, which expires on May 31, 2005.

**Selling, general and administrative expenses.** Selling, general and administrative expenses consist primarily of salaries and related personnel costs, professional fees, rent, insurance and other sales expenses. We expect that selling expenses will increase substantially in absolute dollars as we increase our sales efforts, hire additional sales personnel and initiate additional marketing programs. We expect that general and administrative expenses will increase as we add personnel and incur additional costs related to the growth of our business.

**Interest income, net.** Net interest income consists primarily of interest earned on the holding of short-term, high quality commercial paper, corporate bonds and United States government-backed securities, less any bond premium amortization.

### **Comparison of Three Months Ended September 30, 2003 and 2002**

**Revenues.** Our product revenues for the three months ended September 30, 2003 were \$2.6 million, an increase of \$1.2 million, or 81%, from \$1.5 million for the same period in 2002. The increase in product revenues was due to the increased production capacity of our new manufacturing facility in Marlboro, Massachusetts, and our increased marketing and sales activities. Research revenues for the three months ended September 30, 2003 were \$463,000, a decrease of \$178,000, or 28%, from \$641,000 for the same period in 2002. The decrease in research revenues is the result of unusually high contract revenues in 2002 as at that time we were able to invoice costs on one R&D contract costs incurred prior to Q3 2002 in Q3 2002.

**Cost of product revenues.** Our cost of product revenues for the three months ended September 30, 2003 was \$4.1 million, an increase of \$1.0 million, or 33%, from \$3.0 million for the same period in 2002. Most of the increase was due to an increase in materials consumption and labor costs due to increased product sales. Product gross margin for the three months ended September 30, 2003 was -54% versus -108% for the same period in 2002. Product gross margin improved due primarily to yield and efficiency improvements associated with the scale-up of

our manufacturing line. Due to the relatively large component of fixed costs, product gross margins will still be highly dependent on sales volumes. Therefore, we do not expect substantial improvements in product gross margin until we realize production capacity increases associated with the inauguration of our second manufacturing line, expected in the first half of 2004.

**Research and development expenses, including cost of research revenues.** Our research and development expenses, including cost of research revenues, for the three months ended September 30, 2003 were \$1.1 million, an increase of \$152,000, or 16%, from \$935,000 for the same period in 2002. The increase was due mainly to increased activity associated with our research contract with the National Renewable Energy Laboratory (“NREL”) awarded in late 2002, as well as increased activity associated with other internal research and development programs.

**Selling, general and administrative expenses.** Our selling, general and administrative expenses for the three months ended September 30, 2003 were \$1.3 million, an increase of \$310,000, or 31%, from \$991,000 for the same period in 2002. The increase was primarily due to increased insurance costs and increased costs associated with sales and marketing initiatives.

**Interest income, net.** Our net interest income for the three months ended September 30, 2003 was \$83,000, a decrease of \$50,000, or 38%, from \$133,000 for the same period in 2002. The decrease in interest income was due to declining cash and investment balances for a portion of the period resulting from capital equipment purchases and funding of operations and generally lower yields realized on marketable securities.

**Accretion and dividends on preferred stock.** On May 15, 2003, we issued 26,227,668 shares of Series A convertible preferred stock at a per share purchase price of \$1.12 to several purchasers. Shares of Series A convertible preferred stock pay a compounding dividend of 10% per annum, paid quarterly, in cash, or at our election to be added to the liquidation preference of the Series A convertible preferred stock on a quarterly basis, which would result in an increase in the number of shares of common stock issuable upon conversion of the Series A convertible preferred stock. For the quarter ended September 30, 2003, \$747,395 in dividends accrued on the outstanding Series A convertible preferred stock, which we elected to add to the liquidation preference of the Series A convertible preferred stock. Subject to changes in business conditions, we presently anticipate that the dividend will be added to the liquidation preference for the foreseeable future.

**Other comprehensive income (loss).** Our other comprehensive income for the three months ended September 30, 2003 was \$22,000, compared to a loss of \$46,000 for the same period in 2002, consisting of net unrealized gains and losses on marketable securities.

#### **Comparison of Nine Months Ended September 30, 2003 and 2002**

**Revenues.** Our product revenues for the nine months ended September 30, 2003 were \$6.4 million, an increase of \$2.9 million, or 85%, from \$3.5 million for the same period in 2002. The increase in product revenues was due to the increased production capacity of our manufacturing facility, and our increased marketing and sales activities. Research revenues for the nine months ended September 30, 2003 were \$1.4 million, an increase of \$268,000, or 25%, from \$1.1 million for the same period in 2002. The increase in research revenues reflects revenue recognized on a research contract with the NREL awarded in late 2002.

**Cost of product revenues.** Our cost of product revenues for the nine months ended September 30, 2003 was \$11.0 million, an increase of \$2.1 million, or 24%, from \$8.9 million for the same period in 2002. Most of the increase was due to an increase in materials consumption and labor costs due to increased product sales. Product gross margin for the nine months ended September 30, 2003 was -72% versus -157% for the same period in 2002. Product gross margin improved due primarily to yield and efficiency improvements associated with the scale-up of our manufacturing line. Due to the relatively large component of fixed costs and scale-up of our production, product gross margins will still be highly dependent on sales volumes. Therefore, we do not expect substantial improvements in product gross margin until we realize production capacity increases associated with the inauguration of our second manufacturing line, expected in the first half of 2004.

