

Canadian Solar Inc.
Form F-3ASR
July 14, 2008

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As filed with the Securities and Exchange Commission on July 14, 2008
Registration No. 333-

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

FORM F-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Canadian Solar Inc.
(Exact name of registrant as specified in its charter)
Not Applicable
(Translation of Registrant's name into English)

Canada
*(State or other jurisdiction of
incorporation or organization)*

3674
*(Primary Standard Industrial
Classification Code Number)*

Not Applicable
*(I.R.S. Employer
Identification Number)*

**No. 199 Lushan Road
Suzhou New District
Suzhou, Jiangsu 215129
People's Republic of China**
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**CT Corporation System
111 Eighth Avenue
New York, New York 10011
(212) 664-1666**
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

**David T. Zhang, Esq.
Eugene Y. Lee, Esq.**

Latham & Watkins LLP
41st Floor, One Exchange Square
8 Connaught Place, Central
Hong Kong
(852) 2912-2500

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this registration statement.

If only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.C. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box.

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.C. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered(1)	Amount to Be Registered(2)	Proposed Maximum Offering Price per Unit(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(2)
Common shares, with no par value				
Debt securities				

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- (1) Includes (i) securities initially offered and sold outside the United States that may be resold from time to time in the United States either as part of their distribution or within 40 days after the later of the effective date of this registration statement and the date the securities are first bona fide offered to the public and (ii) securities that may be purchased by underwriters pursuant to over-allotment options. These securities are not being registered for the purposes of sales outside of the United States.
 - (2) An indeterminate aggregate number of securities is being registered as may from time to time be sold at indeterminate prices. In accordance with Rules 456(b) and 457(r), the Registrant is deferring payment of all of the registration fee.
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PROSPECTUS

**Common Shares
Debt Securities**

We may offer and sell the securities in any combination from time to time in one or more offerings, at prices and on terms described in one or more supplements to this prospectus. The debt securities may be convertible into or exercisable or exchangeable for our common shares or our other securities. Our common shares are listed on the NASDAQ Global Market under the symbol CSIQ. In addition, this prospectus may be used to offer securities for the account of persons other than us.

This prospectus provides you with a general description of the securities that may be offered. Each time we or any selling security holder sell securities, we will provide a supplement to this prospectus that contains specific information about the offering and the terms of the securities. The supplement may also add, update or change information contained in this prospectus. We may also authorize one or more free writing prospectuses to be provided in connection with a specific offering. You should carefully read this prospectus, the applicable prospectus supplement and any related free writing prospectuses, as well as any documents incorporated by reference in this prospectus and the applicable prospectus supplement, before you invest in any of our securities.

Investing in our securities involves risks. See the Risk Factors section contained in the applicable prospectus supplement, any related free writing prospectus and in the documents we incorporate by reference in this prospectus to read about factors you should consider before investing in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or completeness of this prospectus. Any representation to the contrary is a criminal offense.

We or any selling security holder may sell the securities described in this prospectus and any prospectus supplement to or through one or more underwriters, dealers and agents, or directly to purchasers, or through a combination of these methods, on a continuous or delayed basis. See Plan of Distribution. If any underwriters, dealers or agents are involved in the sale of any of the securities, their names, and any applicable purchase price, fee, commission or discount arrangements between or among them, will be set forth, or will be calculable from the information set forth, in the applicable prospectus supplement.

The date of this prospectus is July 14, 2008.

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ABOUT THIS PROSPECTUS

You should read this prospectus and any prospectus supplement together with the additional information described under the heading "Where You Can Find More Information About Us" and "Incorporation of Documents by Reference."

In this prospectus, unless otherwise indicated or unless the context otherwise requires,

we, us, our, and our company refer to Canadian Solar Inc. and its subsidiaries;

China or PRC refers to the People's Republic of China, excluding Taiwan, Hong Kong and Macau;

RMB or Renminbi refers to the legal currency of China, US\$ or U.S. dollars refers to the legal currency of the United States, C\$ and Canadian \$ are to the legal currency of Canada; and Euro refers to the legal currency of the European Union; and

shares or common shares refers to our common shares, with no par value.

This prospectus is part of an "automatic shelf" registration statement that we filed with the Securities and Exchange Commission, or SEC, as a "well-known seasoned issuer" as defined in Rule 405 under the Securities Act of 1933, as amended or the Securities Act, using a "shelf" registration process. By using a shelf registration statement, we or any selling security holder may sell any combination of our common shares, and debt securities from time to time and in one or more offerings. Each time we or any selling security holder sell securities, we may provide a supplement to this prospectus that contains specific information about the securities being offered and the specific terms of that offering. The supplement may also add, update or change information contained in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the prospectus supplement. Before purchasing any securities, you should carefully read both this prospectus and any supplement, together with the additional information described under the heading "Where You Can Find More Information About Us" and "Incorporation of Documents by Reference."

You should rely only on the information contained or incorporated by reference in this prospectus, in any applicable prospectus supplement or any related free writing prospectus that we may authorize to be delivered to you. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We will not make an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus, the applicable supplement to this prospectus or in any related free writing prospectus is accurate as of its respective date, and that any information incorporated by reference is accurate only as of the date of the document incorporated by reference, unless we indicate otherwise. Our business, financial condition, results of operations and prospects may have changed since those dates.

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WHERE YOU CAN FIND MORE INFORMATION ABOUT US

We file reports and other information with the SEC. Information filed with the SEC by us can be inspected and copied at the Public Reference Room maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of this information by mail from the Public Reference Section of the SEC at prescribed rates. Further information on the operation of the SEC's Public Reference Room in Washington, D.C. can be obtained by calling the SEC at 1-800-SEC-0330.

The SEC also maintains a web site that contains reports, proxy and information statements and other information about issuers, such as us, who file electronically with the SEC. The address of that site is <http://www.sec.gov>.

Our web site address is <http://www.csisolar.com>. The information on our web site, however, is not, and should not be deemed to be, a part of this prospectus.

This prospectus and any prospectus supplement are part of a registration statement that we filed with the SEC and do not contain all of the information in the registration statement. The full registration statement may be obtained from the SEC or us, as indicated below. Forms of the indenture and other documents establishing the terms of the offered securities are filed as exhibits to the registration statement. Statements in this prospectus or any prospectus supplement about these documents are summaries and each statement is qualified in all respects by reference to the document to which it refers. You should refer to the actual documents for a more complete description of the relevant matters. You may inspect a copy of the registration statement at the SEC's Public Reference Room in Washington, D.C., as well as through the SEC's website.

INCORPORATION OF DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference the information we file with them. This means that we can disclose important information to you by referring you to those documents. Each document incorporated by reference is current only as of the date of such document, and the incorporation by reference of such documents shall not create any implication that there has been no change in our affairs since the date thereof or that the information contained therein is current as of any time subsequent to its date. The information incorporated by reference is considered to be a part of this prospectus and should be read with the same care. When we update the information contained in documents that have been incorporated by reference by making future filings with the SEC, the information incorporated by reference in this prospectus is considered to be automatically updated and superseded. In other words, in the case of a conflict or inconsistency between information contained in this prospectus and information incorporated by reference into this prospectus, you should rely on the information contained in the document that was filed later.

We incorporate by reference the documents listed below:

Our annual report on Form 20-F for the fiscal year ended December 31, 2007 filed with the SEC on June 3, 2008.

Our reports of foreign private issuer on Form 6-K filed with the SEC on June 6, 2008 and July 7, 2008.

All future annual reports on Form 20-F, and any report on Form 6-K that we indicate is incorporated by reference into this prospectus, until we sell all of the securities offered by this prospectus.

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Our annual report on Form 20-F for the fiscal year ended December 31, 2007 filed on June 3, 2008, contains a description of our business and audited consolidated financial statements with a report by our independent auditors. These financial statements are prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP.

Copies of all documents incorporated by reference in this prospectus, other than exhibits to those documents unless such exhibits are specially incorporated by reference in this prospectus, will be provided at no cost to each

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person, including any beneficial owner, who receives a copy of this prospectus on the written or oral request of that person made to:

Canadian Solar Inc.
No. 199 Lushan Road
Suzhou New District
Suzhou, Jiangsu 215129
People's Republic of China
Telephone: (86-512) 6690-8088
Attention: Chief Financial Officer

You should rely only on the information that we incorporate by reference or provide in this prospectus and any supplement. We have not authorized anyone to provide you with different information. We are not making any offer of these securities in any jurisdiction where the offer is not permitted. You should not assume that the information in this prospectus is accurate as of any date other than the date on the front of those documents.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, any accompanying prospectus supplement and the information incorporated herein and therein by reference may contain forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These statements, which are not statements of historical fact, may contain estimates, assumptions, projections and/or expectations regarding future events, which may or may not occur. Words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, similar expressions, which refer to future events and trends, identify forward-looking statements. We do not guarantee that the transactions and events described in this prospectus or in any prospectus supplement will happen as described or that they will happen at all. You should read this prospectus and any accompanying prospectus supplement completely and with the understanding that actual future results may be materially different from what we expect. The forward-looking statements made in this prospectus and any accompanying prospectus supplement relate only to events as of the date on which the statements are made. We undertake no obligation, beyond that required by law, to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made, even though our situation will change in the future.

Whether actual results will conform with our expectations and predictions is subject to a number of risks and uncertainties, many of which are beyond our control, and reflect future business decisions that are subject to change. Some of the assumptions, future results and levels of performance expressed or implied in the forward-looking statements we make inevitably will not materialize, and unanticipated events may occur which will affect our results. The Risk Factors section of this prospectus directs you to a description of the principal contingencies and uncertainties to which we believe we are subject.

This prospectus also contains or incorporates by reference data related to the solar power market in several countries, including China. This market data, including market data from Solarbuzz, an independent solar energy research firm, includes projections that are based on a number of assumptions. The solar power market may not grow at the rates projected by the market data, or at all. The failure of the market to grow at the projected rates may materially and adversely affect our business and the market price of our securities. In addition, the rapidly changing nature of the solar power market and related regulatory regimes subjects any projections or estimates relating to the growth prospects or future condition of our market to significant uncertainties. If any one or more of the assumptions underlying the market data proves to be incorrect, actual results may differ from the projections based on these assumptions. You should not place undue reliance on these forward-looking statements.

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OUR COMPANY

We design, develop, manufacture and sell solar cell and module products that convert sunlight into electricity for a variety of uses. We are incorporated in Canada and conduct all of our manufacturing operations in China. Our products include a range of standard solar modules built to general specifications for use in a wide range of residential, commercial and industrial solar power generation systems. In addition, we recently commenced commercial production of e-Modules, a cost-effective medium power solar module product using 100% upgraded metallurgical grade silicon, or UMgSi. We also design and produce specialty solar modules and products manufactured based on our customers' requirements. Specialty solar modules and products consist of customized modules that our customers incorporate into their own products, such as solar-powered bus stop lighting, and complete specialty products, such as solar-powered car battery chargers. We sell our products under our CSI brand name and to OEM customers under their own brand names. We also implement solar power development projects, primarily in conjunction with government organizations to provide solar power generation in rural areas of China.

We currently sell our products to customers located in various markets worldwide, including Germany, Spain, Italy, the United States, South Korea, the Czech Republic, China and Canada. We sell our standard solar modules to distributors, system integrators and through OEM channels. We sell our e-Modules to distributors and system integrators. We sell our specialty solar modules and products directly to various manufacturers who integrate our specialty solar modules and products into their own products and sell and market them as part of their own product portfolio.

We have historically manufactured our module products from solar cells purchased from third-party manufacturers. In 2007, we began to pursue a new business model that combines internal manufacturing capacity supplemented by direct material purchases and outsourced toll manufacturing relationships which we believe provides us with several competitive benefits. We believe that this approach allows us to benefit from the increased margin available to vertically integrated solar manufacturers while reducing the capital expenditures required relative to a fully vertically integrated business model and produce better returns on our invested capital. We also believe that this approach provides us with greater flexibility to respond to short-term demand patterns and longer-term to take advantage of the availability of low-cost outsourced manufacturing capacity. Additionally, it has enabled us to improve production yields, control our inventory more efficiently and improve cash management, which we believe has resulted in increased confidence in our forecasts for future revenue growth.

We believe that we have contractually secured 95% of our silicon and solar cell requirements to support solar module production of 230 to 260MW in 2008. For silicon material supplies, we have entered into a five-year supply agreement with Luoyang Zhong Gui High Tech Co. Ltd., or Luoyang Poly, for high purity silicon from 2006 to 2010. For silicon wafers, we have entered into a fixed price and volume agreement with LDK Solar Co., Ltd., or LDK, from 2008 to 2010 for specified quantities of solar wafers, including 50MW for delivery in 2008. We also have standby toll manufacturing arrangements with LDK and other ingot and wafer manufacturers to convert our virgin polysilicon and reclaimed silicon feedstock into wafers. In January 2007, we entered into a supply agreement with Deutsche Solar AG, or Deutsche Solar, for a supply of multi-crystalline silicon wafers through 2018. In November 2007, we entered into various agreements with China Sunergy Co., Ltd., or China Sunergy, for a supply of 25MW of solar cells for delivery in 2008, and an agreement with Gintech Energy Corporation, or Gintech, for a supply of 17MW of solar cells for delivery in 2008, with an option, subject to availability, for an extra 5MW. We have other silicon wafer and solar cell supply agreements in place, including a multi-year solar wafer supply contract with Jiangsu Shunda Group Corporation which should provide us with wafer supplies through 2015, a solar cell supply contract with Neo Solar Power and a UMgSi materials supply contract with Timminco Limited, through its subsidiary Becancour Silicon Inc., or BSI. We believe these contracts have diversified our silicon wafer and cell supply sources and also provide an

option of securing additional wafer and cell supplies from multiple sources, helping us to meet demand for our solar products.

We have expanded our in-house manufacturing capacity for both solar cells and solar modules. As of March 31, 2008, we had 400MW of combined annual module manufacturing capacity and 100MW of annual cell manufacturing capacity. Currently, we intend to use all of our solar cells in the manufacturing of our own solar module products.

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We recently announced our new capacity expansion plan which we intend to complete during Q1 2009, which includes:

Increasing our annual internal module capacity to 800MW.

Expansion of our annual solar cell manufacturing capacity to 400MW.

Construction of a solar ingot and wafer plant in Luoyang, China, which will give us an annual solar ingot and wafer capacity of 150 to 200MW.

We recently commenced commercial production of e-Modules, a cost-effective medium power solar module product using 100% UMgSi, in March 2008. We converted one of our solar cell lines and dedicated it to upgraded metallurgical grade cells in early April 2008 and ramped up to full production shortly thereafter. Delivery of e-Modules to some of our European and U.S. customers began in early May. We have announced sales contracts for 24.5MW of e-Modules for shipment in 2008 and believe that we are on track to achieve our prior estimate of shipping 30 to 40MW of e-Modules in 2008. We believe our e-Module product gives us access to more price-sensitive markets such as the United States and South Korea where traditional silicon modules may not be as cost-competitive. We will continue to receive shipments of UMgSi through 2011 and expect to increase production of our UMgSi modules in the future.

We believe that the substantial industry and international experience of our management team has helped us foster strategic relationships with suppliers throughout the solar power industry value chain. We also take advantage of our flexible and low cost manufacturing capability in China to lower our manufacturing and operating costs. We believe we have a proven track record of low cost and rapid expansion of solar cell and solar module manufacturing capacity.

