

HERE COMES THE SUN

BY JACK CALDERON AND JOHN MCMANUS, LINCOLN INTERNATIONAL

Although using the sun as a renewable energy source is not a new phenomenon, the increasing emphasis on powering our everyday lives in this fashion is becoming a viable business model. With the solar energy provisions included in President Obama's stimulus legislation potentially creating more than 100,000 jobs in the solar industry within two years, combined with the global call-to-action for alternative energy, the domestic solar energy industry is truly finding its stride.

During the last decade, worldwide installations of photovoltaic, or PV, cells and modules, which convert light into energy, have grown at a cumulative annual growth rate of more than 35%, according to 2008 findings from the European Photovoltaic Industry Association. The majority of this growth has historically been overseas, with Germany leading in installed capacity at more than 40% of worldwide installations. However, with the increase and extension of the investment tax credit in 2006, U.S. PV installations have grown almost 50%, and new companies are competing in the market every day.

With this in mind, is the U.S. finally ready to wake up to the dealmaking potential of solar energy? And is solar energy the next bright spot for M&A?

While the U.S. solar industry had a record year in 2008, even solar companies have not been immune to the current global recession. Reductions in consumer and commercial spending have slowed new solar installations and have weakened 2009 forecasts. The decreased expectations combined with the overall economic decline have created a unique dynamic for solar companies. Although the downward pressure on valuations is at an all-time high, this is creating unique deal opportunities as solar companies evaluate their strategic options for growth.

From a valuation perspective, multiples have been declining

steadily during the past year. Average Ebitda multiples among solar companies easily exceeded double digits (in some cases, reaching 30 times to 40 times) just a year ago, but now most solar companies face single-digit Ebitda multiple valuations. When evaluating the four sectors that we consider to drive the solar industry supply chain -- wafer/ingot producers, cell/module producers, vertically integrated companies and system installers -- their average Ebitda multiples are also declining across the board.

According to **Lincoln International's** Quarterly Solar Energy Stock Index for the first quarter of 2009, cell/module producers are still exhibiting the highest Ebitda multiples of these four sectors, averaging 9.4 times. Wafer/ingot producers exhibited the second largest average Ebitda multiple of 8.4 times. Vertically integrated companies exhibited an average Ebitda multiple of 7.1 times. Finally, system installers posted the lowest Ebitda multiples of the group, averaging only 5.3 times. These multiples represent an average total decline of 54% from a year ago.

These valuation declines have dampened the amount of new investment in solar companies during the last six months, forcing management to evaluate other strategic options for immediate and long-term growth. Whether it is consolidating to gain scale or acquiring technology or additional capabilities, the U.S. solar industry is well-positioned to see significant M&A activity in the coming years. More than likely, this growth will mirror what more mature foreign markets, such as those in Europe, have experienced historically.

For example, there were 62 completed solar energy transactions in 2008 as reported by Lincoln International's Quarterly Solar Energy Deal Reader, 47% of which came from Europe and another 11% in Asia. Although the U.S. and Canada accounted for 27% of total transactions, the domestic M&A market is still

in its early stages. The effect of the recession is threatening the viability of many smaller solar companies, which can only lead to greater acquisition activity. The inability of smaller participants to use and sell tax credits is sharply slowing growth in installations and projects. As a result, the larger, well-financed solar companies will be acquiring smaller firms to move into additional geographies and provide new and expanded services.

Whether cross-border or domestic, these transactions demonstrate that the majority of the solar industry's 2008 deals were focused on consolidation and vertical integration. In fact, consolidations represented 35% of transactions, or 22 deals in 2008, and we expect this trend to continue this year and beyond. Additionally, many solar companies are establishing economies of scale by integrating up and down the solar food chain. Nearly 34% of transactions, or 21 deals completed in 2008, were vertical integration deals. This was particularly apparent among two of the industry's most active subsectors, system installers and cell/module production companies, which combined represented 58% of total 2008 transactions.

In addition to transactions driven by trends such as consolidation and vertical integration we also see deals being driven by private equity investors and corporations

looking to diversify into solar. Investment in the solar energy industry by private equity or private investors accounted for 10 transactions in 2008, or 16% of the total. Diversification into solar by corporations represented 15% of transactions, with a total of nine this past year. We expect that, as the industry matures and becomes more profitable, this will create opportunities for, and further drive, private equity and corporate investment.

These valuation and transaction trends have created opportunities for investors looking to be a part of this growth industry. The industry is ripe for consolidation and has many outsiders looking for opportunistic avenues to enter solar. The future will pose many strategic and private equity buying opportunities domestically as the industry matures. The time for U.S. solar is now.

Jack Calderon is a managing director of Lincoln International, a global midmarket investment bank. He leads the firm's global electronics and renewable energy groups, which focus on solar energy as well as control electronics, electronics manufacturing services, interconnects and power electronics.

John McManus is a senior research director in Lincoln International's global electronics and renewable energy groups.

AS FEATURED ON



TheDeal.com is published by The Deal LLC.
© Copyright 2009 The Deal LLC. The Copyright Act of 1976 prohibits the reproduction by any means of any portion of this publication except with the permission of the publisher.

WWW.THEDEAL.COM