**Research and development expenses, including cost of research revenues.** Our research and development expenses, including cost of research revenues, for the nine months ended September 30, 2003 were \$2.9 million, an increase of \$96,000, or 4%, from \$2.8 million for the same period in 2002. The increase was due mainly to increased activity associated with our research contract with the NREL awarded in late 2002, as well as increased activity associated with other internal research and development programs.



**Selling, general and administrative expenses.** Our selling, general and administrative expenses for the nine months ended September 30, 2003 were \$3.8 million, an increase of \$713,000, or 23%, from \$3.1 million for the same period in 2002. The increase was primarily due to increased insurance costs and increased costs associated with sales and marketing initiatives.

**Interest income, net.** Our net interest income for the nine months ended September 30, 2003 was \$157,000, a decrease of \$428,000, or 73%, from \$585,000 for the same period in 2002. The decrease in interest income was due to declining cash and investment balances for a portion of the period resulting from capital equipment purchases and funding of operations and generally lower yields realized on marketable securities.

**Accretion and dividends on preferred stock.** As disclosed above, on May 15, 2003, we issued 26,227,668 shares of Series A convertible preferred stock and warrant to purchase 2,400,000 shares of common stock. As a result of the preferred stock and warrant financing, accretion and dividends of \$12.8 million were recorded for the nine-month period ended September 30, 2003. \$11.7 million of this charge was recognized immediately (during the second quarter) since the holders of shares of the Series A convertible preferred stock are entitled to convert their shares into common stock at any time. The sources of the discounts on issuance requiring this accretion charge and dividends are summarized in the following table:

Beneficial conversion feature	\$10,314,000
Proceeds allocated to the fair value of common stock warrant	525,000
Financing costs	849,000
Preferred stock dividend through September 30, 2003	1,114,000
	<hr/>
Total preferred stock accretion and dividends	\$12,802,000
	<hr/>

The difference between the issuance price of the Series A convertible preferred stock and the fair value of our common stock on the date of issuance of preferred stock resulted in a beneficial conversion feature totaling approximately \$10.3 million, which was calculated in accordance with EITF 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*. Certain terms of the Series A convertible preferred stock might require us to calculate and record additional beneficial conversion charges in future periods.

The total proceeds of \$1.1 million from Beacon Power Corporation were allocated between the Series A convertible preferred stock (\$475,000) and the warrant (\$625,000) based on their relative fair values. The value of the warrant was calculated using the Black-Scholes pricing model with the following assumptions: dividend yield of zero percent; expected volatility of 90%; risk free interest rate of 2% and a term of three years. The difference between the proceeds allocated to the relative fair value of the warrant, \$625,000, and the amount paid for the warrant, \$100,000, or \$525,000 was included in the accretion charge of \$12.8 million for the nine-month period ended September 30, 2003.

**Other comprehensive income (loss).** Our other comprehensive loss for the nine months ended September 30, 2003 was \$39,000, compared to comprehensive income of \$47,000 for the same period in 2002, consisting of net unrealized gains and losses on marketable securities.

## Liquidity and Capital Resources

We have historically financed our operations and met our capital expenditures requirements primarily through sales of our capital stock and, to a lesser extent, research and product revenues. At September 30, 2003, we had working capital of \$27.3 million, including cash, cash equivalents and short-term investments of \$24.5 million.

Net cash used in operating activities was \$6.4 million for the nine months ended September 30, 2003, as compared to \$10.9 million for the nine months ended September 30, 2002. The decrease in net cash used in operating activities was primarily due to a decrease in our accounts receivable and inventory and an increase in accounts payable. For the third quarter in 2003, Days Sales Outstanding (DSO) was approximately 69 days, versus approximately 85 days for the second quarter of 2003. The decrease in DSO was due mainly to significant cash receipts during the third quarter of 2003 related to sales originating in the second quarter of 2003. Product sales to customers can fluctuate widely month-to-month, and depending on when sales occur during the quarter, DSO can fluctuate significantly quarter-to-quarter.

Net cash used in investing activities was \$19.4 million for the nine months ended September 30, 2003, as compared to net cash provided by investing activities of \$9.3 million for the nine months ended September 30, 2002. For the nine-months ended September 30, 2003, net cash was used to purchase equipment associated with the build-out of

our Marlboro manufacturing plant as well as purchases of marketable securities. For the nine months ended September 30, 2002, net cash was provided from the net sales of marketable securities somewhat offset by purchases of equipment associated with the build-out of our Marlboro manufacturing plant.

Net cash provided by financing activities was \$28.6 million for the nine months ended September 30, 2003, as compared to \$14,000 for the nine months ended September 30, 2002. The cash provided by financing activities principally represents the net proceeds resulting from our Series A convertible preferred stock and warrant financing which closed on May 15, 2003.

