

“Stock market bubbles don't grow out of thin air. They have a solid basis in reality, but reality as distorted by a misconception.”

George Soros (1930-)

DAZED AND CONFUSED

OUTLINE

This newsletter discusses biases and mistakes that analysts make in covering the solar industry. We begin by discussing why Wall Street completely misses on predictions of the Chinese solar companies. We will also correct a common misconception about oil prices and the solar energy.

For a discussion on how we generate our data, [please click here](#).

MISSING THE MARK WITH CHINA

In our previous newsletter, “Solar Blindness”, we looked at the accuracy of analysts in predicting solar companies’ valuations. We found that portfolios constructed based upon analysts’ recommendations fared poorly, and that analysts were correct in their calls only about half the time.

When we further scrutinized the accuracy of those predictions we found several biases. The primary bias was one of familiarity or geography: analysts were much worse at predicting the performance of companies outside of the United States. Analysts were **wrong** 70% of the time in their calls for Chinese solar companies. For one company, Renesola, the analysts were only correct 8% of the time. Table 1 shows this performance.

Companies	Accuracy
North American Companies	47%
First Solar (FSLR)	51%
SunPower	50%
Evergreen	40%
Chinese Companies	30%
Canadian Solar	35%
China Sunergy	32%
GT Solar	17%
JA Solar	39%
LDK Solar	44%
Renesola	8%
Suntech	43%
Trina	35%
Yingli	25%

Table 1. The accuracy of analysts' calls for solar companies. For US companies, the analysts were right about as often as they were wrong. For Chinese companies, Wall Street analysts were wrong 70% of the time.

It is a bit more difficult to gather non-US company information and to understand the nuances in these financial statement disclosures, but surely it must be possible for the folks on Wall Street to figure these out.

In our modeling of corporate valuations, only US companies maintained consistently over-valued positions. In addition, even after performance variations were taken out, analysts gave US companies much more aggressive Buy ratings than their Chinese competitors.

A portfolio of Chinese solar companies traded based upon the recommendations of Sell-Side analysts generated very poor results, with average annual returns of -35%, a full 20 points lower than the -15% annual returns for a portfolio of U.S. solar companies.

This bias likely has several underlying causes. First, the investment banks are not as likely to do much business with Chinese companies. As such, the attention given to these companies is not likely to be as detailed, nor is it likely to be as overly optimistic, as analysts tend to be when covering potential customers.

Next, the US investment community is simply not used to a central government that provides ongoing industrial support. As such, analysts often conclude that the current subsidies that the industry receives will go away in the future, leading to pessimism. For anyone with experience in the world of Chinese business, this bias is almost amusing. The

central government of China is well known for allocating resources to industries considered to be strategic to China. In addition, this support can take place for extended periods of time. All indications are that China wishes to achieve a leadership position on green energy technologies, and as such, the analysts' continual betting that government support of the solar industry will fade has thus far been a loser's gamble.

Finally, there is a bias that the financial reports of Chinese companies are not as reliable as that of US companies. While it is true that the Chinese companies are typically fairly young, and reporting through a system less stringent than the GAAP standards of U.S. markets, we have found the financial reports to be straightforward to understand. The auditing firms associated with many of these solar companies are top-tier firms, and restatements of financial results are rare.

SOLAR POWER AND OIL

"Solar-energy stocks retreated on Wednesday as the price of oil fell . . . , making solar power look less attractive."

Charles Bady, FOX Business

It is frequently stated that as oil prices fall, solar companies do poorly. This is an odd perception, since solar power competes with other forms of electrical power. In essence, Mr. Bady is implying that when homeowners consider putting solar panels on their house, they don't compare the cost of the panels to their electrical bill, rather they compare it to what it costs them to fill up their cars with gasoline. Or perhaps Mr. Bady is implying that the executives of energy companies, where little of their cost is tied to oil, debate oil futures when they consider the installation of a solar generation plant or a wind farm.

The sources of global sources of electrical energy production are shown in figure 1. As seen in this figure, only 5% of worldwide electrical power comes from petroleum products while in the United States, less than 2% of electricity comes from oil.

