Analysis: Solar industry faces more supply, falling prices

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REUTERS

LOS ANGELES — The booming solar power sector is about to get squeezed by the age-old laws of supply and demand.

Solar energy companies are scrambling to ramp up production amid skyrocketing interest in renewable energy, but the pendulum is swinging quickly toward oversupply.

That places a few players in the sector, including Yingli Green Energy Holding Co. Ltd., First Solar Inc., as well as Q-Cells and SolarWorld AG, in the best position to benefit from the changing dynamics, analysts said.

Torrid investment in 2007 fueled growth at solar companies JA Solar Holdings Co. Ltd., Suntech Power Holdings Co. Ltd., SunPower Corp. and others thanks to global warming concerns, soaring fossil fuel prices and government subsidies in Germany, Spain and the United States.

The shares of those companies soared last year, but have been pummeled in the opening weeks of 2008 as concerns about a possible U.S. recession weigh down the broader market.

Still, strong demand for solar panels is expected to continue through this year, although more of the industry's key raw ingredient, polysilicon, is coming to the market, which will lead to more photovoltaic (PV) cells that convert sunlight into electricity. Cells are then packaged together to form the modules that make up solar panels.

By next year, supply could very well outstrip demand.

"Companies are working really hard over the next year-and- a-half to put the steel in the ground and develop on the expansions that they've promised," said Karina Funk, an analyst with Winslow Green Mutual Funds in Boston, which manages about $580 million.

"The dynamic is definitely going to change once that supply is in the market."

The supply demand shift has investors wondering which solar companies are best prepared to preserve their lofty profit margins by reducing costs as prices fall.

SELECTIVE ON SOLAR

Last week, Banc of America Securities analyst Eric Brown advised clients to be selective about photovoltaic manufacturers over the next year, citing expectations that oncoming capacity would drive down selling prices.

"In spite of strong growth ahead, we are neutral on the PV sector," Brown wrote. "Lower barriers to entry will contribute to lower prices -- and consequently lower margins."

The emergence of dozens of Chinese solar companies and the greater availability of polysilicon, which has been in short supply, are helping drive supply increases, Brown said. He expects module prices to fall 15 percent in 2009, leading to weaker profit margins across the industry.

He said Yingli Green Energy and First Solar were well positioned because of their low cost structures. First Solar, which makes thin-film cells, also benefits because its cells do not rely on polysilicon, he added.

German bank WestLB said Monday that growing supplies of silicon should lead to lower margins for cell, wafer and module producers in 2009. Large, vertically integrated companies such as Q-Cells and SolarWorld were most likely to withstand this development.

ThinkEquity Partners solar industry analyst Jonathan Hoopes said, however, that because so many of the solar module makers are start-ups that are still ramping up production, they have significant opportunities to cut costs in the near term.

"We think there are a lot of costs to come out of this model as they scale up," Hoopes said. "This market is relatively nascent."

One way solar companies have already reduced costs is through deals with companies further up or down the supply stream, Funk said, citing cell manufacturer SunPower's 2006 acquisition of panel installation company PowerLight Corp.

Earlier this month, solar wafer maker LDK Solar Co Ltd made a similar move, taking a 33.5 percent stake in crucible maker Jiangxi Sinoma New Material Co Ltd. Crucibles are used to heat silicon to very high temperatures.

One big unknown is demand. Although the industry is expected to keep expanding at a rapid clip, that growth still depends on the outlook for government incentives and subsidies.

Lehman Brothers analyst Vishal Shah said government incentive programs in Germany and Spain, which have been key to driving growth, would help support prices.

"There is a floor in pricing given the incentives that are in place, even in an oversupply situation," Shah said. "Beyond 2009, the outcome really depends on how the incentives develop in these countries and others."
(Editing by Andre Grenon)

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