Capital expenditures were \$6.0 million for the nine months ended September 30, 2003, as compared to \$1.5 million for the nine months ended September 30, 2002. Capital expenditures for the nine months ended September 30, 2003 were primarily for equipment needed for our manufacturing facility. As of September 30, 2003, our outstanding commitments for capital expenditures were approximately \$3.3 million. Nearly all of our commitments for capital expenditures are associated with infrastructure improvements and equipment purchases for our manufacturing facility. The first of the Marlboro facility's two manufacturing lines became operational in 2001. We have purchased certain equipment that is planned for the second manufacturing line. We will fund our current capital commitments primarily with the proceeds from our Series A convertible preferred stock and warrant financing which closed on May 15, 2003. In addition to the current capital commitments, substantial further capital expenditures will be required over the next twelve to eighteen months to increase the capacity at our manufacturing facility to our target level of 10 to 14 megawatts for both lines. We expect portions of the second manufacturing line to become operational in late 2003 and that it will be completed in 2004. We believe that our cash, cash equivalents and short-term investments will be sufficient to fund our operations for the next 12 months.

We may need additional financing to execute our business plan sooner if we need to respond to business contingencies such as the need to enhance our operating infrastructure, respond to competitive pressures and acquire complementary businesses or necessary technologies. We do not know whether we will be able to raise additional financing or financing on terms favorable to us. If adequate funds are not available or are not available on acceptable terms, our ability to fund our operations, develop and expand our manufacturing operations and distribution network, or otherwise respond to competitive pressures would be significantly limited.

We currently do not have any special purpose entities or off-balance sheet financing arrangements. As of September 30, 2003, our cash commitments, as disclosed in Note 11 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2002, have not significantly changed.

## **Certain Factors Which May Affect Future Results**

### ***Risks Relating to Our Financial Results***

#### ***Evaluating our business and future prospects may be difficult due to our limited operating history.***

We are at an early stage of development and there is limited historical information available upon which you can base your evaluation of our business and prospects. We were formed in 1994 to research and develop crystalline silicon technology for use in manufacturing solar power products. Although we began shipping product from our pilot manufacturing facility in 1997, the primary objective of our pilot production line was the technical development and further refinement of our String Ribbon technology and related manufacturing processes. We shipped our first commercial products from our Marlboro manufacturing facility in September 2001. We have shipped only a limited number of solar power panels and have recognized limited revenues since our inception.

In addition, our early stage of development means that we have less insight into how market and technology trends may affect our business. The revenue and income potential of our business is unproven and the market we are addressing is rapidly evolving. 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 growing and rapidly evolving market.

#### ***We have a history of losses, expect to incur substantial further losses and may not achieve or maintain profitability in the future, which may decrease the market value of our stock.***

Since our inception, we have incurred significant net losses, including net losses of \$9.8 million for the nine-month period ended September 30, 2003. As a result of ongoing operating losses, we had a cumulative net loss of \$51.1 million as of September 30, 2003. We expect to incur substantial losses for the foreseeable future, and may never become profitable. Even if we do achieve profitability, we may be unable to sustain or increase our profitability in

the future, which could materially decrease the market value of our common stock. We expect to continue to incur significant capital expenditures and anticipate that our expenses will increase substantially in the foreseeable future as we seek to: expand our manufacturing operations, develop our distribution network, continue to research and develop our products and manufacturing technologies, implement internal systems and infrastructure in conjunction with our growth and hire additional personnel.

We do not know whether our revenues will grow at all or grow rapidly enough to absorb these expenses, and our limited operating history makes it difficult to assess the extent of these expenses or their impact on our operating results.

***Our stock price could fall substantially if our quarterly revenue or operating results fluctuate or are disappointing.***

Our quarterly revenue and operating results have fluctuated significantly in the past and may fluctuate significantly from quarter to quarter in the future due to a variety of factors, many of which are discussed elsewhere in this section.

We anticipate that our operating expenses will continue to increase significantly. If sales in any quarter do not increase correspondingly, our net losses for that period will increase. For these reasons, quarter-to-quarter comparisons of our results of operations are not necessarily meaningful and you should not rely on results of operations in any particular quarter as an indication of future performance. If our quarterly revenue or results of operations fall below the expectations of investors or public market analysts in any quarter, the market value of our common stock would likely decrease, and could decrease rapidly and substantially.

### ***Risks Relating to Our Industry, Products and Operations***

***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 sales would not significantly increase and we would be unable to achieve or sustain profitability.***

The market for solar power products is emerging and rapidly evolving, and its future success is uncertain. If solar power technology proves unsuitable for widespread commercial deployment or if demand for solar power products fails to develop sufficiently, we would be unable to generate enough revenues to achieve and sustain profitability. In addition, demand for solar power products in the markets and geographic regions we target may not develop or may develop more slowly than we anticipate. Many factors will influence the widespread adoption of solar power technology and demand for solar power products, including:

- cost-effectiveness of solar power technologies as compared with conventional and non-solar alternative energy technologies;
- performance and reliability of solar power products as compared with conventional and non-solar alternative energy products;
- success of alternative distributed generation technologies such as fuel cells, wind power and micro turbines;
- fluctuations in economic and market conditions which impact the viability of conventional and non-solar alternative energy sources, such as increases or decreases in the prices of oil and other fossil fuels;
- continued deregulation of the electric power industry and broader energy industry; and
- availability of government subsidies and incentives.