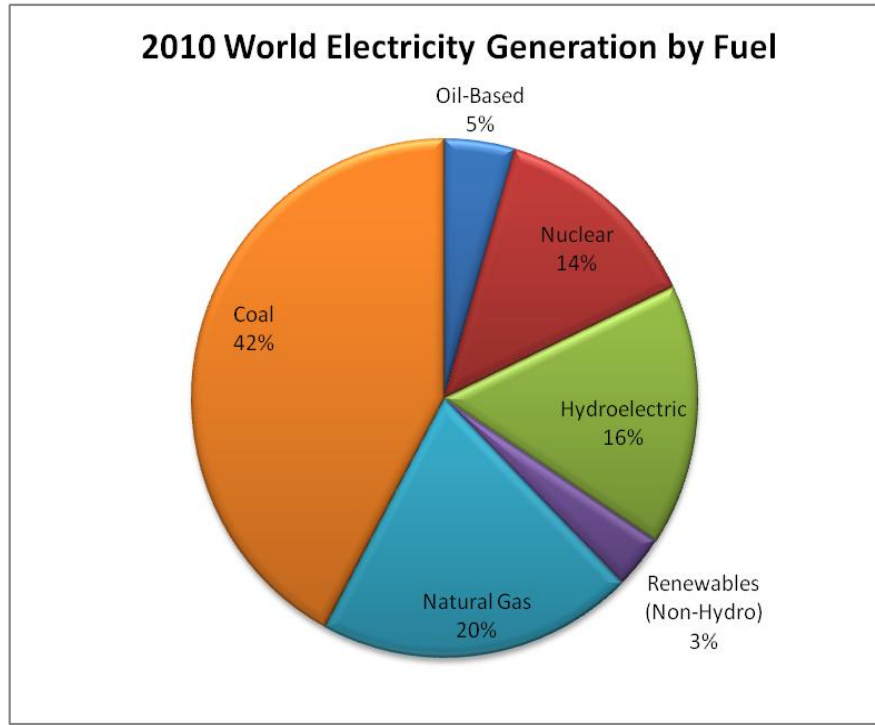


Figure 1. The source of energy of electrical generation. Data projection as reported in Energy Information Administration report: DOE/EIA-0484(2009).

In fact, the price of oil, or gasoline, has very little to do with the price of electricity. In Figure 2, the price of gasoline is compared to the price of electricity in the U.S. (data courtesy of the U.S. Department of Energy). In truth, oil prices go up as demand goes up, whereas electricity prices tend to gradually rise over time. The next time an analyst makes a comment about how oil pricing is “driving” this or that effect in the economy, ask them to explain the difference between causality and coincidence. You could also ask them why they focus upon oil, but not coal, since coal produces approximately 40% of all electrical energy. Don’t fret, they can afford a little gentle teasing.

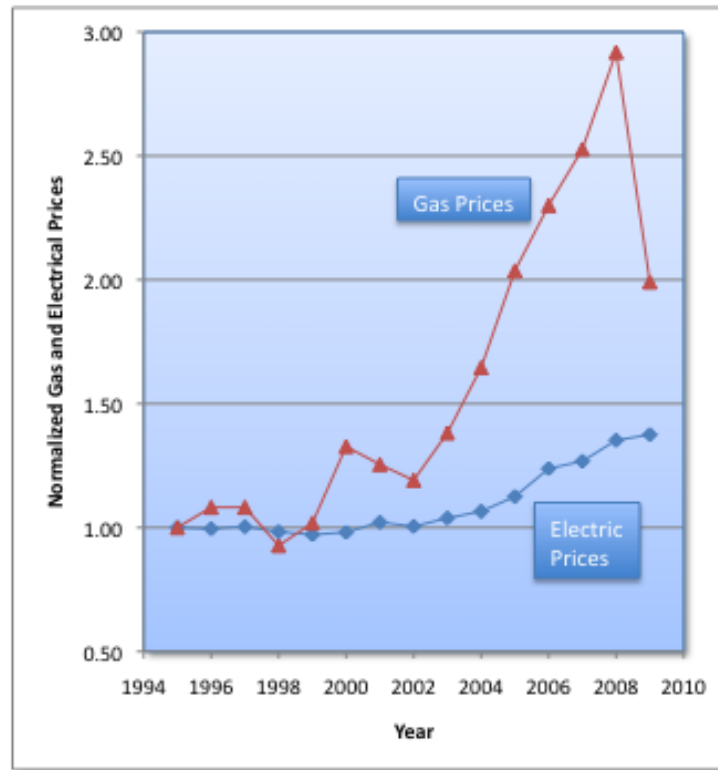


Figure 2. A comparison of the pricing of gasoline and electricity, normalized to 1994 pricing. The price of oil has virtually no impact upon electricity pricing.

CONCLUSIONS

- ✓ Misconceptions are common in business, and quite often are simply stated as fact.
- ✓ Analysts of the solar industry don't predict industry performance very well, at least in part due to several misconceptions about the industry.
- ✓ Analysts' misconceptions about China have led to very inaccurate recommendations and very, very poor economic returns.
- ✓ It is common for Wall Street commentators to incorrectly view oil pricing as a leading indicator, even in industries with no causal linkage.
- ✓ In the development of any crucial decision, it is a critical to list, and test, underlying assumptions for validity.

For the current details of companies within the Telecom and Solar Groups, or to understand the full analytic capabilities of InSite, please contact us [here](#)

Cheers,

The InSite Newsletter Staff

www.insitepartners.biz