

First Solar (FSLR)

FORECAST REDUCTION

Rating	NEUTRAL* [V]
Price (28 Feb 12, US\$)	36.40
Target price (US\$)	30.00 ¹
52-week price range	160.84 - 30.50
Market cap. (US\$ m)	3,145.87
Enterprise value (US\$ m)	2,857.92

*Stock ratings are relative to the relevant country benchmark.

¹Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

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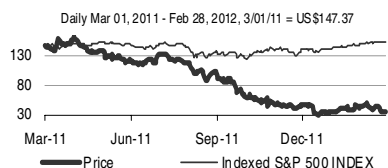
A quarter billion dollar warranty problem

Bottom line. Post earnings yesterday, our view that FSLR stock has risk at least to the ~\$26-\$27 level remains unchanged. Although company did not lower its 2012 EPS guidance as we thought it might – there were two very significant issues: (i) The \$253mm in cumulative warranty and related charges now raises a significant question mark on the reliability and field performance of FSLR's panels – product quality in our view is THE MOST SIGNIFICANT metric for a solar companies' long-term survivability; (ii) FSLR is writing off \$393mm in INTANGIBLE goodwill assets – which we think is an aggressive accounting decision as the underlying assets are productive – this decision by FSLR will inflate future earnings – another reason why you do not want to use P/E. If anything, the TANGIBLE factory assets are the ones that are proving to be less competitive, and FSLR is taking underutilization charges, and eventually runs a higher risk of being written down, if the situation persists. Our PT of \$30 represents an SOTP valuation of projects, panels, and net cash. We are revising our CY12 EPS from \$4.08 to \$3.92 and CY13 EPS from \$5.82 to \$4.51.

4Q11 (Dec) Results Summary. Revenues/EPS of \$660mm/\$1.26 were below implied guidance of \$694-794mm/\$1.46-1.71, CS at \$715.0mm (down 28.9%q/q)/ \$0.58 and consensus at \$782.2mm (down 22.2%q/q)/ \$1.55. GAAP EPS was (\$4.78) including \$393mm for a non-cash goodwill impairment, \$164mm for warranty expenses, and \$60mm for restructuring.

CY12 Guidance Summary. New revenue guidance of \$3.5-3.8bb, below previous guidance of \$3.7-4bb, CS at \$3992.6mm, and cons at \$3772.6mm. FSLR reiterated EPS guidance of \$3.75-\$4.25, CS at \$4.08, and cons at \$4.15. New operating cash flow guidance of \$0.8-0.9bb, below previous guidance of \$0.9-1.1bb.

Share price performance



On 02/28/12 the S&P 500 INDEX closed at 1372.18

Quarterly EPS	Q1	Q2	Q3	Q4
2011A	1.33	0.70	2.25	1.26
2012E	1.40	1.11	1.03	0.38
2013E	—	—	—	—

Financial and valuation metrics

Year	12/11A	12/12E	12/13E	12/14E
EPS (CS adj.) (US\$)	5.55	3.92	4.51	—
Prev. EPS (US\$)	—	4.08	5.82	—
P/E (x)	6.6	9.3	8.1	—
P/E rel. (%)	46.9	72.1	70.6	—
Revenue (US\$ m)	2,766.2	3,752.5	3,594.7	—
EBITDA (US\$ m)	730.1	751.5	483.6	—
OCFPS (US\$)	4.44	5.91	—	—
EV/EBITDA (current)	4.1	4.0	6.2	—
Net debt (US\$ m)	-169	-288	—	—
ROIC (%)	13.82	9.90	24.46	—
Number of shares (m)	86.42	IC (current, US\$ m)	3,475.05	
BV/share (Next Qtr., US\$)	37.4	EV/IC (x)	0.97	
Net debt (Next Qtr., US\$ m)	167.9	Dividend (Next Qtr., US\$)	—	
Net debt/tot cap (Next Qtr., %)	5.2	Dividend yield (%)	—	

Source: Company data, Credit Suisse estimates.

