

## Taiwanese Solar Industry at a Crossroads

Written by Robert Dydo

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After the first two months of the quarter, all three cell manufacturers: **Gintech**, **Neo Solar** and **Motech** have only September left to meet Q2 sales, with a current deficit ranging from 40 to 49%. It also appears that US levies, which lifted pricing and volume in Q2, are having limited impact on Q3.

Multiple factors are contributing to the situation. A major one is the large amount of module inventory. Demand has dried out over the summer, but module assembly was at full-steam in Q2. Two companies, which described inventory during Q2 conferences: **Yingli Green Energy Hold. Co. Ltd. (ADR) (NYSE: YGE)** and **JA Solar Holdings Co., Ltd. (ADR)(NASDAQ: JASO)**, announced as much as 650MW of module inventory between them. Considering other US-listed Chinese companies, the number is probably in the area of 2GW and that may be conservative. Since the Q3 demand has been uneven to the point of causing reduction in the guidance for the rest of the year, tier- 1 companies are prioritizing inventory reductions, combining it with an increase in idle capacity and minimized procurement.

Initially, US levies steered buyers to Taiwan, yet as time goes on, module assembly companies will continue to look for their own resolutions to find cost benefit. Acquisition of **Q-Cel** by **Hanwha Group** is one such example. **Hanwha SolarOne Co Ltd (NASDAQ:HSOL)**, which simply abandoned the US market in Q1, will certainly re-enter it with modules built on Malaysian-made cells.

In all-out pursuit of low cost, Taiwanese companies do not offer much opportunity. Rough calculation shows that cells sold in Q2 by Motech cost 25% more on average than cells sold by JA Solar (\$0.60). Gintech and NSP averages have even higher disproportion. Certainly, part of it is due to the excellent quality and uniformity of manufactured to -spec and desired quantity-product, but costs are an essential part of being competitive, so the pressure on ASP reductions will not be avoidable when selling to the Chinese.

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That pressure collides with processing costs, which in Taiwan are at least 30% higher than in China. Even having positively improved shipment volumes, ASP fluctuations in Q2 have not improved gross margins for the Taiwanese. NSP and Motech reported double digit negatives even when excluding provisions. This shows that there is very little room to lower ASP, while companies already work with costs above it. Further, the new market in Japan, which was considered the light at the end of a tunnel, is exploding with imports of mono cells, but competition along South Koreans includes Chinese cell manufacturers, who have volume once destined for the US, now to sell in Asia.

Taiwan has limited wafer capacity and minute module capacity to create full a vertical integration model to serve European markets directly. Despite what media or even companies themselves see as an opportunity, the EU tariff has little to offer to current infrastructure. The participants also have until May of 2013 to adjust their approach, leaving ample time before the first tariff is collected for finding localized solutions. In case of the EU finding Chinese dumping, Taiwanese infrastructure offers some investment potential to China, new policies may allow 50% of ownership for Mainland- based companies, but value chain is incomplete. Building a new value chain has no benefit, with high construction and labor costs, which would result in high processing costs for solar products. These are the very reasons to why Motech and DelSolar have production plants on the Mainland. Due to shipping costs, which increased in Q2 by some 30%, locations in Europe seem more favorable to service the EU. In Asia, India could offer multiple solutions for the future, including access to this market in case of the tariff craze engulfing Indian politicians, but also the potential of becoming a cheap base of supply to many markets in the region.

When Chinese companies will be required to develop manufacturing infrastructure outside of China, adding cell manufacturing will make logistical sense, but it will circumvent Taiwan. It has to be clear that leading solar companies will not abandon the EU, but will create conditions to operate and sell its goods, even when tariffs are in place. Miniature **China Sunergy Co Ltd (NASDAQ:CSUN)** is planning manufacturing in Turkey, anticipating the worse outcome, so it is unrealistic to expect big peers to act differently.

Lastly, Taiwan does not have the financial magnitude to embark on expansion to compete with Chinese modules. The planning stage has cost disadvantages, which held Taiwan in the current format, and there is little money to experiment with the possibility of a loss. Cash resources of four top Taiwanese companies have less of it than JA Solar, a single Chinese tier-2 module manufacturer.

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To this point, the Taiwanese solar supply chain has played a meaningful role in the globalization efforts of the industry, but under protectionism barriers against the Chinese could be faced with new adversity. Sensing the above Sam Hong, president of Neo Solar Power, have been quoted by Digitimes to say that cooperation between solar firms in Taiwan and China will increase if Europe decides to implement duties on China-made solar products. Invertedly, in our opinion, the situation could place them further apart.