We have grown rapidly since March 2002, when we sold our first solar module products. Our net revenues increased from US\$9.7 million in 2004 to US\$302.8 million in 2007, and from US\$17.5 million for the three month period ended March 31, 2007 to US\$171.2 million for the three months ended March 31, 2008. We sold 2.2MW, 4.1MW, 14.9MW and 83.5MW of our solar module products in 2004, 2005, 2006 and 2007, respectively, and 3.9MW and 41.8MW for the three months ended March 31, 2007 and 2008, respectively.

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RISK FACTORS

Please see the factors set forth under the heading "Risk Factors" in our most recently filed Annual Report on Form 20-F, which is incorporated in this prospectus by reference, and, if applicable, in any accompanying prospectus supplement, before investing in any securities that may be offered pursuant to this prospectus.

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USE OF PROCEEDS

We intend to use the net proceeds from the sale of the securities as set forth in the applicable prospectus supplement. We will not receive proceeds from sales of securities by persons other than us except as may otherwise be stated in any applicable prospectus supplement.

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ENFORCEABILITY OF CIVIL LIABILITIES

We were incorporated as an Ontario corporation in October 2001 and were continued as a Canadian corporation under the Canadian federal corporate statute, the Canada Business Corporations Act, or CBCA, in June 2006.

We are a corporation organized under the federal laws of Canada. Most of our directors and officers and some of the experts named in this prospectus reside principally outside the United States. Because these persons are located outside the United States, it may not be possible for you to effect service of process within the United States upon those persons. Furthermore, it may not be possible for you to enforce against us or them, in the United States, judgments obtained in U.S. courts, because all or a substantial portion of our assets and the assets of those persons are located outside the United States. We have been advised by WeirFoulds LLP, our Canadian counsel, that there are defenses that can be raised to the enforceability, in original actions in Canadian courts, of liabilities based upon the U.S. federal securities laws and to the enforceability in Canadian courts of judgments of U.S. courts obtained in actions based upon the civil liability provisions of U.S. federal securities laws, such that the enforcement in Canada of such liabilities and judgments is not certain. Therefore, it may not be possible to enforce those actions against us, our directors and officers or the experts named in this prospectus.

Our constituent documents do not contain provisions requiring that disputes, including those arising under the securities laws of the United States, between us, our officers, directors and shareholders, be arbitrated.

Substantially all of our current operations are conducted in China, and substantially all of our assets are located in China. A majority of our directors and officers are nationals or residents of jurisdictions other than the United States and a substantial portion of their assets are located outside the United States. As a result, it may be difficult for a shareholder to effect service of process within the United States upon us or such persons, or to enforce against us or them judgments obtained in U.S. courts, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States.

Chen & Co. Law Firm, our counsel as to PRC law, has advised us that there is uncertainty as to whether the courts of the PRC would:

recognize or enforce judgments of U.S. courts obtained against us or our directors or officers predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States; or

entertain original actions brought in each respective jurisdiction against us or our directors or officers predicated upon the securities laws of the United States or any state in the United States.

Chen & Co. Law Firm has advised us further that the recognition and enforcement of foreign judgments are provided for under the PRC Civil Procedures Law. PRC courts may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based either on treaties between the PRC and the country where the judgment is made or on reciprocity between jurisdictions. China does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States or Canada. As a result, it is generally difficult to recognize and enforce in China a judgment rendered by a court in either of these two jurisdictions.

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The following table sets forth our ratio of earnings to fixed changes on a historical basis for the period indicated. The ratios are calculated by dividing earnings by fixed charges. For this purpose, earnings consist of pre-tax income from continuing operations before adjustment for minority interests, plus fixed charges. Fixed charges represent interest, amortization of debt discount and expense, and the estimated interest portion of rental charges.

	Year Ended December 31,				
	2003	2004	2005	2006	2007
Ratio of earnings to fixed charges	149X	166X	17X	(1)	(2)

(1) Earnings for 2006 were insufficient to cover fixed charges by approximately \$9.0 million.

(2) Earnings for 2007 were insufficient to cover fixed charges by approximately \$0.4 million.

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DESCRIPTION OF SECURITIES

We may issue from time to time, in one or more offerings, the following securities:

common shares; and

debt securities.

We will set forth in the applicable prospectus supplement a description of the debt securities and the common shares that may be offered under this prospectus. The terms of the offering of securities, the initial offering price and the net proceeds to us will be contained in the prospectus supplement, and other offering material, relating to such offer. The supplement may also add, update or change information contained in this prospectus. You should carefully read this prospectus and any supplement before you invest in any of our securities.

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DESCRIPTION OF COMMON SHARES

We may issue our common shares either alone or underlying other securities convertible into or exercisable or exchangeable for our common shares.

Holders of our common shares are entitled to certain rights and subject to certain conditions as set forth in our articles and bylaws and the CBCA. See Description of Share Capital.

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DESCRIPTION OF DEBT SECURITIES

We may issue series of debt securities, which may include debt securities convertible into common shares. When we offer to sell a particular series of debt securities, we will describe the specific terms of that series in a supplement to this prospectus. The following description of debt securities will apply to the debt securities offered by this prospectus unless we provide otherwise in the applicable prospectus supplement. The applicable prospectus supplement for a particular series of debt securities may specify different or additional terms.

The debt securities offered hereby may be secured or unsecured, and may be either senior debt securities, senior subordinated debt securities or subordinated debt securities. The debt securities offered hereby will be issued under an indenture between us and The Bank of New York Mellon, as trustee. The indenture will be qualified under, subject to, and governed by, the Trust Indenture Act of 1939, as amended. We have summarized selected portions of the indenture below. The summary is not complete. The form of the indenture has been incorporated by reference as an exhibit to this registration statement and you should read the indenture for provisions that may be important to you.

General

The terms of each series of debt securities will be established by or pursuant to a resolution of our board of directors and detailed or determined in the manner provided in a board of directors' resolution, an officers' certificate or by a supplemental indenture. The particular terms of each series of debt securities will be described in a prospectus supplement relating to the series, including any pricing supplement.

We can issue an unlimited amount of debt securities under an indenture that may be in one or more series with the same or various maturities, at par, at a premium or at a discount. We will set forth in a prospectus supplement, including any pricing supplement, relating to any series of debt securities being offered the initial offering price, the aggregate principal amount and the terms of the debt securities, including the following:

the title of the debt securities;

the price or prices (expressed as a percentage of the aggregate principal amount) at which we will sell the debt securities;

any limit on the aggregate principal amount of the debt securities;

the date or dates on which we will pay the principal on the debt securities;

the rate or rates (which may be fixed or variable) per annum or the method used to determine the rate or rates (including any commodity, commodity index, stock exchange index or financial index) at which the debt securities will bear interest and the right, if any, to extend the maturity of the debt securities, the date or dates from which interest will accrue, the date or dates on which interest will commence and be payable and any regular record date for the interest payable on any interest payment date;

the place or places where the principal of, premium, and interest on the debt securities will be payable;

the terms and conditions upon which we may redeem the debt securities;

any obligation we have to redeem or purchase the debt securities pursuant to any sinking fund or analogous provisions or at the option of a holder of debt securities;

the dates on which and the price or prices at which we will repurchase the debt securities at the option of the holders of debt securities and other detailed terms and provisions of these repurchase obligations;

the denominations in which the debt securities will be issued, if other than denominations of \$1,000 and any integral multiple thereof;

whether the debt securities will be issued in the form of certificated debt securities or global debt securities;

the portion of principal amount of the debt securities payable upon declaration of acceleration of the maturity date, if other than the principal amount;

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the currency of denomination of the debt securities;

the designation of the currency, currencies or currency units in which payment of principal of, premium and interest on the debt securities will be made;

if payments of principal of, premium or interest on the debt securities will be made in one or more currencies or currency units other than that or those in which the debt securities are denominated, the manner in which the exchange rate with respect to these payments will be determined;

the manner in which the amounts of payment of principal of, premium or interest on the debt securities will be determined, if these amounts may be determined by reference to an index based on a currency or currencies other than that in which the debt securities are denominated or designated to be payable or by reference to a commodity, commodity index, stock exchange index or financial index;

any provisions relating to any security provided for the debt securities;

any addition to or change in the events of default described in the indenture with respect to the debt securities and any change in the acceleration provisions described in the indenture with respect to the debt securities;

any addition to or change in the covenants described in the indenture with respect to the debt securities;

whether the debt securities will be senior or subordinated and any applicable subordination provisions;

any other terms of the debt securities, which may modify or delete any provision of the indenture as it applies to that series; and

any depositaries, interest rate calculation agents, exchange rate calculation agents or other agents with respect to the debt securities.

We may issue debt securities that are exchangeable and/or convertible into our common shares. The terms, if any, on which the debt securities may be exchanged for and/or converted will be set forth in the applicable prospectus supplement. Such terms may include provisions for conversion, either mandatory, at the option of the holder or at our option, in which case the number of common shares or other securities to be received by the holders of debt securities would be calculated as of a time and in the manner stated in the prospectus supplement. Neither the trustee nor the conversion agent shall have any duty to verify calculations respecting conversions. All such calculations shall be performed by us and our agents. Neither the trustee nor the conversion agent shall have any liability for not verifying our calculations and shall be entitled to rely upon them.

We may issue debt securities that provide for an amount less than their stated principal amount to be due and payable upon declaration of acceleration of their maturity pursuant to the terms of the indenture. We will provide you with information on the U.S. federal income tax considerations, Canadian federal income tax considerations and other special considerations applicable to any of these debt securities in the applicable prospectus supplement. If we denominate the purchase price of any of the debt securities in a foreign currency or currencies or a foreign currency unit or units, or if the principal of and any premium and interest on any series of debt securities is payable in a foreign currency or currencies or a foreign currency unit or units, we will provide you with information on the restrictions, elections, specific terms and other information with respect to that issue of debt securities and such foreign currency or currencies or foreign currency unit or units in the applicable prospectus supplement.

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Global Securities

The debt securities of a series may be issued in whole or in part in the form of one or more global securities that will be deposited with, or on behalf of, a depository (the depository) identified in the prospectus supplement. Global securities will be issued in registered form and in either temporary or definitive form. Unless and until it is exchanged in whole or in part for the individual debt securities, a global security may not be transferred except as a whole by the depository for such global security to a nominee of such depository or by a nominee of such depository to such depository or another nominee of such depository or by such depository or any such nominee to a successor of such depository or a nominee of such successor. The specific terms of the depository arrangement with respect to any debt securities of a series and the rights of and limitations upon owners of beneficial interests in a global security will be described in the applicable prospectus supplement.

Governing Law

The indenture and the debt securities will be governed by, and construed in accordance with, the internal laws of the State of New York.

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DESCRIPTION OF SHARE CAPITAL

We are a Canadian corporation, and our affairs are governed by our articles of continuance, as amended from time to time (the articles), bylaws as effective from time to time, and the CBCA.

As of the date of this prospectus, our authorized share capital consists of an unlimited number of common shares and an unlimited number of preferred shares issuable in series. As of the date of this registration statement, 32,129,138 common shares were issued and outstanding.

The following summary description of our share capital does not purport to be complete and is qualified in its entirety by reference to our articles and our amended bylaws. If you would like more information on our common shares, you should review our articles and bylaws and the CBCA.

Common Shares

General

All of our common shares are fully paid and non-assessable. Our common shares are issued in registered form and may or may not be certificated although every shareholder is entitled at their option to a share certificate that complies with the CBCA. There are no limitations on the rights of shareholders who are not residents of Canada to hold and vote common shares.

Dividends

Holders of our common shares are entitled to receive, from funds legally available therefor, dividends when and as declared by the board of directors. The CBCA restricts the directors' ability to declare, and our ability to pay, dividends by requiring that certain solvency tests be satisfied at the time of such declaration and payment. See the section entitled Directors Sources of Dividends.

Voting Rights

Each common share is entitled to one vote on all matters upon which the common shares are entitled to vote.

Liquidation

With respect to a distribution of assets in the event of our liquidation, dissolution or winding-up, whether voluntary or involuntary, or any other distribution of our assets for the purposes of winding up our affairs, assets available for distribution among the holders of common shares shall be distributed among the holders of the common shares on a *pro rata* basis.

Variations of Rights of Shares

All or any of the rights attached to our common shares, or any other class of shares duly authorized may, subject to the provisions of the CBCA, be varied either with the unanimous written consent of the holders of the issued shares of that class or by a special resolution passed at a meeting of the holders of the shares of that class.

Preferred Shares

Our board of directors has the authority, without shareholder approval, to issue an unlimited number of preferred shares in one or more series. Our board of directors may establish the number of shares to be included in each such series and may set the designations, preferences, powers and other rights of the shares of a series of preferred shares. While the issuance of preferred shares provides us with flexibility in connection with possible acquisitions or other corporate purposes, it could, among other things, have the effect of delaying, deferring or preventing a change of control transaction and could adversely affect the market price of our common shares and debt securities in this prospectus. We have no current plan to issue any preferred shares.

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Transfer Agent and Registrar

BNY Mellon Shareowner Services is the transfer agent and registrar for our common shares. BNY Mellon Shareowner Services' address is 480 Washington Boulevard, 29th Floor, Jersey City, NJ 07310.

Shareholders' Rights

The CBCA and our articles and bylaws govern us and our relations with our shareholders. The following is a summary of certain rights of holders of our common shares under the CBCA. This summary is not intended to be complete and is qualified in its entirety by reference to the CBCA and to our articles and bylaws.

Stated Objects or Purposes

Our articles do not contain any stated objects or purposes and do not place any limitations on the business that we may carry on.

Shareholder Meetings

We must hold an annual meeting of our shareholders at least once every year at a time and place determined by our board of directors, provided that the meeting must not be held later than 15 months after the preceding annual meeting or later than six months after the end of our preceding financial year. A meeting of our shareholders may be held at a place within Canada determined by our directors or, if determined by our directors, in New York, New York, United States of America, Los Angeles, California, United States of America, London, England, the Hong Kong Special Administrative Region of The People's Republic of China or Shanghai, The People's Republic of China.

Voting at any meeting of shareholders is by show of hands unless a poll or ballot is demanded. A poll or ballot may be demanded by the chairman of our board of directors or by any shareholder present in person or by proxy.

A special resolution is a resolution passed by not less than two-thirds of the votes cast by the shareholders entitled to vote on the resolution at a meeting at which a quorum is present. An ordinary resolution is a resolution passed by not less than a simple majority of the votes cast by the shareholders entitled to vote on the resolution at a meeting at which a quorum is present.

Notice of Meeting of Shareholders

Our bylaws provide that written notice stating the place, day and time of a shareholder meeting and the purpose for which the meeting is called, shall be delivered not less than 21 days nor more than 60 days before the date of the meeting.

Quorum

Under the CBCA, unless a corporation's bylaws provide otherwise, a quorum is present at a meeting of the shareholders, irrespective of the number of shareholders actually present at the meeting, if the holders of a majority of the shares entitled to vote at the meeting are present in person or represented by proxy. Our bylaws provide that a quorum shall be at least two shareholders entitled to vote at the meeting represented in person or by proxy and holding at least one-third of our total issued and outstanding common shares.