***Problems with product quality or product performance may cause us to incur warranty expenses and may damage our market reputation and prevent us from achieving increased sales and market share.***

As is consistent with standard practice in our industry, the duration of our product warranties is lengthy relative to expected product life and has recently been increasing. Our current standard product warranty includes a one or two-year warranty period for defects in material and workmanship and a 25-year warranty period for declines in power performance. 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 product and recognized revenues. Although we have sold over 48,000 solar panels since 1997, none of these panels has been operating more than six

years, and over 50% of them have been operating less than one year. The possibility of future product failures could cause us to incur substantial expense to repair or replace defective product. Furthermore, widespread product failures may damage our market reputation and reduce our market share and cause sales to decline.

***We may fail to successfully bring to market our new solar power products under development, which may prevent us from achieving increased sales and market share.***

Although we have been selling our solar power products since 1997, we expect to derive a substantial portion of our revenues from sales of our new solar power products which are under development and not yet commercially available. Many of these new products are derived from our innovative cell fabrication and advanced panel design technologies, which are under development. If we fail to successfully develop our new solar power products or technologies, we will likely be unable to recover the losses we will have incurred to develop these products and technologies and may be unable to increase our sales and market share and to become profitable. Many of our new product and manufacturing technologies are novel and represent a departure from conventional solar power technologies, and it is difficult to predict whether we will be successful in completing their development. Our manufacturing technologies have been tested only in our pilot manufacturing facility and, in most cases, only limited pre-production prototypes of our new products have been field-tested.

***Our solar power products may not gain market acceptance, which would prevent us from achieving increased sales and market share.***

The development of a successful market for our solar power products may be adversely affected by a number of factors, many of which are beyond our control, including:

- our failure to produce solar power products which compete favorably against other solar power products on the basis of cost, quality and performance;
- our failure to produce solar power products which compete favorably against conventional energy sources and alternative distributed generation technologies, such as fuel cells, on the basis of cost, quality and performance;
- whether customers accept our new panel designs under development and the techniques we are developing to mount them; and
- our failure to develop and maintain successful relationships with distributors, systems integrators and other resellers, as well as strategic partners.

If our solar power products fail to gain market acceptance, we would be unable to increase our sales and market share and to achieve and sustain profitability.

***Technological changes in the solar power industry could render our solar power products obsolete, which could reduce our market share and cause our sales to decline.***

Our failure to further refine our technology and develop and introduce new solar power products could cause our products to become obsolete, which could reduce our market share and cause our sales to decline. The solar power industry is rapidly evolving and competitive. We will need to invest significant financial resources in research and development to keep pace with technological advances in the solar power industry and to effectively compete in the future. We believe that there are a variety of competing solar power technologies under development by other companies that could result in lower manufacturing costs than those expected for our solar power products. Our development efforts may be rendered obsolete by the technological advances of others, and other technologies may prove more advantageous for the commercialization of solar power products.

***The build-out of our manufacturing facility may take longer and cost more than we expect, which would likely result in lower revenues and earnings than anticipated.***

If we fail to successfully complete the build-out of our Marlboro manufacturing facility, our business and results of operations would likely be materially impaired. The first of the Marlboro facility's two manufacturing lines entered service in 2001. The Company expects portions of the second manufacturing line to become operational in late 2003 and that it will be completed in 2004. Completing the build-out of this facility to capacity will require a significant investment of capital and substantial engineering expenditures, and is subject to significant risks, including risks of cost overruns, delays, equipment problems and other start-up and operating difficulties. Our

manufacturing processes also use custom-built equipment that may not be delivered and installed in our new facility in a timely manner. In addition, this equipment may take longer and cost more to debug than planned and may never operate as designed. We plan to incorporate first-time equipment designs and technology improvements, which we expect to lower unit capital and operating costs, but this new technology may not be successful, which would increase cost, limit capacity, and prevent us from achieving increases in sales. If we experience any of these or similar difficulties, we may be unable to complete the build-out of the facility, our manufacturing capacity could be substantially constrained and our revenues and earnings would likely be materially impaired.

***We may not be able to manufacture our solar power products in sufficient quantities or at acceptable costs to meet customer demand.***

We may not be able to achieve our manufacturing cost targets, which could prevent us from ever becoming profitable. If we cannot achieve our targeted production volumes or capacity or if we experience capacity constraints, quality control problems or other disruptions, we may not be able to manufacture our products in large volumes or at acceptable costs and may be unable to satisfy the demand of our customers, which would reduce our market share and revenues and may harm our reputation. The expansion of our manufacturing operations to achieve targeted production volumes will require the successful deployment of advanced equipment and technology utilizing manufacturing processes and components, which we are currently developing.

