Canadian Solar Inc.: Why the Future Might Not Be So Bright

Description

Canadian Solar Inc. (NASDAQ:CSIQ) is an interesting company. The solar industry is one that investors look to in the "new age" economy as a beacon of hope. As the world moves toward renewable energy, many early stage investors would like to get in on the action, and Canadian Solar is certainly one of the bigger players in the global market for solar energy production.

I'll be looking at the numbers on the company's most recent Q3 2016 financial statement to dig a little deeper and let the numbers do the talking.

What the "management discussion" section tells investors

In the company's financial statements, the "management discussion" section notes that net income has been increasing quarter over quarter (78.8% since Q2, nonetheless), as has gross margin (from 15.6% to 17.2%). The company has $1 billion in cash and cash equivalents, and net revenue is up 11.7%, beating the guidance provided in the second quarter.

It sounds like a really nice story. Let's break the numbers down a bit more and dig into what the financial statements say.

Income from operations vs. net income

The company's net income did indeed increase 78.8% quarter over quarter. The problem with taking the net number is that net income includes a number of adjustments that correspond to situations unique to the specific quarter in question.

Looking at the adjustments in Q3 2016, we note that a large currency adjustment accounted for the majority of the increase. In fact, when we look at the income from operations, the operating income was actually relatively flat quarter over quarter ($39,579 vs. $38,376), which means that even though gross margin increased in the third quarter, the costs associated with generating this margin also increased in relative proportion.

Canadian Solar is in the business of providing a commodity and generally will achieve the market price for the electricity it sells. The company's income from operations as a percentage of revenue is a far better measure of the operating efficiency of the company. As a long-term investor, I consider operating efficiency the most important attribute for commodity companies, as this is what will allow the company to ride out hard times and make money in the good times.

By assessing the company's operating income as a percentage of revenue, we see a drop from 5.3% in Q2 2016 to 4.9% in Q3 2016–a substantial decline.

Net cash position

The company stated that its cash and cash equivalents position is $1 billion, and it is. However, to look at the entire story, we need to look at the company's current liabilities, which include short-term borrowings.

These short-term borrowings amount to $1.37 billion. By looking at the overall current ratio, which is a ratio of current assets to current liabilities (those due or expected to be received within a year), we see the ratio come in at 0.81. A number lower than one is considered to be "unhealthy" for a business in the energy/manufacturing sector, and we note this ratio as being important.

Conclusion

From an operating standpoint and a cash-management standpoint, I would encourage other long-term investors to consider other solar options for a long-term position.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:CSIQ (Canadian Solar Inc.)

PARTNER-FEEDS

1. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date
2025/08/18
Date Created
2016/11/16
Author
chrismacdonald