Record Date for Notice of Meeting of Shareholders

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Our directors may fix in advance a date as the record date for the determination of shareholders entitled to receive notice of a meeting of shareholders, but such record date shall not precede by more than 60 days or by less than 21 days the date on which the meeting is to be held. If no record date is fixed, the record date for the determination of shareholders entitled to receive notice of a meeting of shareholders shall be at the close of business on the day immediately preceding the day on which the notice is given or, if no notice is given, the day on which the meeting is held. If a record date is fixed, notice thereof shall be given, not less than seven days before the date so

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fixed by newspaper advertisement in the manner provided by the CBCA and by written notice to each stock exchange in Canada on which our shares are listed for trading.

Ability to Requisition Special Meetings of the Shareholders

The CBCA provides that the holders of not less than five percent of the issued shares of a corporation that carry the right to vote at a meeting sought to be held may give notice to the directors requiring them to call a meeting.

Shareholder Proposals

A shareholder entitled to vote at a meeting of shareholders who has held common shares with a fair market value of at least C\$2,000 for at least six months may submit to us notice of a proposal and discuss at the meeting any matter in respect of which the shareholder would have been entitled to submit a proposal. A proposal may include nominations for the election of directors if the proposal is signed by one or more holders of shares representing in the aggregate not less than five percent of the shares entitled to vote at the meeting to which the proposal is to be presented. This requirement does not preclude nominations being made at a meeting of shareholders. The proposal must be submitted to us at least 90 days before the anniversary date of the notice of meeting that was sent to shareholders in connection with the last annual meeting.

Vote Required for Extraordinary Transactions

Under the CBCA, certain extraordinary corporate actions are required to be approved by special resolution. Such extraordinary corporate actions include:

amendments to articles;

arrangements;

amalgamations other than amalgamations involving a holding body corporate, one or more wholly owned subsidiaries and/or one or more sister corporations;

continuances under the laws of another jurisdiction;

voluntary dissolutions; and

sales, leases or exchanges of all or substantially all the property of a corporation other than in the ordinary course of business.

Related Party Transactions

The CBCA does not prohibit related party transactions.

Dissent Rights

The CBCA provides that our shareholders are entitled to exercise dissent rights and demand payment of the fair value of their shares in certain circumstances. For this purpose, there is no distinction between listed and unlisted shares. Dissent rights exist when we resolve to:

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amalgamate with a corporation other than a holding body corporate, one or more wholly owned subsidiaries and/or one or more sister corporations;

amend the our articles of incorporation to add, change or remove any provisions restricting the issue, transfer or ownership of shares;

amend the ours articles to add, change or remove any restriction upon the business or businesses that the we may carry on;

continue under the laws of another jurisdiction;

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sell, lease or exchange of all or substantially all our property other than in the ordinary course of business; or carry out a going-private or squeeze-out transaction.

In addition, a court order in connection with an arrangement proposed by us may permit shareholders to dissent if the arrangement is adopted.

However, a shareholder is not entitled to dissent if an amendment to the articles of incorporation is effected by a court order approving a reorganization or by a court order made in connection with an action for an oppression remedy.

Action by Written Consent

Under the CBCA, shareholders can take action by written resolution and without a meeting only if all shareholders sign the written resolution.

Directors

Number of Directors and Election

Under the CBCA the number of directors of a corporation must be specified in the corporation's articles. The articles may provide for a minimum and maximum number of directors.

Our articles provide that the number of directors will not be less than three or more than ten. Our board of directors currently consists of six directors.

Our articles provide that our board of directors shall fix and may change the number of directors within the minimum and maximum number of directors provided for in our articles. In addition, our board of directors may appoint one or more additional directors, who shall hold office for a term expiring not later than the close of the next annual meeting of shareholders, but the total number of directors so appointed may not exceed one-third of the number of directors elected at the previous annual meeting of shareholders.

Shareholders of a corporation governed by the CBCA elect directors by ordinary resolution at each annual meeting of shareholders at which such an election is required.

Director Qualifications

Under the CBCA, at least 25% of the directors must be Canadian residents. A director must not be:

- under eighteen years of age;
- adjudicated as mentally unsound;
- a person that is not an individual; or
- a person who has the status of a bankrupt.

Removal of Directors; Staggered Term

Under the CBCA, a corporation's shareholders may remove at a special meeting any director before the expiration of his or her term of office and may elect any qualified person in such director's stead for the remainder of such term by ordinary resolution.

Under the CBCA, directors may be elected for a term expiring not later than the third annual meeting of shareholders following the election. If no term is specified, a director's term expires at the next annual meeting of shareholders. A director may be nominated for re-election to the board of directors at the end of the director's term.

Vacancies on the Board of Directors

Under the CBCA, vacancies that exist on the board of directors, except a vacancy resulting from an increase in the number or the minimum or maximum number of directors or a failure to elect the number or minimum number

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of directors provided for in the articles, may be filled by the board if the remaining directors constitute a quorum. In the absence of a quorum, the remaining directors shall call a meeting of shareholders to fill the vacancy.

Limitation of Personal Liability of Directors and Officers

Under the CBCA, in exercising their powers and discharging their duties, directors and officers must act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. No provision in the corporation's articles, bylaws, resolutions or contracts can relieve a director or officer from the duty to act in accordance with the CBCA or relieve a director from liability for a breach thereof. However, a director will not be liable for breaching his or her duty to act in accordance with the CBCA if the director relied in good faith on:

financial statements represented to him by an officer or in a written report of the auditor to fairly reflect the financial condition of the corporation; or

a report of a person whose profession lends credibility to a statement made by such person.

Indemnification of Directors and Officers

Under the CBCA and pursuant to our bylaws, we may indemnify any present or former director or officer or an individual who acts or acted at our request as a director or officer, or an individual acting in a similar capacity, of another entity, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by such individual in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the corporation or other entity. In order to qualify for indemnification such director or officer must:

have acted honestly and in good faith with a view to the best interests of the corporation, or, as the case may be, to the best interests of the other entity for which the individual acted as a director or officer or in a similar capacity at the corporation's request; and

in the case of a criminal or administrative action or proceeding enforced by a monetary penalty, have had reasonable grounds for believing that his or her conduct was lawful.

Indemnification will be provided to an eligible director or officer who meets both these tests and was substantially successful on the merits in his or her defense of the action.

A director or officer is entitled to indemnification from us as a matter of right if he or she is not judged by the court or other competent authority to have committed any fault or omitted to do anything that the individual ought to have done and fulfilled the conditions set forth above.

Sources of Dividends

Dividends may be declared at the discretion of the board of directors. Under the CBCA, the directors may not declare, and we may not pay, dividends if there are reasonable grounds for believing that (i) we are, or would after such payment be unable to pay our liabilities as they become due or (ii) the realizable value of our assets would thereby be less than the aggregate of our liabilities and of our stated capital of all classes of shares.

Amendments to the Bylaws

The directors may by resolution make, amend or repeal any bylaw unless the articles or bylaws provide otherwise. Our articles and bylaws do not restrict the power of our directors to make, amend or repeal bylaws. When the directors make, amend or repeal a bylaw, they are required under the CBCA to submit the change to the shareholders at the next meeting of shareholders. Shareholders may confirm, reject or amend the bylaw, amendment or repeal by ordinary resolution.

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Interested Directors Transactions

Under the CBCA, if a director or officer of a corporation has any interest in a material contract or material transaction, whether made or proposed, with the corporation if such director or officer is a party to the contract or transaction or is a director or an officer, or an individual acting in a similar capacity, of a party to the contract or transaction or has a material interest in a party to the contract or transaction, the director generally may not vote on any resolution to approve the contract or transaction, but the contract is not invalid by reason only of the relationship if such interest is disclosed in accordance with the requirements set out in the CBCA, the contract or transaction is approved by the other directors or by the shareholders and the contract or transaction was fair and reasonable to the corporation at the time it was approved.

Where a director or officer has an interest in a material contract or transaction or a proposed material contract or transaction that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, the interested director or officer shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors, the nature and the extent of the interest forthwith after the director or officer becomes aware of the contract or transaction or proposed contract or transaction.

Committees

Under the CBCA, directors of a corporation may appoint from their number a committee of directors and delegate to such committee certain powers of the directors.

Derivative Actions

Under the CBCA, a complainant (as defined below) may apply to the court for leave to bring an action in the name of and on behalf of a corporation or any of its subsidiaries, or to intervene in an existing action to which such body corporate is a party for the purpose of prosecuting, defending or discontinuing the action. A complainant includes a present or former shareholder, a present or former officer or director of the corporation or any of its affiliates, the Director appointed under the CBCA or any other person who in the discretion of the court is a proper person to make such an application. Under the CBCA, no such action may be brought and no such intervention in an action may be made unless the court is satisfied that:

the complainant has given notice to the directors of the corporation or its subsidiary of the complainant's intention to apply to the court for such leave not less than 14 days before bringing the application, or as otherwise directed by the court, if the directors of the corporation or its subsidiary do not bring, diligently prosecute or defend or discontinue the action;

the complainant is acting in good faith; and

it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.

Under the CBCA, the court in a derivative action may make any order it thinks fit, including orders pertaining to the conduct of the action, the making of payments to former and present shareholders and payment of reasonable legal fees incurred by the complainant.

Oppression Remedy

The CBCA provides an oppression remedy that enables a court to make any intention or final order it thinks fit to rectify the matters complained of, if the court is satisfied upon application of a complainant (as defined below) that:

any act or omission of the corporation or any of its affiliates effects a result;

the business or affairs of the corporation or any of its affiliates are or have been conducted in a manner; or

the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner,

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that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation.

A complainant for this purpose includes a present or former shareholder, a present or former officer or director of the corporation or any of its affiliates, the Director appointed under the CBCA and any other person who in the discretion of the court is a proper person to make such an application.

The exercise of the court's jurisdiction does not depend on a finding of a breach of such legal and equitable rights. Furthermore, the court may order a corporation to pay the interim costs of a complainant seeking an oppression remedy, but the complainant may be held accountable for such interim costs on final disposition of the complaint.

Inspection of Books and Records

Under the CBCA, our shareholders and creditors, their personal representatives and the Director appointed under the CBCA may examine, free of charge during our usual business hours:

- our articles, bylaws and all amendments thereto;
- the minutes and resolutions of shareholders;
- copies of all notices of directors filed under the CBCA; and
- our securities register.

Any of our shareholders may request a copy of the articles, bylaws and all amendments thereto free of charge.

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PLAN OF DISTRIBUTION

We or any selling security holder may sell or distribute the securities offered by this prospectus, from time to time, in one or more offerings, as follows:

through agents;

to dealers or underwriters for resale;

directly to purchasers; or

through a combination of any of these methods of sale.

In addition, we may issue the securities as a dividend or distribution or in a subscription rights offering to our existing security holders. In some cases, we or dealers acting for us or on our behalf may also repurchase securities and reoffer them to the public by one or more of the methods described above. This prospectus may be used in connection with any offering of our securities through any of these methods or other methods described in the applicable prospectus supplement.

Our securities distributed by any of these methods may be sold to the public, in one or more transactions, either:

at a fixed price or prices, which may be changed;

at market prices prevailing at the time of sale;

at prices related to prevailing market prices; or

at negotiated prices.

Sale through Underwriters or Dealers

If underwriters are used in the sale, the underwriters will acquire the securities for their own account, including through underwriting, purchase, security lending or repurchase agreements with us or any selling security holder. The underwriters may resell the securities from time to time in one or more transactions, including negotiated transactions. Underwriters may sell the securities in order to facilitate transactions in any of our other securities (described in this prospectus or otherwise), including other public or private transactions and short sales. Underwriters may offer securities to the public either through underwriting syndicates represented by one or more managing underwriters or directly by one or more firms acting as underwriters. Unless otherwise indicated in the applicable prospectus supplement, the obligations of the underwriters to purchase the securities will be subject to certain conditions, and the underwriters will be obligated to purchase all the offered securities if they purchase any of them. The underwriters may change from time to time any initial public offering price and any discounts or concessions allowed or reallocated or paid to dealers.

If dealers are used in the sale of securities offered through this prospectus, we or any selling security holder will sell the securities to them as principals. They may then resell those securities to the public at varying prices determined by the dealers at the time of resale. The applicable prospectus supplement will include the names of the dealers and the terms of the transaction.

Direct Sales and Sales through Agents

We or any selling security holder may sell the securities offered through this prospectus directly. In this case, no underwriters or agents would be involved. Such securities may also be sold through agents designated from time to time. The applicable prospectus supplement will name any agent involved in the offer or sale of the offered securities and will describe any commissions payable to the agent. Unless otherwise indicated in the applicable prospectus supplement, any agent will agree to use its commonly reasonable efforts to solicit purchases for the period of its appointment.

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We or any selling security holder may sell the securities directly to institutional investors or others who may be deemed to be underwriters within the meaning of the Securities Act with respect to any sale of those securities. The terms of any such sales will be described in the applicable prospectus supplement.

Delayed Delivery Contracts

If the applicable prospectus supplement indicates, we or any selling security holder may authorize agents, underwriters or dealers to solicit offers from certain types of institutions to purchase securities at the public offering price under delayed delivery contracts. These contracts would provide for payment and delivery on a specified date in the future. The contracts would be subject only to those conditions described in the prospectus supplement. The applicable prospectus supplement will describe the commission payable for solicitation of those contracts.

Market Making, Stabilization and Other Transactions

Unless the applicable prospectus supplement states otherwise, each series of offered securities will be a new issue and will have no established trading market. We may elect to list any series of offered securities on an exchange. Any underwriters that we or any selling security holder uses in the sale of offered securities may make a market in such securities, but may discontinue such market making at any time without notice. Therefore, we cannot assure you that the securities will have a liquid trading market.

Any underwriter may also engage in stabilizing transactions, syndicate covering transactions and penalty bids in accordance with Rule 104 under the Securities Exchange Act of 1934. Stabilizing transactions involve bids to purchase the underlying security in the open market for the purpose of pegging, fixing or maintaining the price of the securities. Syndicate covering transactions involve purchases of the securities in the open market after the distribution has been completed in order to cover syndicate short positions.

Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when the securities originally sold by the syndicate member are purchased in a syndicate covering transaction to cover syndicate short positions. Stabilizing transactions, syndicate covering transactions and penalty bids may cause the price of the securities to be higher than it would be in the absence of the transactions. The underwriters may, if they commence these transactions, discontinue them at any time.

Derivative Transactions and Hedging

We, any selling security holder and the underwriters may engage in derivative transactions involving the securities. These derivatives may consist of short sale transactions and other hedging activities. The underwriters may acquire a long or short position in the securities, hold or resell securities acquired and purchase options or futures on the securities and other derivative instruments with returns linked to or related to changes in the price of the securities. In order to facilitate these derivative transactions, we or any selling security holder may enter into security lending or repurchase agreements with the underwriters. The underwriters may effect the derivative transactions through sales of the securities to the public, including short sales, or by lending the securities in order to facilitate short sale transactions by others. The underwriters may also use the securities purchased or borrowed from us or others (or, in the case of derivatives, securities received from us in settlement of those derivatives) to directly or indirectly settle sales of the securities or close out any related open borrowings of the securities.

