

SunPower's Future Not So Bright

BY MICHAEL MARKOWSKI

SunPower (NASDAQ: SPWR) is the envy of many alternative energy companies since it sports one of the largest market caps among its peers and stock research reports have issued or have maintained positive ratings on its shares since October 2007.

For its year ended Dec. 31, 2006, SunPower became profitable for the first time when it reported record earnings of \$26,516,000. However, SunPower's accolades are suspect, as its earnings were actually cashless in 2006, when it generated negative cash flow from operations (CFFO) of \$37,951,000 and negative free cash flow (FCF) of \$126,000,000. SunPower's condition has since worsened. For its nine months ended Sept. 30, 2007, it generated net income of \$4,326,000, a negative CFFO of \$18,557,000, and a negative FCF of \$162,480,000.

Since going public in 2005, SunPower has not had a single quarter in which it has generated positive FCF; since its inception, it's generated a cumulative \$370 million of negative FCF. And it does not appear that SunPower's January 2007 acquisition of PowerLight (for \$256 million in cash and stock) has done anything to stem the negative tide of cash flow.

Cashless earnings are not the only concern about SunPower. Here are other reasons why I believe its shares should be avoided at any price:

- SunPower's gross margin has steadily gone down over its latest four quarters, resulting in razor-thin operating margins of 2.9%. Due to these low margins, the company has had to resort to borrowing a cumulative \$425 million for needed capital expenditures.

- Despite its negative cash flow, SunPower has built up significant overhead. It now has over 1,500 employees. The high

employee count will make it difficult for the company to be nimble in a deteriorating economic environment.

- The company has three customers that account for over 50% of its business. Should any one of these customers have financial difficulties, it could have a severe impact due to its razor-thin margins and its inability to generate any positive FCF.

- The company's inability to generate any positive FCF speaks volumes, because if it can't do so in an extremely favorable economic environment of consistently increasing energy prices, how can it do so in an unfavorable one?

The major problem with SunPower is the same that exists with most alternative energy companies: It does not have a viable and sustainable business model that will work when the price of energy declines. When energy prices are rising, there is a tendency for many, including consumers and investors to quickly jump on the alternative energy bandwagon. As soon as energy prices stabilize or decline, everyone jumps off.

SunPower reminds me of AstroPower, a former NASDAQ-listed solar-power company that was well-financed and highly recommended by Wall Street. It had a history of never generating any positive FCF, and it had low gross margins. As director of research for StockDiagnostics.com, I issued a warning on AstroPower in May 2002, when its shares were priced at \$22.63. In the fall of 2002, I began issuing

bankruptcy warnings on AstroPower. The company filed for bankruptcy in 2004, and everyone was completely wiped out.

SunPower is a dangerous stock to own, because it generates cashless earnings and it also has a lot of sex appeal and hype. (Cashless earnings are a cardinal sin, because they give the perception that a company is profitable when it really isn't). The solar-power industry is widely perceived to be the long-term cure for the world's energy problems, and many investors have purchased because of this hype. Shares of SunPower hit an all-time high of \$164.49 in November 2007, but they dropped over \$100 per share to \$55.49 in January 2008. I believe the company could be out of business and a bankruptcy candidate by the end of 2010 if it does not start generating positive FCF.

Though I'm extremely negative on SunPower, its shares could easily bounce back to \$100 to \$115 before they again come down under severe pressure. This is because shares that typically spike down or collapse (as fast SPWR's shares have) tend to retrace 50% of their swoon before they retest their lows. **E**

Broker Research Upgrades & Positive Initiations for SunPower
Source: Yahoo Finance

Date	Research Firm	Action	From	To
25-Jan-08	Piper Jaffray	Upgrade	Neutral	Buy
25-Jan-08	Janco Partners	Upgrade	Accumulate	Buy
16-Jan-08	Wedbush Morgan	Upgrade	Buy	Strong Buy
16-Jan-08	Pacific Growth Equities	Upgrade	Neutral	Buy
7-Dec-08	Jefferies & Co.	Upgrade	Hold	Buy
5-Dec-07	JP Morgan	Initiated		Overweight
31-Oct-07	RBC Capital Mkts.	Upgrade	Sector Perform	Outperform
23-Oct-07	Lehman Brothers	Upgrade	Equal-weight	Overweight
1-Oct-07	William Blair	Initiated		Outperform
26-Sep-07	Ardour Capital	Initiated		Accumulate