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The warranty issues are a BIG DEAL (to us at least). We are very disappointed that FSLR has now taken a cumulative \$253mm of warranty and related charges as its panels are underperforming in the field – these issues we think are VERY concerning. Field reliability of thin film panels are less proven as is – and high temperature degradation of CdTe panels is a known issue (ask us for an NREL study on this topic). We have confirmed FSLR is building the Topaz project to 586MW AC, above the 550MW specified in the contract – we think there is some risk that this “over spec” is to provide protection given the minimum energy performance specs that FSLR has committed to in the project given the lower confidence on field performance.

Goodwill write off looks aggressive to us. FSLR has chosen to write off \$393mm of goodwill – we think this is an aggressive accounting decision. The goodwill represents the profit potential from system projects that are still good – we think the goodwill should be amortized as revenues are recognized and not expensed. By expensing the goodwill FSLR will now inflate reported earnings in future periods from projects – another reason why we think looking at FSLR on P/E or P/B provides little value. We stick with our SOTP analysis - \$15-\$20 for projects, and our \$30 PT implies a fairly generous valuation for panels given all the warranty and cost issues in the panel business.

Reiterated 2012 EPS guidance. Despite all the issues in Germany, FSLR was able to maintain its 2012 EPS guidance to \$3.75-4.25. Management noted that the new efficiencies in the balance of system (BOS) had enabled the higher net margin. However, we suspect the system EPS guidance was too conservative to begin with, so has likely helped FSLR maintain its guidance.

More warranty charges related to prior manufacturing excursion issue. Recall FSLR had noted it had a manufacturing excursion issue from June 2008 to June 2009 on 5% of its panels. FSLR had announced in mid-2010 that it will take a charge for additional warranty expenses – at the time, it was an impact of just ~20c to EPS. However, these charges have now ballooned much higher – FSLR took \$125.8mm in charges in 4Q11 charges and has so far taken \$215.7mm in total manufacturing excursion related charges. FSLR noted there could be another \$44mm in charges from the remaining 200 claims (the last 5% of claims).

Ongoing warranty charges also higher. The warranty accrual costs have increased costs by 1 c/watt leading to an additional \$37.8mm in 4Q11 charges. FSLR expects a higher return rate of its panels as mix shifts to geographies with hotter temperatures as its panels appear to fail at a higher rate in hotter climates. This is the first time FSLR is talking about this issue, although we have heard of this issue in our discussions with industry contacts (it is always difficult to ascertain whether such industry chatter are material or not which is why we had not raised this issue. For example, FSLR noted the construction roadmap for Topaz is on track, whereas industry magazines widely reported delays). FIELD RELIABILITY IS THE MOST IMPORTANT METRIC for solar panels and doubly so for thin film panels which have a lower 20-year field performance track record compared to c-Si panels. The fact that FSLR is reporting performance issues in the field in the first few years and is accruing higher charges on an ongoing basis is worrying – as the hotter regions tend to make more sense for solar. We are concerned this may not be the last time we hear of the warranty related issues for FSLR. In this context, SPWR's panels have the least thermal degradation coefficient as it uses n-type silicon. P-type silicon is most common for c-Si and also has degradation – but probably lower than thin film – due to the formation of boron-oxygen pairs in p-type silicon – this does not occur in n-type silicon. We confirmed overnight that neither SPWR nor STP build “over spec” projects – if a project is 10MW, these companies build 10MW, unlike the situation with Topaz for FSLR.

Losing competitiveness with c-Si. FSLR is further reducing 3rd party volumes to 300-400MW from ~700MW, and further cutting utilizations to 60-70% from prior planned 80% (idling 4 lines in Germany by 6 months) In 2H11, FSLR reduced its future capacity expansions. Then in Dec 2011, FSLR reduced its planned 2012 utilizations to 80%. Now planned utilizations are lowered to 60-70%. This lower utilization and higher warranty

accruals are increasing average costs to 74c/watt – 2c higher than before – the same level as CSIQ for 1Q12.