Loans of Securities

We or a selling shareholder may loan or pledge securities to a financial institution or other third party that in turn may sell the securities using this prospectus and an applicable prospectus supplement.

General Information

Agents, underwriters, and dealers may be entitled, under agreements entered into with us, to indemnification by us, against certain liabilities, including liabilities under the Securities Act. Our agents, underwriters, and dealers, or their affiliates, may be customers of, engage in transactions with or perform services for us or our affiliates, in the ordinary course of business for which they may receive customary compensation.

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VALIDITY OF THE SECURITIES

The validity of the debt securities offered hereby will be passed upon for us by Latham & Watkins LLP. The validity of the common shares offered hereby will be passed upon for us by WeirFoulds LLP.

EXPERTS

The financial statements and the related financial statement schedule of Canadian Solar Inc. and subsidiaries (the Company) incorporated in this prospectus by reference from the Company s Annual Report on Form 20-F for the year ended December 31, 2007, and the effectiveness of internal control over financial reporting as of December 31, 2007 have been audited by Deloitte Touche Tohmatsu CPA Ltd., an independent registered public accounting firm, as stated in their reports which are incorporated herein by reference (which reports (1) express an unqualified opinion on the consolidated financial statements and related financial statement schedule and include an explanatory paragraph referring to the adoption of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, effective January 1, 2007 and (2) express an unqualified opinion on the effectiveness of internal control over financial reporting).

The offices of Deloitte Touche Tohmatsu CPA Ltd. are located at 30th Floor, Bund Center, 222 Yan An Road East, Shanghai, People s Republic of China.

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PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 8. *INDEMNIFICATION OF DIRECTORS AND OFFICERS*

Under the CBCA, we may indemnify a present or former director or officer or a person who acts or acted at our request as a director or officer or an individual acting in a similar capacity, of another corporation or entity, and his or her heirs and legal representatives, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by him or her in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the corporation or other entity, provided that the director or officer acted honestly and in good faith with a view to the best interests of the corporation or other entity and, in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, had reasonable grounds for believing that his or her conduct was lawful. We may advance monies to such an individual for such costs, charges and expenses. Such indemnification may be made in connection with a derivative action only with court approval. A director or officer or other individual described above is entitled to indemnification from us in respect of all costs, charges and expenses reasonably incurred by him or her in connection with the defense of any civil, criminal, administrative, investigative or other proceeding to which he or she is subject because of his or her association with the corporation or other entity described above as a matter of right if he or she is not judged by the court or other competent authority to have committed any fault or omitted to do anything that the individual ought to have done and fulfilled the conditions set forth above. Our directors and officers are covered by directors and officers insurance policies.

Any underwriting agreement entered into in connection with an offering of securities will also provide for indemnification of us and our officers and directors in certain cases.

ITEM 9. *EXHIBITS*

The exhibits to this registration statement are listed on the Index to Exhibits to this registration statement, which Index to Exhibits is hereby incorporated by reference.

ITEM 10. *UNDERTAKINGS*

(A) The undersigned Registrant hereby undertakes:

- (1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement;
- (i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;
- (ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or any decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the SEC pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

provided, however, that paragraphs (a)(1)(i), (a)(1)(ii) and (a)(1)(iii) of this section do not apply if the registration statement is on Form F-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed with or furnished to the SEC by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 that are incorporated

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by reference in the registration statement, or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) To file a post-effective amendment to the registration statement to include any financial statements required by Item 8.A of Form 20-F at the start of any delayed offering or throughout a continuous offering. Financial statements and information otherwise required by Section 10(a)(3) of the Act need not be furnished, provided that the Registrant includes in the prospectus, by means of a post-effective amendment, financial statements required pursuant to this paragraph (a)(4) and other information necessary to ensure that all other information in the prospectus is at least as current as the date of those financial statements. Notwithstanding the foregoing, with respect to registration statements on Form F-3, a post-effective amendment need not be filed to include financial statements and information required by Section 10(a)(3) of the Act or Rule 3-19 of Regulation S-K if such financial statements and information are contained in periodic reports filed with or furnished to the SEC by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Act of 1934 that are incorporated by reference in this Form F-3.

(5) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser:

(i) Each prospectus filed by the Registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and

(ii) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5), or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii), or (x) for the purpose of providing the information required by section 10(a) of the Securities Act of 1933 shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of 314 securities in the offering described in the prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which that prospectus relates, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such effective date.

(6) That, for the purpose of determining liability of the Registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities:

The undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 424;

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned Registrant or used or referred to by the undersigned Registrant;

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(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

(B) The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the Registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(C) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form F-3 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in Suzhou, People's Republic of China, on July 14, 2008.

CANADIAN SOLAR INC.

By: /s/ Shawn (Xiaohua) Qu

Name: Shawn (Xiaohua) Qu

Title: Chairman and Chief Executive Officer

POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Mr. Shawn (Xiaohua) Qu as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any or all amendments (including post-effective amendments) to this registration statement and any and all related registration statements pursuant to Rule 462(b) of the Securities Act, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the SEC, hereby ratifying and confirming all that said attorney-in-fact and agent, or its substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act, this registration statement has been signed by the following persons in the capacities and on July 14, 2008.

Signature	Title
/s/ Shawn (Xiaohua) Qu Shawn (Xiaohua) Qu	Chairman and Chief Executive Officer (principal executive officer)
/s/ Arthur Chien Arthur Chien	Director and Chief Financial Officer (principal financial and accounting officer)
/s/ Robert McDermott Robert McDermott	Director
/s/ Lars-Eric Johansson Lars-Eric Johansson	Director
/s/ Michael G. Potter Michael G. Potter	Director

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/s/ Yan Zhuang

Director

Yan Zhuang

/s/ Donald J. Puglisi

Authorized U.S. Representative

Donald J. Puglisi
Managing Director
Puglisi & Associates

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INDEX TO EXHIBITS

Exhibit Number	Description of Document
1.1*	Form of Underwriting Agreement.
4.1	Registrant's Specimen Certificate for Common shares (incorporated by reference to Exhibit 4.11 of the Registration Statement on Form F-1 (file no. 333-138144) filed with the SEC)
4.2	Form of Indenture
4.3*	Form of Note
5.1	Opinion of Latham & Watkins LLP regarding the validity of the debt securities
5.2	Opinion of WeirFoulds LLP regarding the validity of the common shares
12.1	Statement regarding the computation of ratio of earnings to fixed charges
21.1	List of Subsidiaries
23.1	Consent of Deloitte Touche Tohmatsu, Independent Registered Public Accounting Firm
23.2	Consent of Latham & Watkins LLP (included in Exhibit 5.1)
23.3	Consent of WeirFoulds LLP (included in Exhibit 5.2)
23.4	Consent of Chen & Co. Law Firm
24.1	Powers of Attorney (included as part of signature page)
25.1	Form T-1 Statement of Eligibility and Qualification under the Trust Indenture Act of 1939 of the Trustee under the Indenture

* To be filed as an exhibit to a post-effective amendment to this registration statement or as an exhibit to a report filed under the Securities Exchange Act of 1934 and incorporated herein by reference.

TD> Collateralized corporate bank loans 20 (36) 48 (18)Municipal
bonds 101 (44) 84 (68)Mortgage-backed - - - Equity securities 17 490 2,377 490 (Loss) gain on
investments (10) 410 2,491 484 Change in unrealized losses on other
investments (62) - (503) - Other-than-temporary impairments (3,407) (2,587) (3,407) (2,888)Net realized
losses \$(3,479) \$(2,177) \$(1,419) \$(2,404)

We realized gross gains on investments of \$0.4 million and \$0.6 million during the three months ended June 30, 2017 and 2016, respectively, and \$3.0 million and \$0.7 million for the six months ended June 30, 2017 and 2016, respectively. We realized gross losses on investments of \$0.4 million and \$0.2 million for the three months ended June 30, 2017 and 2016, respectively, and \$0.5 million and \$0.2 million for the six months ended June 30, 2017 and 2016, respectively. We recorded proceeds from the sale of investment securities of \$0.1 million and \$11.0 million during the three months ended June 30, 2017 and 2016, respectively, and \$8.0 million and \$15.9 million for the six months ended June 30, 2017 and 2016, respectively. Realized investment gains and losses are recognized in operations on the specific identification method.

The following schedules summarize the gross unrealized losses showing the length of time that investments have been continuously in an unrealized loss position as of June 30, 2017 and December 31, 2016 (in thousands):

	As of June 30, 2017					
	12 months or less		Longer than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	\$36,947	\$ (14)	\$ -	\$ -	\$36,947	\$ (14)
Corporate bonds	72,355	(161)	-	-	72,355	(161)
Collateralized corporate bank loans	36,049	(150)	2,408	(142)	38,457	(292)
Municipal bonds	42,718	(524)	6,859	(177)	49,577	(701)
Mortgage-backed	12,781	(249)	1,628	(3)	14,409	(252)
Total debt securities	200,850	(1,098)	10,895	(322)	211,745	(1,420)
Total equity securities	5,653	(598)	2,106	(43)	7,759	(641)
Total other investments	614	-	-	-	614	-
Total investments	\$207,117	\$ (1,696)	\$ 13,001	\$ (365)	\$220,118	\$ (2,061)

	As of December 31, 2016					
	12 months or less		Longer than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government	\$7,037	\$ (20)	\$ -	\$ -	\$7,037	\$ (20)
Corporate bonds	86,592	(575)	-	-	86,592	(575)
Collateralized corporate bank loans	2,637	(7)	8,314	(163)	10,951	(170)
Municipal bonds	70,633	(1,327)	13,574	(1,634)	84,207	(2,961)
Mortgage-backed	29,475	(348)	2,430	(5)	31,905	(353)
Total debt securities	196,374	(2,277)	24,318	(1,802)	220,692	(4,079)
Total equity securities	4,109	(483)	2,037	(307)	6,146	(790)
Total other investments	-	-	-	-	-	-
Total investments	\$200,483	\$ (2,760)	\$ 26,355	\$ (2,109)	\$226,838	\$ (4,869)

At June 30, 2017, the gross unrealized losses more than twelve months old were attributable to 15 debt security positions and one equity position. At December 31, 2016, the gross unrealized losses more than twelve months old were attributable to 28 debt security positions and one equity position. We consider these losses as a temporary decline in value as they are predominately on bonds that we do not intend to sell and do not believe we will be required to sell prior to recovery of our amortized cost basis. We see no other indications that the decline in values of these securities is other-than-temporary. We recognized \$3.4 million of other-than-temporary impairments for the six months ended June 30, 2017 related to six municipal bond securities.

We complete a detailed analysis each quarter to assess whether any decline in the fair value of any investment below cost is deemed other-than-temporary. All securities with an unrealized loss are reviewed. We recognize an impairment

loss when an investment's value declines below cost, adjusted for accretion, amortization and previous other-than-temporary impairments, and it is determined that the decline is other-than-temporary.

Debt Investments: We assess whether we intend to sell, or it is more likely than not that we will be required to sell, a fixed maturity investment before recovery of its amortized cost basis less any current period credit losses. For fixed maturity investments that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the investment's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the investment's fair value and the present value of future expected cash flows is recognized in other comprehensive income.

Equity Investments: Some of the factors considered in evaluating whether a decline in fair value for an equity investment is other-than-temporary include: (1) our ability and intent to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; (2) the recoverability of cost; (3) the length of time and extent to which the fair value has been less than cost; and (4) the financial condition and near-term and long-term prospects for the issuer, including the relevant industry conditions and trends, and implications of rating agency actions and offering prices. When it is determined that an equity investment is other-than-temporarily impaired, the security is written down to fair value, and the amount of the impairment is included in earnings as a realized investment loss. The fair value then becomes the new cost basis of the investment, and any subsequent recoveries in fair value are recognized at disposition. We recognize a realized loss when impairment is deemed to be other-than-temporary even if a decision to sell an equity investment has not been made. When we decide to sell a temporarily impaired available-for-sale equity investment and we do not expect the fair value of the equity investment to fully recover prior to the expected time of sale, the investment is deemed to be other-than-temporarily impaired in the period in which the decision to sell is made.

Details regarding the carrying value of the other investments portfolio as of June 30, 2017 and December 31, 2016 were as follows (in thousands):

	June 30, 2017	December 31, 2016
Investment Type		
Equity warrant	\$ 4,448	\$ 4,951
Total other investments	\$ 4,448	\$ 4,951

We acquired this warrant in an active market. The warrant entitles us to buy the underlying common stock of a publicly traded company at a fixed price until the expiration date of January 19, 2021.

The amortized cost and estimated fair value of debt securities at June 30, 2017 by contractual maturity are as follows. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties.

	Amortized Fair	
	Cost	Value
	(in thousands)	
Due in one year or less	\$153,323	\$153,486
Due after one year through five years	231,340	232,487
Due after five years through ten years	143,558	144,413
Due after ten years	42,884	42,915
Mortgage-backed	34,881	34,773
	\$605,986	\$608,074

5. Pledged Investments

We have pledged certain of our securities for the benefit of various state insurance departments and reinsurers. These securities are included with our available-for-sale debt securities because we have the ability to trade these securities. We retain the interest earned on these securities. These securities had a carrying value of \$25.6 million and \$21.1 million at June 30, 2017 and December 31, 2016, respectively.

6. Reserves for Unpaid Losses and Loss Adjustment Expenses

Activity in the consolidated reserves for unpaid losses and LAE is summarized as follows (in thousands):

	June 30, 2017	June 30, 2016
Balance at January 1	\$481,567	\$450,878
Less reinsurance recoverable	123,237	102,791
Net balance at January 1	358,330	348,087
Incurred related to:		
Current year	122,862	116,654
Prior years	9,684	(2,757)
Total incurred	132,546	113,897
Paid related to:		
Current year	33,687	35,217
Prior years	90,042	88,377
Total paid	123,729	123,594
Net balance at June 30	367,147	338,390
Plus reinsurance recoverable	138,211	105,222
Balance at June 30	\$505,358	\$443,612

The impact from the (favorable) unfavorable net prior years' loss development on each reporting segment is presented below:

	Six Months Ended June 30,	
	2017	2016
Specialty Commercial Segment	\$ 8,332	\$ (1,594)
Standard Commercial Segment	264	(3,674)
Personal Segment	1,088	2,511

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Corporate	-	-
Total (favorable) unfavorable net prior year development	\$ 9,684	\$ (2,757)

The following describes the primary factors behind each segment's prior accident year reserve development for the six months ended June 30, 2017 and 2016:

Six months ended June 30, 2017:

Specialty Commercial Segment. Our MGA Commercial products operating unit experienced net unfavorable development primarily in the commercial auto liability line of business in the 2015 and prior accident years, partially offset by favorable development in the 2016 accident year. Our Specialty Commercial operating unit experienced net unfavorable development in general aviation primarily in the 2010 accident year, commercial excess liability primarily in the 2013 accident year and specialty risk programs primarily in the 2015, 2013 and 2012 accident years, partially offset by net favorable development in the medical professional liability lines of business primarily in the 2016 accident years.

Standard Commercial Segment. Our Standard Commercial P&C operating unit experienced net unfavorable development in the 2016 and prior accident years in the occupational accident line of business, partially offset by net favorable development primarily in the general liability line of business in the 2016 and prior accident years.