***Our ability to increase market share and sales depends on our ability to successfully maintain our existing distribution relationships and expand our distribution channels.***

We currently sell our solar power products primarily to distributors, system integrators and other value-added resellers within and outside of North America, which typically resell our products to end users on a global basis. Through September 30, 2003, we sold our solar power products to approximately 20 distributors, system integrators and other value-added resellers. If we are unable to successfully maintain our existing distribution relationships and expand our distribution channels, our revenues and future prospects will be materially harmed. As we seek to grow our sales by entering new markets in which we have little experience selling our solar power products, our ability to increase market share and sales will depend substantially on our ability to expand our distribution channels by identifying, developing and maintaining relationships with resellers both within and outside of North America. We may be unable to enter into relationships with resellers in the markets we target or on terms and conditions favorable to us, which could prevent us from entering these markets or entering these markets in accordance with our plans. Our ability to enter into and maintain relationships with resellers will be influenced by the relationships between these resellers and our competitors, market acceptance of our solar power products and our low brand recognition as a new entrant.

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

From our inception through September 30, 2003, approximately 65% of our product sales have been made to resellers outside North America. We expect that our sales both to resellers and distributors outside of North America and through our resellers and distributors to end users outside of North America will continue to be significant. Sales in Germany constituted approximately 61% of our total product sales for the nine month period ended September 30, 2003. It will require significant management attention and financial resources to successfully develop our international sales channels. In addition, the marketing, distribution and sale of our solar power products internationally exposes us to a number of markets with which we have limited experience. If we are unable to effectively manage these risks, it could impair our ability to grow our business abroad. These risks include:

- difficult and expensive compliance with the commercial and legal requirements of international markets, with which we have only limited experience;
- inability to obtain intellectual property protection;
- encountering trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses, which could affect the competitive pricing of our solar power products and reduce our market share in some countries;
- difficulty of enforcing revenue collection internationally; and
- our continued ability to sell our products in the German market.

We expect that our international sales will be generally denominated in United States dollars. As a result, increases in the value of the United States dollar relative to foreign currencies would cause our products to become less competitive in international markets and could result in limited, if any, sales and profitability. To the extent that we denominate sales in foreign currencies, we will be exposed to increased risks of currency fluctuations.

Our strategy includes establishing local manufacturing facilities in international markets, although we have not yet done so. As we implement our strategy, we may encounter legal and commercial restrictions and incur taxes and other expenses to establish our manufacturing facilities in certain countries. In addition, we may potentially forfeit, voluntarily or involuntarily, foreign assets due to economic or political instability in the countries where our local manufacturing facilities are located.

***Our dependence on a small number of resellers may cause significant fluctuations or declines in our product revenues.***

From our inception through September 30, 2003, our three largest resellers accounted for approximately 58% of our product sales and our 10 largest resellers accounted for approximately 83% of our product sales. We anticipate that sales of our solar power products to a limited number of key resellers will continue to account for a significant portion of our total product revenues for the foreseeable future. Consequently, any one of the following events may cause significant fluctuations or declines in our product revenues:

- reduction, delay or cancellation of orders from one or more of our significant resellers;
- selection by one or more of our significant resellers of products competitive with ours;
- loss of one or more of our significant resellers and our failure to recruit additional or replacement resellers; and
- failure of any of our significant resellers to make timely payment of our invoices.

***Our dependence on a limited number of third party suppliers for raw materials, key components for our solar power products and custom-built equipment for our operations could prevent us from delivering our products to our customers within required timeframes and we may experience order cancellation and loss of market share.***

We manufacture all of our solar power products using materials and components procured from a limited number of third-party suppliers. If we fail to develop or maintain our relationships with these or our other suppliers, we may be unable to manufacture our products or our products may be available only at a higher cost or after a long delay, which could prevent us from delivering our products to our customers within required time frames and we may experience order cancellation and loss of market share. We currently do not have contracts with many of our suppliers and may not be able to procure sufficient quantities of the materials and components necessary to manufacture our products on acceptable commercial terms or at all. To the extent the processes that our suppliers use to manufacture materials and components are proprietary, we may be unable to obtain comparable materials and components from alternative suppliers. The failure of a supplier to supply materials and components in a timely manner, or to supply materials and components that meet our quality, quantity and cost requirements could impair our ability to manufacture our products and/or increase their costs, particularly if we are unable to obtain substitute sources of these materials and components on a timely basis or on terms acceptable to us. In addition, our manufacturing processes utilize custom-built equipment that is currently produced by a limited number of suppliers. A supplier's failure to supply this equipment in a timely manner, with adequate quality and on terms acceptable to us could delay our capacity expansion of our manufacturing facility and otherwise disrupt our production schedule or increase our costs of production.

***Our use of forecasts to manage our inventory could result in insufficient quantities to meet reseller demand or excess inventory.***

We generally do not obtain long-term contracts or purchase orders prior to the production of our solar power products. Instead, we rely on forecasts to determine the timing of our production schedules and the volume and mix of product to be manufactured. The level and timing of orders placed by our resellers may vary for many reasons. As a result, at any particular time, we may not have enough inventory to meet demand or we may have excess inventory, each of which could negatively impact our operating results. In addition, as we manufacture more solar power products without related purchase orders, we increase our risk of loss of revenues due to the obsolescence of products held in inventory for which we have already incurred production costs.

