



Sunny Days for Solar Power Stocks

Description

Solar power, accounting for a mere 1% of electricity generation in the U.S., is the fastest growing source of clean energy, growth that we can expect to continue.

The U.S. Energy Department last week has guaranteed at least \$2.5 billion in loans for innovative solar projects, and has also launched a program to encourage the installation of more solar panels on rooftops. The push also extends to private companies, as President Obama has implemented more solar-related packages and has called for commitments from the private sector.

This push comes as solar power is fast becoming an increasingly affordable and reliable power solution. Here's why.

Costs have been decreasing sharply

The solar industry has seen costs decrease sharply in the last few years. A recent report from consulting firm McKinsey & Co. discusses the magnitude of this decline in costs and the potential for solar to be a "disruptive" technology, as solar increases its market share in global energy markets.

GTM Research reports that the price that U.S. residential consumers pay to install rooftop solar PV systems has fallen 43% since 2008, to \$4.00 or less per watt peak of capacity in 2013. This has been due to sharp reductions in the cost of solar equipment.

Likewise, costs associated with installation and service have also fallen dramatically. And at less than 1% of the market, solar will have plenty of opportunity to lower costs further as economies of scale are realized as demand continues to grow.

Soaring demand for solar

GTM Research reports that demand from U.S. residential consumers has risen sharply over the last few years. Cumulative installations in the U.S. rose 547%, from 1.7 gigawatts in 2009 to an estimated 11 gigawatts by the end of 2013.

Also, many companies have been setting ambitious targets for the usage of solar power. Walmart, for example, aims to switch to 100% renewable power by 2020, from approximately 20% currently.

And globally, India, Africa, and Saudi Arabia are among the countries that are aggressively expanding their solar capacity.

Pure play solar companies

SolarCity's (Nasdaq: SCTY) market share of the U.S. residential PV market has risen to 32%. Great news, but looking at the financials of the company leaves me less excited. In 2013, EPS was -\$0.75 versus -\$0.56, and debt levels are high. Furthermore, the stock is trading at over 30 times sales, which is a red flag for me no matter how good the prospects of a company. The stock is up slightly year-to-date.

Canadian Solar ([Nasdaq: CSIQ](#)) is another company that will benefit from this transformation in the power industry. This stock is more richly valued, at 47 times earnings, so investors may want to wait for a lower entry point into the stock. The stock is down 10% year-to-date.

Diversified companies with exposure to solar

Northland Power ([TSX: NPI](#)) is a well-diversified clean energy company that offers exposure not only to solar power, but also to wind and thermal power. The company estimates that by 2015, 21% of EBITDA will be from its solar power segment. The stock trades at 16 times earnings, and operating margins and ROE are very attractive, at 28% and 25% respectively.

Innergex ([TSX: INE](#)) is also an interesting company that is involved in the solar industry. In fact, 10% of EBITDA in 2013 was from solar power. Innergex trades at a P/E ratio of 24 times. But again, this company is diversified and generating earnings and cash flow, so the risk in investing in this stock would be lower than that of a company that does not generate earnings, like SolarCity, and/or trades at a lofty valuation, like Canadian Solar.

Foolish bottom line

Solar power is a transformational energy source that has caused investors, corporations, and governments to take notice. And rightly so. With costs declining, and technology and reliability improving, the solar industry seems headed for continued exponential growth.

The excitement over this new technology and the potential growth rates of this industry has been evident in the stock price returns in this sector. We can look to the larger and more diversified names that are trading at more reasonable valuations for good exposure to this industry with an attractive risk/reward trade-off.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:CSIQ (Canadian Solar Inc.)

2. TSX:INE (Innergex Renewable Energy Inc.)
3. TSX:NPI (Northland Power Inc.)

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