Personal Segment. Net unfavorable development in our Specialty Personal Lines operating unit was mostly attributable to the 2016, 2014 and 2013 accident years, partially offset by favorable development in the 2015 accident year.

Six months ended June 30, 2016:

Specialty Commercial Segment. Our MGA Commercial products operating unit experienced net favorable development primarily in the commercial auto liability and general liability lines of business in the 2015 and 2011 accident years, partially offset by net unfavorable development in the 2014, 2013 and 2012 accident years. Our Specialty Commercial operating unit experienced net favorable development primarily in the general aviation, commercial excess liability and medical professional liability lines of business.

Standard Commercial Segment. Our Standard Commercial P&C operating unit experienced net favorable development primarily in the general liability line of business in the 2015 and prior accident years. Our Workers Compensation operating unit experienced net favorable development in the 2015 and prior accident years, partially offset by net unfavorable development in the occupational accident line of business in the 2015 and prior accident years.

Personal Segment. Our Specialty Personal Lines operating unit experienced net unfavorable development mostly attributable to the 2015 and 2013 accident years.

7. Share-Based Payment Arrangements

Our 2005 Long Term Incentive Plan (“2005 LTIP”) is a stock compensation plan for key employees and non-employee directors that was initially approved by the shareholders on May 26, 2005 and expired by its terms on May 27, 2015. As of June 30, 2017, there were outstanding incentive stock options to purchase 168,187 shares of our common stock, non-qualified stock options to purchase 259,157 shares of our common stock and restricted stock units representing the right to receive up to 77,640 shares of our common stock. The exercise price of all such outstanding stock options is equal to the fair market value of our common stock on the date of grant.

Our 2015 Long Term Incentive Plan (“2015 LTIP”) was approved by shareholders on May 29, 2015. There are 2,000,000 shares authorized for issuance under the 2015 LTIP. As of June 30, 2017, restricted stock units representing the right to receive up to 292,961 shares of our common stock were outstanding under the 2015 LTIP. There were no stock option awards granted under the 2015 LTIP as of June 30, 2017.

Stock Options:

Incentive stock options granted under the 2005 LTIP prior to 2009 vest 10%, 20%, 30% and 40% on the first, second, third and fourth anniversary dates of the grant, respectively, and terminate five to ten years from the date of grant. Incentive stock options granted in 2009 vest in equal annual increments on each of the first seven anniversary dates and terminate ten years from the date of grant. One grant of 25,000 incentive stock options in 2010 vests in equal annual increments on each of the first three anniversary dates and terminates ten years from the date of grant. Non-qualified stock options granted under the 2005 LTIP generally vest 100% six months after the date of grant and terminate ten years from the date of grant. One grant of 200,000 non-qualified stock options in 2009 vests in equal annual increments on each of the first seven anniversary dates and terminates ten years from the date of grant.

A summary of the status of our stock options as of June 30, 2017 and changes during the six months then ended is presented below:

	Number of Shares	Weighted Average Exercise Price	Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2017	624,231	\$ 9.14		
Granted	-			
Exercised	(21,887)	\$ 6.61		
Forfeited or expired	(175,000)	\$ 12.49		
Outstanding at June 30, 2017	427,344	\$ 7.89	1.7	\$ 1,469
Exercisable at June 30, 2017	427,344	\$ 7.89	1.7	\$ 1,469

The following table details the intrinsic value of options exercised, total cost of share-based payments charged against income before income tax benefit and the amount of related income tax benefit recognized in income for the periods indicated (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Intrinsic value of options exercised	\$ 80	\$ -	\$ 101	\$ -
Cost of share-based payments (non-cash)	\$ -	\$ -	\$ -	\$ 38
Income tax benefit of share-based payments recognized in income	\$ -	\$ -	\$ -	\$ 8

As of June 30, 2017, there was no unrecognized compensation cost related to non-vested stock options granted under our plans which is expected to be recognized in the future.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option pricing model. Expected volatilities are based on the historical volatility of Hallmark's and similar companies' common stock for a period equal to the expected term. The risk-free interest rates for periods within the contractual term of the options are based on rates for U.S. Treasury Notes with maturity dates corresponding to the option's expected lives on the dates of grant. Expected term is determined based on the simplified method as we do not have sufficient historical exercise data to provide a basis for estimating the expected term. There were no stock options granted during the first six months of 2017 or 2016.

Restricted Stock Units:

The 2005 LTIP was amended by the stockholders on May 30, 2013 to authorize the grant of restricted stock units, in addition to the other types of awards available thereunder. Restricted stock units awarded under the 2005 LTIP and 2015 LTIP represent the right to receive shares of common stock upon the satisfaction of vesting requirements, performance criteria and other terms and conditions. On July 27, 2012 and April 10, 2013, an aggregate of 129,463 and 122,823 restricted stock units, respectively, were conditionally granted to certain of our employees subject to shareholder approval of the amendments to the 2005 LTIP at the May 30, 2013 shareholder meeting. One conditional grant of 9,280 restricted stock units was forfeited prior to approval at the shareholder meeting. Subsequently on September 8, 2014, an aggregate of 175,983 restricted stock units were granted to certain employees under the 2005 LTIP. On May 29, 2015, an aggregate of 103,351 restricted stock units were granted to certain employees under the 2015 LTIP. Subsequently on July 22, 2016, an aggregate of 122,770 restricted stock units were granted to certain employees under the 2015 LTIP.

The performance criteria for all restricted stock units require that we achieve certain compound average annual growth rates in book value per share over the vesting period in order to receive shares of common stock in amounts ranging from 50% to 150% of the number of restricted stock units granted. In addition, certain restricted stock unit grants contain an additional performance criteria related to the attainment of an average combined ratio percentage over the vesting period. Grantees of restricted stock units do not have any rights of a stockholder, and do not participate in any distributions to our common stockholders, until the award fully vests upon satisfaction of the vesting schedule, performance criteria and other conditions set forth in their award agreement. Therefore, unvested restricted stock units are not considered participating securities under ASC 260, "Earnings Per Share," and are not included in the calculation of basic or diluted earnings per share.

On April 1, 2017, 5,998 shares of common stock were issued with respect to 5,998 restricted stock units which were granted on September 8, 2014 and vested on March 31, 2017. On April 1, 2016, 7,144 shares of common stock were issued with respect to 7,144 restricted stock units which were granted on April 10, 2013 and vested on March 31, 2016. If and to the extent specified performance criteria have been achieved, one grant of restricted stock units granted on September 8, 2014 will vest on March 31, 2018, the restricted stock units granted on May 29, 2015 will vest on March 31, 2018 and the restricted stock units granted on July 22, 2016 will vest on March 31, 2019.

Compensation cost is measured as an amount equal to the fair value of the restricted stock units on the date of grant and is expensed over the vesting period if achievement of the performance criteria is deemed probable, with the amount of the expense recognized based on our best estimate of the ultimate achievement level. The grant date fair value of the restricted stock units granted in 2014 is \$9.66 per unit. The grant date fair value of the restricted stock units granted in 2015 is \$11.10 per unit. The grant date fair value of the restricted stock units granted in 2016 is \$11.41 per unit. We incurred compensation expense of \$19 thousand and \$46 thousand related to restricted stock units during the three months and six months ended June 30, 2017, respectively. We incurred compensation expense of \$89 thousand and \$190 thousand during the three months and six months ended June 30, 2016, respectively. We recorded income tax benefit of \$7 thousand and \$16 thousand related to restricted stock units during the three months and six months ended June 30, 2017, respectively. We recorded income tax benefit of \$32 thousand and \$67 thousand related to restricted stock units during the three months and six months ended June 30, 2016.

A summary of the status of our restricted stock units as of June 30, 2017 and 2016 and changes during the six months then ended is presented below:

	Number of Restricted Stock Units	
	2017	2016
Non-vested at January 1	296,574	296,571
Granted	-	-
Vested	(5,998)	(7,144)
Forfeited	(43,509)	(71,460)
Non-vested at June 30	247,067	217,967

As of June 30, 2017, there was \$98 thousand of total unrecognized compensation cost related to unvested restricted stock units granted under our 2015 LTIP, of which \$37 thousand is expected to be recognized during the remainder of 2017, \$50 thousand is expected to be recognized in 2018 and \$11 thousand is expected to be recognized in 2019.

8. Segment Information

The following is business segment information for the three and six months ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Specialty Commercial Segment	\$ 69,501	\$ 63,040	\$ 135,336	\$ 123,623
Standard Commercial Segment	17,322	18,219	35,048	36,211
Personal Segment	10,684	12,147	22,547	24,237
Corporate	(4,032)	(2,354)	(2,508)	(2,991)
Consolidated	\$ 93,475	\$ 91,052	\$ 190,423	\$ 181,080
Pre-tax income (loss):				
Specialty Commercial Segment	\$ 3,632	\$ 7,287	\$ 11,730	\$ 17,599
Standard Commercial Segment	(199)	3,011	652	4,427
Personal Segment	(892)	(1,014)	(1,650)	(2,097)
Corporate	(7,459)	(7,797)	(9,812)	(12,453)
Consolidated	\$ (4,918)	\$ 1,487	\$ 920	\$ 7,476

The following is additional business segment information as of the dates indicated (in thousands):

	June 30, 2017	December 31, 2016
Assets		
Specialty Commercial Segment	\$ 782,301	\$ 734,763
Standard Commercial Segment	164,915	164,295
Personal Segment	239,882	241,686
Corporate	25,742	21,716
	\$ 1,212,840	\$ 1,162,460

9. Reinsurance

We reinsure a portion of the risk we underwrite in order to control the exposure to losses and to protect capital resources. We cede to reinsurers a portion of these risks and pay premiums based upon the risk and exposure of the policies subject to such reinsurance. Ceded reinsurance involves credit risk and is generally subject to aggregate loss

limits. Although the reinsurer is liable to us to the extent of the reinsurance ceded, we are ultimately liable as the direct insurer on all risks reinsured. Reinsurance recoverables are reported after allowances for uncollectible amounts. We monitor the financial condition of reinsurers on an ongoing basis and review our reinsurance arrangements periodically. Reinsurers are selected based on their financial condition, business practices and the price of their product offerings. In order to mitigate credit risk to reinsurance companies, most of our reinsurance recoverable balance as of June 30, 2017 was with reinsurers that had an A.M. Best rating of “A-” or better.

The following table shows earned premiums ceded and reinsurance loss recoveries by period (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Ceded earned premiums	\$ 50,884	\$ 41,118	\$96,601	\$80,098
Reinsurance recoveries	\$ 31,729	\$ 24,420	\$58,430	\$48,369

10. Revolving Credit Facility

Our Second Restated Credit Agreement with Frost Bank (“Frost”) dated June 30, 2015, reinstated the credit facility with Frost which expired by its terms on April 30, 2015. The Second Restated Credit Agreement also amended certain provisions of the credit facility and restated the agreement with Frost in its entirety. The Second Restated Credit Agreement provides a \$15.0 million revolving credit facility (“Facility A”), with a \$5.0 million letter of credit sub-facility. The outstanding balance of the Facility A bears interest at a rate equal to the prime rate or LIBOR plus 2.5%, at our election. We pay an annual fee of 0.25% of the average daily unused balance of Facility A and letter of credit fees at the rate of 1.00% per annum. As of June 30, 2017, we had no outstanding borrowings under Facility A.

On December 17, 2015, we entered into a First Amendment to Second Restated Credit Agreement and a Revolving Facility B Agreement (the “Facility B Agreement”) with Frost to provide a new \$30.0 million revolving credit facility (“Facility B”), in addition to Facility A. On November 1, 2016, we amended the Facility B Agreement with Frost to extend by one year the termination date for draws under Facility B and the maturity date for amounts outstanding thereunder. We paid Frost a commitment fee of \$75,000 when Facility B was established and an additional \$30,000 fee when Facility B was extended.

We may use Facility B loan proceeds solely for the purpose of making capital contributions to AHIC and HIC. As amended, we may borrow, repay and reborrow under Facility B until December 17, 2018, at which time all amounts outstanding under Facility B are converted to a term loan. Through December 17, 2018, we pay Frost a quarterly fee of 0.25% per annum of the average daily unused balance of Facility B. Facility B bears interest at a rate equal to the prime rate or LIBOR plus 3.00%, at our election. Until December 17, 2018, interest only on amounts from time to time outstanding under Facility B are payable quarterly. Any amounts outstanding on Facility B as of December 17, 2018 are converted to a term loan payable in quarterly installments over five years based on a seven year amortization of principal plus accrued interest. All remaining principal and accrued interest on Facility B become due and payable on December 17, 2023. As of June 30, 2017, we had \$30.0 million outstanding under Facility B.

The obligations under both Facility A and Facility B are secured by a security interest in the capital stock of AHIC and HIC. Both Facility A and Facility B contain covenants that, among other things, require us to maintain certain financial and operating ratios and restrict certain distributions, transactions and organizational changes. As of June 30, 2017, we were in compliance with all of these covenants.

11. Subordinated Debt Securities

On June 21, 2005, we entered into a trust preferred securities transaction pursuant to which we issued \$30.9 million aggregate principal amount of subordinated debt securities due in 2035. To effect the transaction, we formed Trust I as a Delaware statutory trust. Trust I issued \$30.0 million of preferred securities to investors and \$0.9 million of common securities to us. Trust I used the proceeds from these issuances to purchase the subordinated debt securities. The initial interest rate on our Trust I subordinated debt securities was 7.725% until June 15, 2015, after which interest adjusts quarterly to the three-month LIBOR rate plus 3.25 percentage points. Trust I pays dividends on its preferred securities at the same rate. Under the terms of our Trust I subordinated debt securities, we pay interest only each quarter and the principal of the note at maturity. The subordinated debt securities are uncollateralized and do not require maintenance of minimum financial covenants. As of June 30, 2017, the principal balance of our Trust I subordinated debt was \$30.9 million and the interest rate was 4.50% per annum.

On August 23, 2007, we entered into a trust preferred securities transaction pursuant to which we issued \$25.8 million aggregate principal amount of subordinated debt securities due in 2037. To effect the transaction, we formed Trust II as a Delaware statutory trust. Trust II issued \$25.0 million of preferred securities to investors and \$0.8 million of common securities to us. Trust II used the proceeds from these issuances to purchase the subordinated debt securities. Our Trust II subordinated debt securities bear an initial interest rate of 8.28% until September 15, 2017, at which time interest will adjust quarterly to the three-month LIBOR rate plus 2.90 percentage points. Trust II pays dividends on its preferred securities at the same rate. Under the terms of our Trust II subordinated debt securities, we pay interest only each quarter and the principal of the note at maturity. The subordinated debt securities are uncollateralized and do not require maintenance of minimum financial covenants. As of June 30, 2017, the principal balance of our Trust II subordinated debt was \$25.8 million.

12. Deferred Policy Acquisition Costs

The following table shows total deferred and amortized policy acquisition cost activity by period (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Deferred	\$ (10,616)	\$ (6,978)	\$ (21,713)	\$ (20,716)
Amortized	10,375	7,091	21,571	20,458
Net	\$ (241)	\$ 113	\$ (142)	\$ (258)

13. Earnings per Share

The following table sets forth basic and diluted weighted average shares outstanding for the periods indicated (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Weighted average shares - basic	18,424	18,878	18,518	18,945
Effect of dilutive securities	-	174	145	170
Weighted average shares - assuming dilution	18,424	19,052	18,663	19,115

For each of the three and six months ended June 30, 2017, 97,500 shares of common stock potentially issuable upon the exercise of employee stock options were excluded from the weighted average number of shares outstanding on a diluted basis because the effect of such options would be anti-dilutive. For each of the three and six months ended June 30, 2016, 385,000 shares of common stock potentially issuable upon the exercise of employee stock options were excluded from the weighted average number of shares outstanding on a diluted basis because the effect of such options would be anti-dilutive.