Exhibit 1: FSLR P&L

in millions, unless otherwise stated

\$ in millions		1Q11A	2Q11A	3Q11A	4Q11A	1Q12E	2Q12E	3Q12E	4Q12E	2011A	2012E	2013E
Revenues		\$567.3	\$532.8	\$1,005.8	\$660.4	\$1,017.6	\$978.1	\$955.4	\$801.4	\$2,766.2	\$3,752.5	\$3,594.7
	% change q/q	-7%	-6%	89%	-34%	54%	-4%	-2%	-16%			
	% change q/q	0%	-9%	26%	8%	79%	84%	-5%	21%	8%	36%	-4%
COGS		\$307.6	\$338.0	\$626.6	\$422.0	\$712.9	\$703.3	\$699.0	\$616.9	\$1,694.2	\$2,732.0	\$2,472.5
	% of sales	54%	63%	62%	64%	70%	72%	73%	77%			
Ramp Cost			\$0.0	\$0.0	\$0.0		\$5.0			\$0.0	\$5.0	\$5.0
Gross profit		\$259.7	\$194.8	\$379.2	\$238.4	\$304.7	\$269.9	\$256.4	\$184.5	\$1,072.0	\$1,015.5	\$1,117.2
	%GM	45.8%	36.6%	37.7%	36.1%	29.9%	27.6%	26.8%	23.0%	38.8%	27.1%	31.1%
SG&A		\$87.0	\$86.9	\$112.7	\$125.9	\$123.4	\$117.2	\$111.4	\$105.8	\$412.5	\$457.8	\$450.3
	% of sales	15.3%	16.3%	11.2%	19.1%	12.1%	12.0%	11.7%	13.2%	14.9%	12.2%	12.5%
R&D		\$31.4	\$33.1	\$38.2	\$37.9	\$39.0	\$39.0	\$39.0	\$39.0	\$140.5	\$156.2	\$168.2
	% of sales	5.5%	6.2%	3.8%	5.7%	3.8%	4.0%	4.1%	4.9%	5.1%	4.2%	4.7%
Tot. OpEx		\$118.4	\$120.0	\$150.9	\$163.8	\$162.5	\$156.3	\$150.4	\$144.8	\$553.1	\$614.0	\$618.6
	% of sales	<u>20.9%</u>	<u>22.5%</u>	<u>15.0%</u>	<u>24.8%</u>	<u>16.0%</u>	<u>16.0%</u>	<u>15.7%</u>	<u>18.1%</u>	<u>20.0%</u>	16.4%	17.2%
Production Startup		\$11.9	\$10.3	\$5.5	\$5.9	\$3.8	\$3.8	\$3.8	\$3.8	\$33.6	\$15.0	\$15.0
	% of sales	<u>2.1%</u>	<u>1.9%</u>	<u>0.5%</u>	<u>0.9%</u>	<u>0.4%</u>	<u>0.4%</u>	<u>0.4%</u>	<u>0.5%</u>	<u>1.2%</u>	0.4%	0.4%
Operating Income		\$129.4	\$64.5	\$222.7	\$68.7	\$138.5	\$109.8	\$102.2	\$35.9	\$485.3	\$386.5	\$483.6
	%OpM	22.8%	12.1%	22.1%	10.4%	13.6%	11.2%	10.7%	4.5%	17.5%	10.3%	13.5%
	Foreign Currency Gain(loss)	\$1.0	\$1.7	-\$1.9	\$0.2	\$0.0	\$0.0	\$0.0	\$0.0	\$1.0	\$0.0	\$0.0
	Interest Income (Expense)	\$3.0	\$3.4	\$3.2	\$3.6	\$3.6	\$3.6	\$3.6	\$3.6	\$13.3	\$14.5	\$14.5
	Non Oper Income	-\$0.3	\$2.4	-\$1.3	\$62.0	\$0.0	\$0.0	\$0.0	\$0.0	\$62.6	\$0.0	\$0.0
Pre-tax Income		\$133.0	\$72.0	\$222.8	\$134.5	\$142.1	\$113.5	\$105.9	\$39.5	\$562.3	\$401.0	\$498.1
	% of sales	23.4%	13.5%	22.1%	20.4%	14.0%	11.6%	11.1%	4.9%	20.3%	10.7%	13.9%
Taxes		\$17.0	\$10.8	\$26.3	\$25.8	\$21.3	\$17.0	\$15.9	\$5.9	\$79.9	\$60.1	\$99.6
	%TR	12.8%	15.0%	11.8%	19.2%	15.0%	15.0%	15.0%	15.0%	14.2%	15.0%	20.0%
Net Income		\$116.0	\$61.1	\$196.5	\$108.7	\$120.8	\$96.4	\$90.0	\$33.6	\$482.3	\$340.8	\$398.5
	% of sales	20.4%	11.5%	19.5%	16.5%	11.9%	9.9%	9.4%	4.2%	17.4%	9.1%	11.1%
EPS		\$1.33	\$0.70	\$2.25	\$1.26	\$1.40	\$1.11	\$1.03	\$0.38	\$5.55	\$3.92	\$4.51