***The success of our business depends on the continuing contributions of our key personnel and our ability to attract and retain new qualified employees in a competitive labor market.***

We have attracted a highly skilled management team and specialized workforce, including scientists, engineers, researchers, and manufacturing and marketing professionals. If we were to lose the services of Mark A. Farber, our Chief Executive Officer, President and a director, or any of our other executive officers and key employees, our business could be materially and adversely impacted. We had 142 employees as of September 30, 2003, and anticipate that we will need to hire a significant number of new highly-skilled technical, manufacturing, sales and marketing, and administrative personnel if we are to successfully develop and market our products, develop our distribution network, and operate our expanded manufacturing facility. Competition for personnel is intense, and qualified technical personnel are likely to remain a limited resource for the foreseeable future. Locating candidates with the appropriate qualifications, particularly in the desired geographic location, can be costly and difficult. We may not be able to hire the necessary personnel to implement our business strategy, or we may need to provide higher compensation or more training to our personnel than we currently anticipate. Moreover, any officer or employee can terminate his or her relationship with us at any time.

***Our management team may not be able to successfully implement our business strategies because it has limited experience managing a rapidly growing company.***

The existing members of our management team have had only limited experience managing a rapidly growing company on either a public or private basis. In connection with the planned expansion of our manufacturing capacity, we have undergone and anticipate undergoing further rapid growth in the scope of our operations and the number of our employees, which is likely to place a significant strain on our senior management team and other resources. In addition, we may encounter difficulties in effectively managing the budgeting, forecasting and other process control issues presented by this rapid growth. We may seek to augment or replace members of our management team or we may lose key members of our management team, and we may not be able to attract new management talent with sufficient skill and experience. If our management team is unable to manage the rapid growth of our business operations, then our product development, the expansion of our manufacturing operations and distribution network, and our sales and marketing activities would be materially and adversely affected.

***We have significant capital requirements in order to maintain and grow our business.***

On May 15, 2003, we consummated a private placement financing transaction that raised \$29,475,000 through the issuance of 26,227,668 shares of Series A convertible preferred stock and the sale of a warrant to purchase 2,400,000 shares of our common stock. We believe that our current cash, cash equivalents and short-term investments will be sufficient to fund our planned manufacturing capacity expansion and operating expenditures over the next twelve months. In addition to the capital raised in our private placement financing transaction, we may need additional financing to execute our business plan sooner if we need to respond to business contingencies such as the need to further enhance our operating infrastructure, respond to competitive pressures and acquire complementary businesses or necessary technologies. We do not know whether we will be able to raise additional financing or financing on terms favorable to us. If adequate funds are not available or are not available on acceptable terms, our ability to fund our operations, develop and expand our manufacturing operations and distribution network, or otherwise respond to competitive pressures would be significantly limited. In addition, if we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our existing stockholders will be reduced. These newly issued securities may have rights, preferences and privileges senior to those of existing stockholders.

***We face intense competition from other companies producing solar power and other energy generation products. If we fail to compete effectively, we may be unable to increase our market share and sales.***

The solar power market is intensely competitive and rapidly evolving. Our competitors have established a market position more prominent than ours, and if we fail to attract and retain customers and establish a successful distribution network for our solar power products, we may be unable to increase our sales and market share. There are over 20 companies in the world that produce solar power products, including BP Solar, Kyocera Corporation, Royal Dutch Shell, Sharp Corporation, and AstroPower, Inc. All of these solar power product producers, as well as several others, have historically derived all or a majority of their sales from conventional manufacturing technology that involves using wafers made from slicing solid blocks of crystalline silicon. In addition, some of these companies are developing advanced crystalline silicon or thin film technologies, including technologies such as advanced crystalline sheet and ribbon technologies and thin films of amorphous silicon, cadmium telluride and copper indium diselenide, and project future cost savings similar to or greater than ours. Other existing and potential competitors in the solar power market include universities and research institutions. We also expect that future

competition will include new entrants to the solar power market offering new technological solutions. Further, many of our competitors are developing and are currently producing products based on new solar power technologies, including other crystalline silicon ribbon and sheet technologies, that they believe will ultimately have costs similar to, or lower than, our projected costs.

Most of our competitors are substantially larger than we are, have longer operating histories and have substantially greater financial, technical, manufacturing and other resources than we do. Many also have greater name recognition, a more established distribution network and a larger installed base of customers. In addition, many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of our target markets. As a result, our competitors may be able to devote greater resources to the research, development, promotion and sale of their products and respond more quickly to evolving industry standards and changing customer requirements than we can.

***If we are unable to protect our intellectual property adequately, we could lose our competitive advantage in the solar power market.***

Our ability to compete effectively against competing solar power technologies will depend, in part, on our ability to protect our current and future proprietary technology, product designs and manufacturing processes through a combination of patent, copyright, trademark, trade secret and unfair competition laws. We may not be able to adequately protect our intellectual property and may need to defend our intellectual property against infringement claims, either of which could result in the loss of our competitive advantage in the solar power market and materially harm our business and profitability. We face the following risks in protecting our intellectual property:

- we cannot be certain that our pending United States and foreign patent applications will result in issued patents or that the claims allowed are or will be sufficiently broad to protect our technology or processes;
- our license, but not our right, to practice the String Ribbon technology terminates upon expiration of the underlying patents, the first of which expired in June 2003, and our historical operating experience with String Ribbon and our related patented and proprietary manufacturing processes may not adequately protect our competitive advantage after these patents have expired;
- third parties may design around our patented technologies or seek to challenge or invalidate our patented technologies;
- we may incur significant costs and diversion of management resources in prosecuting or defending patent infringement suits;
- we may not be successful in prosecuting or defending patent infringement suits and, as a result, may need to seek to obtain a license of the third party's intellectual property rights; however, a license may not be available to us or may not be available to us on commercially reasonable terms; and
- the contractual provisions we rely on to protect our trade secrets and proprietary information, such as our confidentiality and non-disclosure agreements with our employees, consultants and other third parties, may be breached and our trade secrets and proprietary information disclosed to the public.