14. Net Periodic Pension Cost

The following table details the net periodic pension cost incurred by period (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Interest cost	\$ 111	\$ 128	\$ 222	\$ 256
Amortization of net loss	35	29	70	57
Expected return on plan assets	(161)	(162)	(323)	(323)
Net periodic pension cost	\$ (15)	\$ (5)	\$ (31)	\$ (10)
Contributed amount	\$ -	\$ -	\$ -	\$ -

Refer to Note 14 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2016 for more discussion of our retirement plans.

15. Income Taxes

Our effective income tax rate for the six months ended June 30, 2017 and 2016 was 30.9% and 31.2%, respectively. The rates varied from the statutory tax rate primarily due to the amount of tax exempt income in relation to total pre-tax income.

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16. Commitments and Contingencies

We are engaged in various legal proceedings in the ordinary course of business, none of which, either individually or in the aggregate, are believed likely to have a material adverse effect on our consolidated financial position or results of operations, in the opinion of management. The various legal proceedings to which we are a party are routine in nature and incidental to our business.

In November 2015, one of the subsidiaries in our MGA Commercial operating unit, Hallmark Specialty Underwriters, Inc. (“HSU”), was informed by the Texas Comptroller of Public Accounts that a surplus lines tax audit covering the period January 1, 2010 through December 31, 2013 was complete. HSU frequently acts as a managing general underwriter (“MGU”) authorized to underwrite policies on behalf of Republic Vanguard Insurance Company and HSIC, both Texas eligible surplus lines insurance carriers. In its role as the MGU, HSU underwrites policies on behalf of these carriers while other agencies located in Texas (generally referred to as “producing agents”) deliver the policies to the insureds and collect all premiums due from the insureds. During the period under audit, the producing agents also collected the surplus lines premium taxes due on the policies from the insureds, held them in trust, and timely remitted those taxes to the Comptroller. We believe this system for collecting and paying the required surplus lines premium taxes complies in all respects with the Texas Insurance Code and other regulations, which clearly require that the same party who delivers the policies and collects the premiums will also collect premium taxes, hold premium taxes in trust, and pay premium taxes to the Comptroller. It also complies with long standing industry practice. In addition, effective January 1, 2012 the Texas legislature enacted House Bill 3410 (HB3410) which allows an MGU to contractually pass the collection, payment and administration of surplus lines taxes down to another Texas licensed surplus line agent.

The Comptroller has asserted that HSU is liable for the surplus lines premium taxes related to policy transactions and premiums collected from surplus lines insureds during January 1, 2010 through December 31, 2011, the period prior to the passage of HB3410, and that HSU therefore owes \$2.5 million in premium taxes, as well as \$0.7 million in penalties and interest for the audit period. During the second quarter of 2017, we reached an agreement with the Comptroller to settle the matter for \$0.2 million, which was accrued as of June 30, 2017.

17. Changes in Accumulated Other Comprehensive Income Balances

The changes in accumulated other comprehensive income balances as of June 30, 2017 and 2016 were as follows (in thousands):

	Minimum Pension Liability	Unrealized Gains (Loss)	Accumulated Other Comprehensive Income
Balance at December 31, 2015	\$ (2,572)	\$ 9,990	\$ 7,418
Other comprehensive income:			
Change in net actuarial gain	57	-	57
Tax effect on change in net actuarial gain	(20)	-	(20)
Net unrealized holding gains arising during the period	-	5,729	5,729
Tax effect on unrealized gains arising during the period	-	(2,005)	(2,005)
Reclassification adjustment for gains included in net realized gains	-	(484)	(484)
Tax effect on reclassification adjustment for gains included in income tax expense	-	169	169
Other comprehensive income, net of tax	37	3,409	3,446
Balance at June 30, 2016	\$ (2,535)	\$ 13,399	\$ 10,864
Balance at December 31, 2016	\$ (2,666)	\$ 13,037	\$ 10,371
Other comprehensive income:			
Change in net actuarial gain	70	-	70
Tax effect on change in net actuarial gain	(24)	-	(24)
Net unrealized holding gains arising during the period	-	7,900	7,900
Tax effect on unrealized gains arising during the period	-	(2,765)	(2,765)
Reclassification adjustment for gains included in net realized gains	-	(2,491)	(2,491)
Tax effect on reclassification adjustment for gains included in income tax expense	-	872	872
Other comprehensive income, net of tax	46	3,516	3,562
Balance at June 30, 2017	\$ (2,620)	\$ 16,553	\$ 13,933

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read together with our consolidated financial statements and the notes thereto. This discussion contains forward-looking statements. Please see "Risks Associated with Forward-Looking Statements in this Form 10-Q" for a discussion of some of the uncertainties, risks and assumptions associated with these statements.

Introduction

Hallmark Financial Services, Inc. ("Hallmark" and, together with subsidiaries, "we," "us" or "our") is an insurance holding company that, through its subsidiaries, engages in the sale of property/casualty insurance products to businesses and individuals. Our business involves marketing, distributing, underwriting and servicing our insurance products, as well as providing other insurance related services. Our business is geographically concentrated in the south central and northwest regions of the United States, except for our Specialty Commercial business which is written on a national basis. We pursue our business activities through subsidiaries whose operations are organized into product-specific operating units, which are supported by our insurance company subsidiaries.

Our non-carrier insurance activities are segregated by operating units into the following reportable segments:

Specialty Commercial Segment. Our Specialty Commercial Segment includes the excess and surplus lines commercial property/casualty insurance products and services handled by our MGA Commercial Products operating unit and the general aviation, satellite launch, commercial umbrella and primary/excess liability, medical and financial professional liability and primary/excess commercial property insurance products and services handled by our Specialty Commercial operating unit, as well as certain specialty risk programs which are managed at the parent level.

Standard Commercial Segment. Our Standard Commercial Segment includes the standard lines commercial property/casualty and occupational accident insurance products and services handled by our Standard Commercial P&C operating unit and the workers compensation insurance products handled by our Workers Compensation operating unit. We discontinued marketing new and renewal occupational accident policies effective June 1, 2016. During 2015, we discontinued our workers' compensation line of business by transferring all renewal rights and ceding substantially all unearned premiums to a third party. As a result, effective July 1, 2015, the Workers Compensation operating unit no longer retains any risk on new or renewal policies.

Personal Segment. Our Personal Segment includes the non-standard personal automobile and renters insurance products and services handled by our Specialty Personal Lines operating unit.

The retained premium produced by these reportable segments is supported by our American Hallmark Insurance Company of Texas (“AHIC”), Hallmark Specialty Insurance Company (“HSIC”), Hallmark Insurance Company (“HIC”), Hallmark National Insurance Company (“HNIC”) and Texas Builders Insurance Company (“TBIC”) insurance subsidiaries. In addition, control and management of Hallmark County Mutual (“HCM”) is maintained through our wholly owned subsidiary, CYR Insurance Management Company (“CYR”). CYR has as its primary asset a management agreement with HCM which provides for CYR to have management and control of HCM. HCM is used to front certain lines of business in our Specialty Commercial and Personal Segments in Texas. HCM does not retain any business.

AHIC, HIC, HSIC and HNIC have entered into a pooling arrangement pursuant to which AHIC retains 34% of the total net premiums written by any of them, HIC retains 32% of our total net premiums written by any of them, HSIC retains 24% of our total net premiums written by any of them and HNIC retains 10% of our total net premiums written by any of them. Neither HCM nor TBIC is a party to the intercompany pooling arrangement.

Results of Operations

Management overview. During the three and six months ended June 30, 2017, our total revenues were \$93.5 million and \$190.4 million, representing an increase of 3% and 5%, respectively, from the \$91.1 million and \$181.1 million in total revenues for the same periods of 2016. This increase in revenue was primarily attributable to higher net earned premiums in our Specialty Commercial Segment during the three and six months ended June 30, 2017 as compared to the same periods during 2016. Further contributing to this increase in revenues was higher net investment income during the three and six months ended June 30, 2017 as compared to the same periods during 2016. These increases in revenue during the second quarter of 2017 were partially offset by higher realized losses recognized during the three months ended June 30, 2017 as compared to the same period during 2016, as well as lower finance charges during the three and six months ended June 30, 2017.

The increase in revenue for the three and six months ended June 30, 2017 was offset by higher losses and loss adjustment expenses (“LAE”) of \$12.2 million and \$18.6 million, respectively, as compared to the same periods in 2016. The increase in losses and LAE was primarily the result of unfavorable net prior year loss reserve development of \$10.2 million and \$9.7 million for the three and six months ended June 30, 2017 as compared to favorable net prior year loss reserve development of \$1.0 million and \$2.8 million for the same periods of 2016, as well as higher current accident year loss trends in our MGA Commercial Products operating unit. Other operating expenses decreased due mostly as a result of a \$1.8 million accrual to the earn-out related to the previous acquisition of TBIC during the second quarter of 2016 and lower production related expenses due primarily to increased ceding commissions in our Specialty Commercial Segment, partially offset by increased salary and related expenses and professional service fees for the three and six months ended June 30, 2017 as compared to the same periods during 2016.

We reported a net loss of \$3.4 million for the three months ended June 30, 2017 as compared to net income of \$1.1 million for the same period of 2016. We reported net income of \$0.6 million for the six months ended June 30, 2017 as compared to net income of \$5.1 million for the same period of 2016. On a diluted basis per share, we reported a net loss of \$0.18 per share for the three months ended June 30, 2017, as compared to net income of \$0.06 per share for the same period in 2016. On a diluted basis per share, we reported net income of \$0.03 per share for the six months ended June 30, 2017, as compared to net income of \$0.27 per share for the same period in 2016.

Second Quarter 2017 as Compared to Second Quarter 2016

The following is additional business segment information for the three months ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended June 30									
	Specialty		Standard Commercial Segment		Personal Segment		Corporate		Consolidated	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Gross premiums written	\$127,805	\$103,717	\$19,769	\$21,024	\$14,482	\$19,296	\$-	\$-	\$162,056	\$144,000
Ceded premiums written	(52,386)	(37,538)	(2,086)	(2,210)	(6,690)	(9,046)	-	-	(61,162)	(48,000)
Net premiums written	75,419	66,179	17,683	18,814	7,792	10,250	-	-	100,894	95,000
Change in unearned premiums	(10,635)	(6,410)	(1,301)	(1,473)	1,749	338	-	-	(10,187)	(7,500)
Net premiums earned	64,784	59,769	16,382	17,341	9,541	10,588	-	-	90,707	87,500
Total revenues	69,501	63,040	17,322	18,219	10,684	12,147	(4,032)	(2,354)	93,475	91,000
Losses and loss adjustment expenses	50,529	39,518	11,863	9,369	8,312	9,615	-	-	70,704	58,500
Pre-tax income (loss)	3,632	7,287	(199)	3,011	(892)	(1,014)	(7,459)	(7,797)	(4,918)	1,400
Net loss ratio (1)	78.0 %	66.1 %	72.4 %	54.0 %	87.1 %	90.8 %			77.9 %	66.7 %
Net expense ratio (1)	23.2 %	26.2 %	34.9 %	34.0 %	26.6 %	23.7 %			27.2 %	29.2 %
Net combined ratio (1)	101.2 %	92.3 %	107.3 %	88.0 %	113.7 %	114.5 %			105.1 %	95.9 %
Favorable (Unfavorable) Prior Year Development	(8,032)	(753)	(1,722)	3,316	(419)	(1,523)			(10,173)	1,000

(1)

The net loss ratio is calculated as incurred losses and LAE divided by net premiums earned, each determined in accordance with GAAP. The net expense ratio is calculated as total underwriting expenses offset by agency fee income divided by net premiums earned, each determined in accordance with GAAP. Net combined ratio is calculated as the sum of the net loss ratio and the net expense ratio.

Specialty Commercial Segment

Gross premiums written for the Specialty Commercial Segment were \$127.8 million for the three months ended June 30, 2017, which was \$24.1 million, or 23%, more than the \$103.7 million reported for the same period of 2016. Net premiums written were \$75.4 million for the three months ended June 30, 2017 as compared to \$66.2 million for the same period of 2016. The increase in gross and net premiums written were primarily the result of increased premium production in both our Specialty Commercial operating unit and MGA Commercial Products operating unit.

The \$69.5 million of total revenue for the three months ended June 30, 2017 was \$6.5 million more than the \$63.0 million reported by the Specialty Commercial Segment for the same period in 2016. This increase in revenue was primarily due to higher net premiums earned of \$5.0 million due mostly to increased premium production in both our MGA Commercial Products operating unit and our Specialty Commercial operating unit. Further contributing to the increased revenue was higher net investment income of \$1.0 million and higher commission and fees of \$0.5 million for the three months ended June 30, 2017 as compared to the same period of 2016.

Pre-tax income for the Specialty Commercial Segment of \$3.6 million for the second quarter of 2017 was \$3.7 million lower than the \$7.3 million reported for the same period in 2016. The decrease in pre-tax income was primarily the result of higher losses and LAE of \$11.0 million, partially offset by lower operating expenses of \$0.8 million and the increased revenue discussed above.

Our MGA Commercial Products operating unit reported a \$9.0 million increase in losses and LAE due largely to \$6.8 million unfavorable prior year net loss reserve development recognized during the three months ended June 30, 2017 as compared to \$1.3 million unfavorable prior year net loss reserve development during the same period of 2016, as well as higher current accident year loss trends. Our Specialty Commercial operating unit reported a \$2.0 million increase in losses and LAE which consisted of (a) a \$1.5 million increase in losses and LAE in our commercial umbrella and primary/excess liability line of business, (b) a \$0.6 million increase in losses and LAE in our satellite launch insurance line of business, (c) a \$0.4 million increase in losses and LAE attributable to our primary/excess property insurance products due to increase premium production (d) a \$0.4 million increase in our general aviation line of business, partially offset by (e) a \$0.6 million decrease in losses and LAE attributable to our professional liability insurance products and (f) a \$0.3 million decrease in losses and LAE in our specialty programs. The \$0.8 million decrease in operating expense was primarily the result of lower production related expenses of \$1.5 million due primarily to increased ceding commissions in our Specialty Commercial operating unit, partially offset by increased salary and related expenses of \$0.4 million, higher travel related expenses of \$0.1 million and higher occupancy and other operating expenses of \$0.2 million.

The Specialty Commercial Segment reported a net loss ratio of 78.0% for the three months ended June 30, 2017 as compared to 66.1% for the same period during 2016. The gross loss ratio before reinsurance was 73.0% for the three months ended June 30, 2017 as compared to 62.1% for the same period in 2016. The higher gross and net loss ratios were largely the result of \$8.0 million of unfavorable prior year net loss reserve development for the three months ended June 30, 2017 as compared to unfavorable prior year net loss reserve development of \$0.8 million for the same period of 2016 as well as higher current accident year loss trends driven by commercial auto lines of business. The Specialty Commercial Segment reported a net expense ratio of 23.2% for the second quarter of 2017 as compared to 26.2% for the same period of 2016. The decrease in the expense ratio was due predominately to the impact of higher net premiums earned.