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 28 Feb 12)

Canadian Solar (CSIQ, \$3.82)

First Solar (FSLR, \$36.40, NEUTRAL [V], TP \$30.00)

SunPower Corp. (SPWR, \$7.82, NEUTRAL [V], TP \$8.00)

Suntech Power Holdings Co., Ltd. (STP.N, \$3.29, UNDERPERFORM [V], TP \$2.50)

Disclosure Appendix

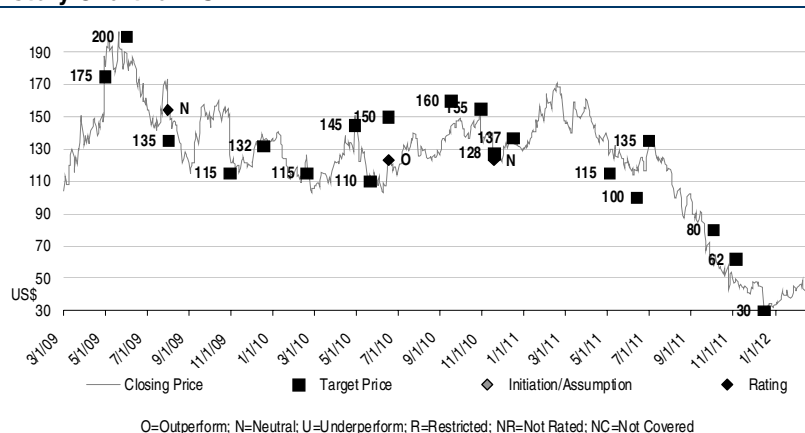
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3-Year Price, Target Price and Rating Change History Chart for FSLR

FSLR	Closing Price (US\$)	Target Price (US\$)	Initiation/ Rating Assumption
4/30/09	187.29	175	
6/1/09	189.06	200	
7/31/09	154.39	135	N
10/29/09	126.47	115	
12/17/09	135.73	132	
2/18/10	126.29	115	
4/29/10	150.87	145	
5/21/10	113.95	110.2	
6/17/10	123.45	150	O
9/16/10	144.38	160	
10/29/10	137.68	155	
11/17/10	122.83	127.5	N
12/15/10	135.15	137	
5/4/11	126.33	115	
6/13/11	116.31	100	
6/30/11	132.27	135	
10/3/11	57.9	80	
11/4/11	49.59	62	
12/15/11	31.45	30	



Trading Alerts for FSLR were produced on:

Date

8/17/2009

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Price Target: (12 months) for (FSLR)

Method: Our \$30 target price for FSLR is calculated using sum of parts method. The revised valuation of \$30/share includes a discounted cash flow of the project pipeline + the module business + net cash.

Risks: We see these risks to the achievement of our \$30 target price for First Solar: (1) the reduction of government incentives before 2012-15, because solar energy is not economical today; (2) the challenge of driving down manufacturing costs, (3) the company's high concentration of sales in Europe, (4) the public's association of the toxicity of Cadmium with First Solar's product, (5) rising interest rates and economic weakness, (6) EUR/USD exchange rate, and (7) industry oversupply.

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