***Existing regulations and changes resulting from electric utility deregulation 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 federal, state and local government regulations and policies concerning the electric utility industry, as well as internal policies and regulations promulgated by electric utilities. These regulations and policies often relate to electricity pricing and technical interconnection of customer-owned electricity generation. In the United States and in a number of other countries, these regulations and policies are being 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 solar power products.

We anticipate that our solar power products and their installation will be subject to oversight and regulation in accordance with national and local ordinances relating to building codes, safety, environmental protection, utility interconnection and metering and related matters. Any new government regulations or utility policies pertaining to



our solar power products may result in significant additional expenses to us, our resellers and their customers and, as a result, could cause a significant reduction in demand for our solar power products.

***The reduction or elimination of government subsidies and economic incentives for on-grid applications could cause our sales to decline.***

We believe that the growth of some of our target markets, including the market for on-grid applications, depends in part on the availability and size of government subsidies and economic incentives. Accordingly, the reduction or elimination of government subsidies and economic incentives may adversely affect the growth of these markets, which could cause our sales to decline. Today, the cost of solar power substantially exceeds the cost of power furnished by the electric utility grid. As a result, federal, state and local governmental bodies in many countries, most notably the United States, Japan and Germany, have provided subsidies in the form of cost reductions, tax write-offs and other incentives to end users, distributors, systems integrators and manufacturers of solar power products to promote the use of solar energy in on-grid applications and to reduce dependency on other forms of energy. These government subsidies and economic incentives could be reduced or eliminated altogether.

***The lack or inaccessibility of financing for off-grid solar power applications could cause our sales to decline.***

One of our key markets is off-grid solar power applications to developed and developing countries. In some developing countries, government agencies and the private sector have, from time to time, provided subsidies or financing on preferred terms for rural electrification programs. We believe that the availability of financing could have a significant effect on the level of sales of off-grid solar power applications, particularly in developing countries where users may not have sufficient resources or credit to otherwise acquire solar power systems. If existing financing programs for off-grid solar power applications are eliminated or if financing is inaccessible, the growth of the market for off-grid applications may be adversely affected, which could cause our sales to decline.

***Our reliance on government contracts to partially fund our research and development programs could impair our ability to commercialize our solar power technologies and would increase our research and development expenses.***

We intend to continue our policy of selectively pursuing contract research, product development, and market development programs funded by various agencies of the United States, state and international governments to complement and enhance our own resources. The percentage of our total revenues derived from government-related contracts was approximately 18% for the nine-month period ended September 30, 2003. We currently have two active research contracts with total estimated revenues of approximately \$5.0 million, \$3.5 million of which has been authorized by the sponsoring agencies and \$3.4 million of which has been recorded as revenue as of September 30, 2003. We have fully recognized all revenue associated with our contract that expires on October 31, 2003, and we expect the remaining \$1.6 million of revenue will be recognized somewhat ratably over the remaining life of the second contract, which expires on May 31, 2005. These government agencies may not continue their commitment to programs to which our development projects are applicable. Moreover, we may not be able to compete successfully to obtain funding through these or other programs. A reduction or discontinuance of these programs or of our participation in these programs would increase our research and development expenses, which could impair our ability to develop our solar power technologies.

In addition, contracts involving government agencies may be terminated at the convenience of the agency. Other risks include potential disclosure of our confidential information to third parties and the exercise of “march-in” rights by the government. Our government-sponsored research contracts require that we provide regular written technical updates on a monthly, quarterly or annual basis, and, at the conclusion of the research contract, a final report on the results of our technical research. Because these reports are generally available to the public, third parties may obtain some aspects of our sensitive confidential information. March-in rights refer to the right of the United States government or government agency to require us to grant a license to the technology to a responsible applicant or, if we refuse, the government may grant the license itself. The government can exercise its march-in rights if it determines that action is necessary because we fail to achieve practical application of the technology, because action is necessary to alleviate health or safety needs, or to meet requirements of federal regulations, or to give the United States industry preference. Funding from government contracts also may limit when and how we can deploy our technology developed under those contracts.

***Compliance with environmental regulations can be expensive and inadvertent noncompliance may result in adverse publicity and potentially significant monetary damages and fines.***

We are required to comply with all federal, state and local regulations regarding protection of the environment. If more stringent regulations are adopted in the future, the costs of compliance with these new regulations could be substantial. We believe that we have all necessary permits to conduct our business as it is presently conducted. If we fail to comply with present or future environmental regulations, however, we may be required to pay substantial fines, suspend production or cease operations. We use, generate and discharge toxic, volatile and otherwise hazardous chemicals and wastes in our research and development and manufacturing activities. 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. In addition, under some federal and state statutes and regulations, a governmental agency may seek recovery and response costs from operators of property where releases of hazardous substances have occurred or are ongoing, even if the operator was not responsible for such release or otherwise at fault.