Standard Commercial Segment

Gross premiums written for the Standard Commercial Segment were \$19.8 million for the three months ended June 30, 2017, which was \$1.2 million, or 6%, less than the \$21.0 million reported for the same period in 2016. The decrease in gross premiums was primarily due to a \$1.8 million reduction from the impact of the discontinued marketing of new and renewal occupational accident policies effective June 1, 2016, partially offset by higher premium production in our Standard Commercial P&C Operating unit of \$0.6 million. Net premiums written were \$17.7 million for the three months ended June 30, 2017 as compared to \$18.8 million for the same period in 2016. The decrease in net premiums written was primarily attributable to a \$1.6 million reduction from the impact of the discontinued marketing of new and renewal occupational accident policies, partially offset by higher net premiums written in our Standard Commercial P&C Operating unit of \$0.5 million.

Total revenue for the Standard Commercial Segment of \$17.3 million for the three months ended June 30, 2017, was \$0.9 million, or 5%, less than the \$18.2 million reported for the same period in 2016. This decrease in total revenue was due to lower net premiums earned of \$1.0 million resulting primarily from a \$1.7 million impact to net premiums earned due to the discontinued marketing of new and renewal occupational accident policies, partially offset by higher net premiums earned of \$0.7 million in our Standard Commercial P&C Operating unit. This decrease in net premiums earned was partially offset by higher net investment income of \$0.1 million for the three months ended June 30, 2017 as compared to the same period during 2016.

Our Standard Commercial Segment reported a pre-tax loss of \$0.2 million for the three months ended June 30, 2017 as compared to pre-tax income of \$3.0 million reported for the same period of 2016. The pre-tax loss was the result of higher losses and LAE of \$2.5 million and the decreased revenue discussed above, partially offset by a \$0.2 million decrease in operating expense. The \$0.2 million decrease in operating expense was the combined result of lower production related expenses of \$0.6 million due primarily to the discontinued marketing of new and renewal occupational accident policies, partially offset by increased salary and related expenses of \$0.2 million and a \$0.2 million increase in other expenses due predominately to an investment in technology.

The Standard Commercial Segment reported a net loss ratio of 72.4% for the three months ended June 30, 2017 as compared to 54.0% for the same period of 2016. The gross loss ratio before reinsurance for the three months ended June 30, 2017 was 64.1% as compared to the 47.7% reported for the same period of 2016. Our Standard Commercial Segment's net loss ratio included 7.3 additional loss ratio points attributable to the discontinued workers compensation and occupational accident business for the three months ended June 30, 2017 as compared to 12.0 fewer loss ratio points for the same period the prior year. During the three months ended June 30, 2017, the Standard Commercial Segment reported unfavorable net loss reserve development of \$1.7 million as compared to favorable net loss reserve development of \$3.3 million during the same period of 2016. The Standard Commercial Segment reported a net expense ratio of 34.9% for the second quarter of 2017 as compared to 34.0% for the same period of 2016. The increase in the expense ratio was primarily due to the decreased earned premium, partially offset by lower operating expenses.

Personal Segment

Gross premiums written for the Personal Segment were \$14.5 million for the three months ended June 30, 2017 as compared to \$19.3 million for the same period in the prior year. Net premiums written for our Personal Segment were \$7.8 million in the second quarter of 2017, which was a decrease of \$2.5 million, or 24%, from the \$10.3 million reported for the second quarter of 2016.

Total revenue for the Personal Segment was \$10.7 million for the second quarter of 2017 as compared to \$12.1 million for the same period in 2016. The \$1.4 million decrease in revenue was primarily the result of lower net

premiums earned of \$1.0 million and lower finance charges of \$0.4 million reported during the second quarter of 2017 as compared to the same period during 2016.

Pre-tax loss for the Personal Segment was \$0.9 million for the three months ended June 30, 2017 as compared to pre-tax loss of \$1.0 million for the same period of 2016. The decrease in the pre-tax loss was primarily the result of decreased losses and LAE of \$1.3 million for the three months ended June 30, 2017 as compared to the same period during 2016 and lower operating expenses of \$0.2 million, partially offset by the decreased revenue discussed.

The Personal Segment reported a net loss ratio of 87.1% for the three months ended June 30, 2017 as compared to 90.8% for the same period of 2016. The gross loss ratio before reinsurance was 79.0% for the three months ended June 30, 2017 as compared to 89.2% for the same period in 2016. The lower gross and net loss ratios were primarily the result of lower unfavorable prior year net loss reserve development as well as lower gross current accident year loss trends. The Personal Segment reported \$0.4 million of unfavorable prior year net loss reserve development for the three months ended June 30, 2017 as compared to \$1.5 million of net unfavorable development for the same period in the prior year. Operating expenses decreased \$0.2 million primarily as a result of a decrease in production related expenses. The Personal Segment reported a net expense ratio of 26.6% for the second quarter of 2017 as compared to 23.7% for the same period of 2016. The increase in the expense ratio was due predominately to the lower finance charges and lower net premiums earned.

Corporate

Total revenue for Corporate decreased by \$1.7 million for the three months ended June 30, 2017 as compared to the same period the prior year. This decrease in total revenue was due predominately to net realized losses recognized on our investment portfolio of \$3.5 million for the three months ended June 30, 2017 as compared to net realized losses of \$2.2 million for the same period of 2016 and lower net investment income of \$0.4 million.

Corporate pre-tax loss was \$7.5 million for the three months ended June 30, 2017 as compared to pre-tax loss of \$7.8 million for the same period of 2016. The decrease in pre-tax loss was primarily due to lower operating expenses of \$2.1 million, partially offset by higher interest expense of \$0.1 million and the decreased revenue discussed above. The lower operating expenses of \$2.1 million were a combined result of an additional \$1.8 million earn-out accrued during the second quarter of 2016 in conjunction with the previous acquisition of TBIC (which was subsequently paid in July 2016) and lower salary and related expenses of \$0.4 million during the second quarter of 2017 as compared to the second quarter of 2016, partially offset by higher professional service fees and other expenses of \$0.1 million.

Six Months Ended June 30, 2017 as Compared to Six Months Ended June 30, 2016

The following is additional business segment information for the six months ended June 30, 2017 and 2016 (in thousands):

	Six Months Ended June 30									
	Specialty		Standard Commercial Segment		Personal Segment		Corporate		Consolidated	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Gross premiums written	\$223,312	\$191,117	\$40,462	\$41,122	\$33,394	\$40,245	\$-	\$-	\$297,168	\$297,168
Ceded premiums written	(88,310)	(66,201)	(3,927)	(4,562)	(15,518)	(18,852)	-	-	(107,755)	(107,755)
Net premiums written	135,002	124,916	36,535	36,560	17,876	21,393	-	-	189,413	189,413
Change in unearned premiums	(8,289)	(7,894)	(3,439)	(2,569)	2,245	(381)	-	-	(9,483)	(9,483)
Net premiums earned	126,713	117,022	33,096	33,991	20,121	21,012	-	-	179,930	179,930
Total revenues	135,336	123,623	35,048	36,211	22,547	24,237	(2,508)	(2,991)	190,423	190,423
Losses and adjustment expenses	92,119	73,931	22,909	20,438	17,518	19,528	-	-	132,546	132,546
Pre-tax income (loss)	11,730	17,599	652	4,427	(1,650)	(2,097)	(9,812)	(12,453)	920	920
Net loss ratio (1)	72.7 %	63.2 %	69.2 %	60.1 %	87.1 %	92.9 %			73.7 %	73.7 %
Net expense ratio (1)	24.4 %	27.0 %	35.2 %	34.1 %	26.3 %	21.4 %			28.2 %	28.2 %
Net combined ratio (1)	97.1 %	90.2 %	104.4 %	94.2 %	113.4 %	114.3 %			101.9 %	101.9 %
Favorable (Unfavorable) Prior Year Development	(8,332)	1,594	(264)	3,674	(1,088)	(2,511)			(9,684)	(9,684)

(1) The net loss ratio is calculated as incurred losses and LAE divided by net premiums earned, each determined in accordance with GAAP. The net expense ratio is calculated as total underwriting expenses offset by agency fee income divided by net premiums earned, each determined in accordance with GAAP. Net combined ratio is calculated as the sum of the net loss ratio and the net expense ratio.

Specialty Commercial Segment

Gross premiums written for the Specialty Commercial Segment were \$223.3 million for the six months ended June 30, 2017, which was \$32.2 million, or 17%, more than the \$191.1 million reported for the same period in 2016. The increase in gross premiums written was due to increased premium production in both our MGA Commercial Products and our Specialty Commercial operating units. Net premiums written were \$135.0 million for the six months ended June 30, 2017 as compared to \$124.9 million reported for the same period in 2016. The higher net premiums written were due primarily to increased production in both our MGA Commercial and Specialty Commercial operating units.

The \$135.3 million of total revenue for the Specialty Commercial Segment for the six months ended June 30, 2017 was \$11.7 million higher than the \$123.6 million reported for the same period in 2016. This increase in revenue was due to higher net premiums earned of \$9.7 million due mostly to increased premium production in both our MGA Commercial Products operating unit and our Specialty Commercial operating unit. Further contributing to the increased revenue was higher net investment income of \$1.6 million and higher commission and fees of \$0.4 million for the six months ended June 30, 2017 as compared to the same period of 2016.

Pre-tax income for the Specialty Commercial Segment of \$11.7 million for the six months ended June 30, 2017 was \$5.9 million lower than the \$17.6 million reported for the same period in 2016. The decrease in pre-tax income was primarily the result of higher losses and LAE of \$18.2 million, partially offset by lower operating expenses of \$0.6 million and the increased revenue discussed above.

Our MGA Commercial Products operating unit reported a \$15.7 million increase in losses and LAE due primarily to \$7.5 million of unfavorable prior year net loss reserve development recognized for the six months ended June 30, 2017 as compared to \$1.1 million favorable prior year net loss reserve development recognized for the same period of 2016, as well as higher current accident year loss trends. Our Specialty Commercial operating unit reported a \$2.5 million increase in losses and LAE which consisted of (a) a \$2.6 million increase in losses and LAE in our commercial umbrella and primary/excess liability line of business, (b) a \$0.6 million increase in losses and LAE in our satellite launch insurance line of business, (c) a \$0.6 million increase in losses and LAE attributable to our primary/excess property insurance products due to increased premium production (d) a \$0.4 million increase in our general aviation line of business, partially offset by (e) a \$1.4 million decrease in losses and LAE attributable to our professional liability insurance products and (f) a \$0.3 million decrease in losses and LAE in our specialty programs. The \$0.6 million decrease in operating expense was primarily the result of lower production related expenses of \$2.2 million due primarily to increased ceding commissions in our Specialty Commercial operating unit, partially offset by increased salary and related expenses of \$0.9 million, higher occupancy and other operating expenses of \$0.4 million, higher travel related expenses of \$0.2 million and higher professional service fee expense of \$0.1 million.

The Specialty Commercial Segment reported a net loss ratio of 72.7% for the six months ended June 30, 2017 as compared to 63.2% for the same period during 2016. The gross loss ratio before reinsurance was 68.3% for the six months ended June 30, 2017 as compared to 60.2% for the same period in 2016. The higher gross and net loss ratios for the six months ended June 30, 2017 were primarily the result of \$8.3 million unfavorable prior year net loss reserve development recognized for the six months ended June 30, 2017 as compared to \$1.6 million favorable prior year net loss reserve development for the same period of 2016 as well as higher current accident year loss trends driven by our commercial auto line of business.

Standard Commercial Segment

Gross premiums written for the Standard Commercial Segment were \$40.5 million for the six months ended June 30, 2017, which was \$0.6 million, or 2%, less than the \$41.1 million reported for the same period in 2016. Net premiums written of \$36.5 million for the six months ended June 30, 2017 were relatively unchanged from the same period of 2016. The gross and net premiums written include a \$2.9 million increase in our Standard Commercial P&C operating unit for the six months ended June 30, 2107 as compared to the same period during 2016, offset by a decrease in premium volume of \$3.0 million due to the discontinued marketing of new and renewal occupational accident policies and a \$0.5 million decrease in gross premiums written due to the discontinued marketing of workers compensation policies.

Total revenue for the Standard Commercial Segment of \$35.0 million for the six months ended June 30, 2017 was \$1.2 million less than the \$36.2 million reported during the same period in 2016. This 3% decrease in total revenue was mostly due to a \$0.9 million decrease in net premiums earned primarily as a result of a \$2.7 million decrease in net premiums earned due to the discontinued marketing of new and renewal occupational accident policies, partially offset by \$1.8 million higher net premiums earned in our Standard Commercial P&C operating unit due to increased premium production. Further contributing to the decrease in revenue was lower commission and fees of \$0.4 million, partially offset by higher net investment income of \$0.1 million for the six months ended June 30, 2017 as compared to the same period in 2016.

Our Standard Commercial Segment reported pre-tax income of \$0.7 million for the six months ended June 30, 2017 as compared to \$4.4 million for the same period during 2016. The lower pre-tax income was the result of higher losses and LAE expenses of \$2.5 million and the decreased revenue discussed above.

The Standard Commercial Segment reported a net loss ratio of 69.2% for the six months ended June 30, 2017 as compared to 60.1% for the same period in 2016. The gross loss ratio before reinsurance for the six months ended June 30, 2017 was 60.9% as compared to the 56.6% reported for the same period of 2016. Our Standard Commercial Segment's net loss ratio included 6.8 additional loss ratio points attributable to the discontinued workers compensation and occupational accident business for the six months ended June 30, 2017 as compared to 4.9 fewer loss ratio points for the same period the prior year. During the six months ended June 30, 2017 the Standard Commercial Segment reported unfavorable prior year net loss reserve development of \$0.3 million as compared to favorable prior year net loss reserve development of \$3.7 million for the same period of 2016. The Standard Commercial Segment reported a net expense ratio of 35.2% for the six months ended June 30, 2017 as compared to 34.1% for the same period of 2016. The increase in the expense ratio is primarily due to the decreased earned premium.

Personal Segment

Gross premiums written for the Personal Segment were \$33.4 million for the six months ended June 30, 2017, which was \$6.8 million, or 17%, less than the \$40.2 million reported for the same period in 2016. Net premiums written for our Personal Segment were \$17.9 million for the six months ended June 30, 2017, which was a decrease of \$3.5 million, or 16%, from the \$21.4 million reported for the same period of 2016.

Total revenue for the Personal Segment decreased 7% to \$22.5 million for the six months ended June 30, 2017 from \$24.2 million for the same period during 2016. The decrease in revenue was primarily due to lower net premiums earned of \$0.9 million as a result of lower premiums written and lower finance charges of \$0.8 million.

Pre-tax loss for the Personal Segment was \$1.7 million for the six months ended June 30, 2017 as compared to pre-tax loss of \$2.1 million for the same period of 2016. The lower pre-tax loss was the result of decreased losses and LAE of \$2.0 million and lower operating expenses of \$0.1 million for the six months ended June 30, 2017 as compared to the same period during 2016, partially offset by the decreased revenue discussed above.

The Personal Segment reported a net loss ratio of 87.1% for the six months ended June 30, 2017 as compared to 92.9% for the same period of 2016. The gross loss ratio before reinsurance was 83.0% for the six months ended June 30, 2017 as compared to 89.7% for the same period in 2016. The lower gross and net loss ratios were primarily the result of lower unfavorable prior year net loss reserve development of \$1.1 million for the six months ended June 30, 2017 as compared to unfavorable development of \$2.5 million for the same period in the prior year, as well as lower gross current accident year loss trends. The decrease in operating expenses of \$0.1 million was the combined result of a \$0.1 million decrease in salary and related expenses and a \$0.1 million decrease in professional service fees, partially offset by \$0.1 million increase in other operating expenses driven by our investment in technology. The Personal Segment reported a net expense ratio of 26.3% for the six months ended June 30, 2017 as compared to 21.4% for the same period of 2016. The increase in the expense ratio was due predominately to the lower finance charges and lower net premiums earned.

Corporate

Total revenue for Corporate increased by \$0.5 million for the six months ended June 30, 2017 as compared to the same period the prior year. This increase in total revenue was due to net realized losses recognized on our investment portfolio of \$1.4 million for the six months ended June 30, 2017 as compared to the net realized losses of \$2.4 million for the same period of 2016, partially offset by lower net investment income of \$0.5 million.

Corporate pre-tax loss was \$9.8 million for the six months ended June 30, 2017 as compared to pre-tax loss of \$12.5 million for the same period of 2016. The decrease in pre-tax loss was primarily due to the increased revenue discussed above, lower operating expenses of \$2.3 million partially offset by higher interest expense of \$0.1 million. The lower operating expenses of \$2.3 million were primarily a result of an additional \$1.8 million earn-out accrued during the second quarter of 2016 in conjunction with the previous acquisition of TBIC (which was subsequently paid in July 2016) and lower salary and related expenses of \$0.8 million for the six months ended June 30, 2017 as compared to the same period during 2016, partially offset by higher professional service fees of \$0.2 million and other operating expenses of \$0.1 million.

Financial Condition and Liquidity

Sources and Uses of Funds

Our sources of funds are from insurance-related operations, financing activities and investing activities. Major sources of funds from operations include premiums collected (net of policy cancellations and premiums ceded), commissions, and processing and service fees. As a holding company, Hallmark is dependent on dividend payments and management fees from its subsidiaries to meet operating expenses and debt obligations. As of June 30, 2017, we had \$10.4 million in unrestricted cash and cash equivalents, as well as \$1.1 million in debt securities, at the holding company and our non-insurance subsidiaries. As of that date, our insurance subsidiaries held \$67.0 million of unrestricted cash and cash equivalents, as well as \$607.0 million in debt securities with an average modified duration of 1.7 years. Accordingly, we do not anticipate selling long-term debt instruments to meet any liquidity needs.

AHIC and TBIC, domiciled in Texas, are limited in the payment of dividends to their stockholders in any 12-month period, without the prior written consent of the Texas Department of Insurance, to the greater of statutory net income for the prior calendar year or 10% of statutory policyholders' surplus as of the prior year end. Dividends may only be paid from unassigned surplus funds. HIC and HNIC, both domiciled in Arizona, are limited in the payment of dividends to the lesser of 10% of prior year policyholders' surplus or prior year's net investment income, without prior written approval from the Arizona Department of Insurance. HSIC, domiciled in Oklahoma, is limited in the payment

of dividends to the greater of 10% of prior year policyholders' surplus or prior year's statutory net income, not including realized capital gains, without prior written approval from the Oklahoma Insurance Department. During 2017, the aggregate ordinary dividend capacity of these subsidiaries is \$28.0 million, of which \$19.4 million is available to Hallmark. As a county mutual, dividends from HCM are payable to policyholders. During the first six months of 2017 and 2016, our insurance company subsidiaries paid \$6.5 million and \$4.6 million in dividends to Hallmark, respectively.

Comparison of June 30, 2017 to December 31, 2016

On a consolidated basis, our cash (excluding restricted cash) and investments at June 30, 2017 were \$746.4 million compared to \$733.8 million at December 31, 2016. The primary reasons for this increase in unrestricted cash and investments were cash flow from operations, the collection of an unsettled investment disposal and an increase in investment fair values, partially offset by capital expenditures and repurchases of our common stock.

Comparison of Six Months Ended June 30, 2017 and June 30, 2016

Net cash provided by our consolidated operating activities was \$12.4 million for the first six months of 2017 as compared to \$2.3 million for the first six months of 2016. The increase in operating cash flow was primarily due to decreased paid losses (including timing of reinsurance claim settlements), higher collected net investment income, lower net paid operating expenses, lower income taxes paid and higher collected ceding commission, partially offset by lower collected net premiums and lower finance charges collected.

Net cash used in investing activities during the first six months of 2017 was \$10.3 million as compared to \$20.1 million during the first six months of 2016. The decrease in cash used by investing activities during the first six months of 2017 was comprised of an increase of \$37.5 million in maturities, sales and redemptions of investment securities and an increase in transfers from restricted cash of \$4.6 million, partially offset by an increase in purchases of debt and equity securities of \$31.8 million and an increase in purchases of property and equipment of \$0.5 million.

Cash used in financing activities during the first six months of 2017 was \$4.3 million primarily as a result of repurchases of our common stock. Cash used in financing activities during the first six months of 2016 was \$4.7 million as a result of the repurchase of our common stock.

Credit Facilities

Our Second Restated Credit Agreement with Frost Bank (“Frost”) dated June 30, 2015, reinstated the credit facility with Frost which expired by its terms on April 30, 2015. The Second Restated Credit Agreement also amended certain provisions of the credit facility and restated the agreement with Frost in its entirety. The Second Restated Credit Agreement provides a \$15.0 million revolving credit facility (“Facility A”), with a \$5.0 million letter of credit sub-facility. The outstanding balance of the Facility A bears interest at a rate equal to the prime rate or LIBOR plus 2.5%, at our election. We pay an annual fee of 0.25% of the average daily unused balance of Facility A and letter of

credit fees at the rate of 1.00% per annum. As of June 30, 2017, we had no outstanding borrowings under Facility A.

On December 17, 2015, we entered into a First Amendment to Second Restated Credit Agreement and a Revolving Facility B Agreement (the “Facility B Agreement”) with Frost to provide a new \$30.0 million revolving credit facility (“Facility B”), in addition to Facility A. On November 1, 2016, we amended the Facility B Agreement with Frost to extend by one year the termination date for draws under Facility B and the maturity date for amounts outstanding thereunder. We paid Frost a commitment fee of \$75,000 when Facility B was established and an additional \$30,000 fee when Facility B was extended.

We may use Facility B loan proceeds solely for the purpose of making capital contributions to AHIC and HIC. As amended, we may borrow, repay and reborrow under Facility B until December 17, 2018, at which time all amounts outstanding under Facility B are converted to a term loan. Through December 17, 2018, we pay Frost a quarterly fee of 0.25% per annum of the average daily unused balance of Facility B. Facility B bears interest at a rate equal to the prime rate or LIBOR plus 3.00%, at our election. Until December 17, 2018, interest only on amounts from time to time outstanding under Facility B are payable quarterly. Any amounts outstanding on Facility B as of December 17, 2018 are converted to a term loan payable in quarterly installments over five years based on a seven year amortization of principal plus accrued interest. All remaining principal and accrued interest on Facility B become due and payable on December 17, 2023. As of June 30, 2017, we had \$30.0 million outstanding under Facility B.

The obligations under both Facility A and Facility B are secured by a security interest in the capital stock of AHIC and HIC. Both Facility A and Facility B contain covenants that, among other things, require us to maintain certain financial and operating ratios and restrict certain distributions, transactions and organizational changes. As of June 30, 2017, we were in compliance with all of these covenants.

Subordinated Debt Securities

On June 21, 2005, we entered into a trust preferred securities transaction pursuant to which we issued \$30.9 million aggregate principal amount of subordinated debt securities due in 2035. To effect the transaction, we formed a Delaware statutory trust, Hallmark Statutory Trust I (“Trust I”). Trust I issued \$30.0 million of preferred securities to investors and \$0.9 million of common securities to us. Trust I used the proceeds from these issuances to purchase the subordinated debt securities. The initial interest rate on our Trust I subordinated debt securities was 7.725% until June 15, 2015, after which interest adjusts quarterly to the three-month LIBOR rate plus 3.25 percentage points. Trust I pays dividends on its preferred securities at the same rate. Under the terms of our Trust I subordinated debt securities, we pay interest only each quarter and the principal of the note at maturity. The subordinated debt securities are uncollateralized and do not require maintenance of minimum financial covenants. As of June 30, 2017, the principal balance of our Trust I subordinated debt was \$30.9 million and the interest rate was 4.50% per annum.

On August 23, 2007, we entered into a trust preferred securities transaction pursuant to which we issued \$25.8 million aggregate principal amount of subordinated debt securities due in 2037. To effect the transaction, we formed a Delaware statutory trust, Hallmark Statutory Trust II (“Trust II”). Trust II issued \$25.0 million of preferred securities to investors and \$0.8 million of common securities to us. Trust II used the proceeds from these issuances to purchase the subordinated debt securities. Our Trust II subordinated debt securities bear an initial interest rate of 8.28% until September 15, 2017, at which time interest will adjust quarterly to the three-month LIBOR rate plus 2.90 percentage points. Trust II pays dividends on its preferred securities at the same rate. Under the terms of our Trust II subordinated debt securities, we pay interest only each quarter and the principal of the note at maturity. The subordinated debt securities are uncollateralized and do not require maintenance of minimum financial covenants. As of June 30, 2017, the principal balance of our Trust II subordinated debt was \$25.8 million.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes to the market risks discussed in Item 7A to Part II of our Form 10-K for the fiscal year ended December 31, 2016.

Item 4. Controls and Procedures.

The principal executive officer and principal financial officer of Hallmark have evaluated our disclosure controls and procedures and have concluded that, as of the end of the period covered by this report, such disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is timely recorded, processed, summarized and reported. The principal executive officer and principal financial officer also concluded that such disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under such Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. During the most recent fiscal quarter, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Risks Associated with Forward-Looking Statements Included in this Form 10-Q

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of our business activities and availability of funds. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties.

Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, regulatory framework, weather-related events and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

During the third quarter of 2015, we paid \$1.2 million to the sellers of the subsidiaries comprising our Workers Compensation operating unit pursuant to the terms of the acquisition agreement. The sellers disputed the calculation of the amount paid and, pursuant to the terms of the acquisition agreement, an independent actuary was engaged to resolve this matter. In accordance with the report of the independent actuary, we accrued during the second quarter of 2016 and paid during the third quarter of 2016 an additional \$1.8 million to the sellers.

In November 2015, one of the subsidiaries in our MGA Commercial operating unit, Hallmark Specialty Underwriters, Inc. (“HSU”), was informed by the Texas Comptroller of Public Accounts that a surplus lines tax audit covering the period January 1, 2010 through December 31, 2013 was complete. HSU frequently acts as a managing general underwriter (“MGU”) authorized to underwrite policies on behalf of Republic Vanguard Insurance Company and HSIC, both Texas eligible surplus lines insurance carriers. In its role as the MGU, HSU underwrites policies on behalf of these carriers while other agencies located in Texas (generally referred to as “producing agents”) deliver the policies to the insureds and collect all premiums due from the insureds. During the period under audit, the producing agents also collected the surplus lines premium taxes due on the policies from the insureds, held them in trust, and timely remitted those taxes to the Comptroller. We believe this system for collecting and paying the required surplus lines premium taxes complies in all respects with the Texas Insurance Code and other regulations, which clearly require that the same party who delivers the policies and collects the premiums will also collect premium taxes, hold premium taxes in trust, and pay premium taxes to the Comptroller. It also complies with long standing industry practice. In addition, effective January 1, 2012 the Texas legislature enacted House Bill 3410 (HB3410) which allows an MGU to contractually pass the collection, payment and administration of surplus lines taxes down to another Texas licensed surplus line agent.

The Comptroller has asserted that HSU is liable for the surplus lines premium taxes related to policy transactions and premiums collected from surplus lines insureds during January 1, 2010 through December 31, 2011, the period prior to the passage of HB3410, and that HSU therefore owes \$2.5 million in premium taxes, as well as \$0.7 million in penalties and interest for the audit period. During the second quarter of 2017, we reached an agreement with the Comptroller to settle the matter for \$0.2 million, which was accrued as of June 30, 2017.

We are engaged in various legal proceedings that are routine in nature and incidental to our business. None of these proceedings, either individually or in the aggregate, are believed, in our opinion, to have a material adverse effect on our consolidated financial position or our results of operations.

Item 1A. Risk Factors.

There have been no material changes to the risk factors discussed in Item 1A to Part I of our Form 10-K for the fiscal year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Our stock buyback program initially announced on April 18, 2008, authorized the repurchase of up to 1,000,000 shares of our common stock in the open market or in privately negotiated transactions (the “Stock Repurchase Plan”). On January 24, 2011, we announced an increased authorization to repurchase up to an additional 3,000,000 shares. The Stock Repurchase Plan does not have an expiration date.

The following table furnishes information for purchases made pursuant to the Stock Repurchase Plan during the quarter ended June 30, 2017:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Cumulative Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan
April 1st-April 30th	115,015	\$ 10.75	2,756,034	1,243,966
May 1st- May 31st	64,389	\$ 10.33	2,820,423	1,179,577
June 1st- June 30th	174,180	\$ 11.25	2,994,603	1,005,397

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

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Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are filed herewith or incorporated herein by reference:

**Exhibit
Number Description**

- 3(a) Restated Articles of Incorporation of the registrant, as amended (incorporated by reference to Exhibit 3.1 to the registrant's Registration Statement on Form S-1 [Registration No. 333-136414] filed September 8, 2006).
- 3(b) Amended and Restated By-Laws of the registrant (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K filed March 28, 2017).
- 31(a) Certification of principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 31(b) Certification of principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
- 32(a) Certification of principal executive officer Pursuant to 18 U.S.C. § 1350.
- 32(b) Certification of principal financial officer Pursuant to 18 U.S.C. § 1350.
- 101 INS+ XBRL Instance Document.
- 101 SCH+ XBRL Taxonomy Extension Schema Document.
- 101 CAL+ XBRL Taxonomy Extension Calculation Linkbase Document.
- 101 LAB+ XBRL Taxonomy Extension Label Linkbase Document.
- 101 PRE+ XBRL Taxonomy Extension Presentation Linkbase Document.

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DEF+ XBRL Taxonomy Extension Definition Linkbase Document.

+ Filed with this Quarterly Report on Form 10-Q and included in Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016, (ii) Consolidated Statements of Operations for the three and six months ended June 30, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and 2016, (iv) Consolidated Statements of Stockholder's Equity for the three and six months ended June 30, 2017 and 2016, (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and 2016 and (vi) related notes.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HALLMARK FINANCIAL SERVICES, INC.

(Registrant)

Date: August 7, 2017 /s/ Naveen Anand
Naveen Anand, Chief Executive Officer and President

Date: August 7, 2017 /s/ Jeffrey R. Passmore
Jeffrey R. Passmore, Chief Accounting Officer and Senior Vice
President