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

Like other retailers, distributors and manufacturers of products that are used by consumers, we face an inherent risk of exposure to product liability claims in the event that the use of the solar power products we sell results in injury. Since our products are electricity producing devices, it is possible that consumers could be injured or killed by our products, whether by product malfunctions, defects, improper installation or other causes. In addition, since sales of our existing products have been modest and the products we are developing incorporate new technologies and use new installation methods, we cannot predict whether product liability claims will be brought against us in the future or the effect of any resulting adverse publicity on our business. Moreover, we may not have adequate resources in the event of a successful claim against us. We have evaluated the potential risks we face and believe that we have appropriate levels of insurance for product liability claims. We rely on our general liability insurance to cover product liability claims and have not obtained separate product liability insurance. If our insurance protection is inadequate, the successful assertion of product liability claims against us could result in potentially significant monetary damages.

***Risks Associated With the Market for Our Common Stock***

***Our officers and directors control 69% of our voting stock and may be able to significantly influence corporate actions.***

As of November 1, 2003, our executive officers, directors and entities affiliated with them controlled 69% of our voting stock. As a result, these stockholders, acting together, may be able to significantly influence all matters requiring approval by our stockholders, including the election of directors, the approval of charter and by-law amendments, and the approval of mergers or other business combinations.

***The price of our common stock may be volatile.***

The stock market has, from time to time, experienced extreme price and trading volume fluctuations, and the market prices of technology companies such as ours have been extremely volatile. Our operating performance will significantly affect the market price of our common stock. To the extent we are unable to compete effectively and gain market share or the other factors described in this section affect us, our stock price will likely decline. The market price of our common stock also may be adversely impacted by broad market and industry fluctuations regardless of our operating performance, including general economic and technology trends. In addition, companies that have experienced volatility in the market price of their stock have been the subject of securities class action litigation. We may be involved in securities class action litigation in the future. This litigation often results in substantial costs and a diversion of management's attention and resources.

***The large number of shares eligible for public sale could cause our stock price to decline.***

The market price of our common stock could decline as a result of the resale of the shares of common stock issuable upon conversion of the Series A convertible preferred stock and the exercise of the warrant issued in connection with the private placement financing or the perception that these sales could occur. These sales also might make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate.

*We are subject to anti-takeover provisions in our charter and by-laws and under Delaware law that could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our stockholders.*

Provisions of our certificate of incorporation, our by-laws and Delaware law could make it more difficult and expensive for a third party to pursue a tender offer, change in control transaction or takeover attempt that is opposed by our board of directors. Stockholders who wish to participate in these transactions may not have the opportunity to do so. We also have a staggered board of directors, which makes it difficult for stockholders to change the composition of our board of directors in any one year. If a tender offer, change in control transaction, takeover attempt or change in our board of directors is prevented or delayed, the market price of our common stock could decline.

### ***ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK***

#### **Interest Rate Risk**

We do not use derivative financial instruments. Interest income earned on our cash, cash equivalents and short-term investments is subject to interest rate fluctuations, but we believe that the impact of these fluctuations does not have a material effect on our financial position due to the short-term nature of these financial instruments. We have no long-term debt. Our interest income is sensitive to the general level of interest rates in the United States. Sensitivity analysis is used to measure our interest rate risk. For the three and nine months ended September 30, 2003, a 100-basis point adverse change in interest rates would not have had a material effect on our consolidated financial position, earnings or cash flow.

#### **Foreign Currency Exchange Rate Risk**

All of our sales are currently denominated in United States dollars. Accordingly, we have not been materially exposed to fluctuations in currency exchange rates with respect to our product sales. However, since we sell a significant portion of our products internationally, the relative competitiveness of our products is impacted by foreign currency exchange rates. In addition, market conditions in the future may require us to denominate a portion of our sales in local currencies, which could further expose us to foreign exchange gains or losses. As we expand our manufacturing operations and distribution network internationally, our exposure to fluctuations in currency exchange rates may increase. Additionally, from time to time we may purchase equipment and materials internationally, and to the extent that such purchases are billed in foreign currency, we may be exposed to currency gains or losses.

### ***ITEM 4. CONTROLS AND PROCEDURES***

#### **Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report (the "Evaluation Date"), have concluded that as of the Evaluation Date, our disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports that we file and submit under the Exchange Act of 1934 is recorded, processed, summarized and reported as and when required.

#### **Internal Control Over Financial Reporting**

During the period covered by this report, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits:

Number	Description
31.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

#### (b) Reports on Form 8-K:

During the quarter ended September 30, 2003, the Company filed a report on Form 8-K dated July 31, 2003, reporting information under Item 5 relating to the press release regarding its financial results for the quarter ending June 30, 2003.

## SIGNATURES

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

EVERGREEN SOLAR, INC.

Date: November 12, 2003

/s/ Richard G. Chleboski

Richard G. Chleboski  
Chief Financial Officer, Treasurer and Secretary  
(Principal Financial Officer)