Classical Rationales Propel Solar Industry M&A

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Recent statistics and deal trends reveal that the solar M&A market is undergoing robust activity as 2010 draws to an end. Notwithstanding that renewable energy M&A as a whole decreased in Q3, 2010 as compared to Q2 2010 (139 transactions, 36 disclosed totaling $4.04 billion in Q3 versus 205 transactions, 56 disclosed totaling $5.77 billion in Q2 2010), the pace of solar M&A actually increased, hurdling back to the sizeable deal volume seen in Q1. In Q3, 2010, solar M&A almost doubled the volume of Q2, 2010, with $585.65 million in disclosed transactions compared to Q2's $298 million (12 transactions in Q3, eight of which were disclosed, compared to 11 transactions, two of which were disclosed in Q2, 2010).

Although a small number of large-scale transactions disclosed to the markets can distort the underlying quarterly data, it remains that solar M&A is advancing on many fronts. These transactions are largely precipitated by what appear to be classical rationales for M&A including vertical and horizontal integration, geographic diversification, technology acquisition, economies of scale, and entry into new markets. With Feed-in-Tariff rates under assault in Europe and the US, and §1603 cash grant possibly extinct in the near future, understanding the rationales and trends driving the brisk pace of solar M&A is critical to determining whether such activity will continue at the same rate and predicting if the objectives of the buyers and sellers will be realized.

Solar M&A trends and motivations

1. Vertical integration. The most compelling dynamic driving large-scale solar M&A transactions is the increasingly pervasive maneuver by upstream panel and equipment makers to acquire downstream project generation assets. Solar panel makers, in particular, have emerged as the winning bidders in a number of high-profile auctions, outpacing suspected bids by various funds and independent power producers. The consensus view is these acquisitions are occurring for the strategic purpose of panel makers assuring a long-term end market for their products.

Prominent examples of such transactions include: Sharp's recently announced acquisition of Recurrent for up to $305 million (subject to closing balance sheet adjustments) expected to close by year-end; First Solar's $297 million acquisition of NextLight, which closed in July; and, First Solar's $400 million acquisition of OptiSolar in 2009. The apparent dominance of panel makers in auctions of solar energy generation portfolios, with fully commercialized projects and/or late-stage development pipelines, has meant other active bidders for solar project assets have focused on middle market asset selections and bilateral negotiation to achieve their acquisition objectives. In addition, the demand for late-stage project portfolios (i.e. with approved PPAs, interconnection agreements, and permits in place) has triggered surging demand for the management and project talent teams that have developed these assets as panel makers find themselves needing to acquire project development expertise at least through COD.

2. Geographic diversification. Based on the divergent policy incentives, domestically and internationally, both strategic and financial buyers of solar projects and the equipment makers are pursuing geographic diversification. Project acquirers are seeking the highest Feed-in-Tariff rates (e.g. through acquisitions of project pipelines in Ontario, Canada as happened with Sharp's purchase of Recurrent), and the most green-friendly legislative dispositions. Equipment makers are looking to ensure access to diverse markets and seeking to obtain the lowest cost manufacturing capabilities. In Ontario, in particular, the domestic content requirement associated with the Feed-in-Tariff has forced panel makers and installation companies to outsource panel assembly and equipment procurement to companies with a local presence in Ontario.

3. Emergence of utility scale solar. Recent studies have characterized 2010 as the year that will be recognized as the official kickoff of the commercialization of utility scale solar projects. In 2010, more than 20 utility projects are expected to come online. Additional large-scale commercial PV projects are expected to achieve commercial operation in the near future, including the 45 MW Avenal project in California. Up to 80 MW of CSP-based projects are also expected to come online in 2010 with a substantial pipeline in place for the future. Utility scale solar projects have become more economical as a result of the long-term downtrend in solar panel pricing. In addition, these projects are attractive to large corporate conglomerates and power producers who can afford the hefty capital investments to develop and construct such projects.

4. Technology driven acquisitions. Competing technologies in the solar market are also shaping the M&A marketplace. While project finance investors have shown a willingness to lend to a variety of solar technologies, it's becoming increasingly clear that different technologies are better suited for different types of project sizes, climate characteristics, and off-take arrangements. Consequently, certain large players in the industry have adopted a diversification strategy, adopting technologies as needed to match project economics and environmental characteristics. Manufacturers and investors alike continue to watch fluctuations in the prices for components, finished products, and electricity prices carefully. An abundance of seed money in the cleantech space means there are a number of young companies with promising technologies available for acquisition.

Predictions for future solar M&A activity

The classical M&A rationales will continue to impact solar M&A for the foreseeable future with panel makers continuing to make aggressive acquisitions of project assets and equipment makers pursuing similar strategies to a lesser degree. Smaller developers will look to use M&A as an exit strategy, instead of owning and operating their projects, as larger companies will have greater expertise and capacity to procure project financing. Despite the carnage in the panel supply industry resulting from steep long-term drops in module pricing, there has been recent firming of panel prices linked to the demand for panels in Ontario, Canada and Europe, as well as the growing US market. It is likely there will be a continued emergence of new low-cost panel suppliers looking to have their panels added to the list of known "financeable" panel makers (particularly from China).

Distressed acquisitions of panel suppliers, as well as project developers lacking the capital to complete their projects may occur. The solar equipment and servicing industries remain fragmented and ripe for additional consolidation so makers of inverters, mounting systems, combiner boxes, chemicals used in solar panels, as well as EPC contractors and O&M providers will continue to engage in M&A transactions. Federal and state legislation in the US will be monitored with keen interest as the fate of the §1603 cash grant, Feed-in-Tariff legislation, and RPS standards continue to be key factors influencing solar M&A activity. Overall, a seller-friendly market has emerged in the US for sales of advanced solar projects, and it will be intriguing to see how long the sellers' market continues as buyers continue to have genuine reasons for acquiring solar assets. Competition for PPAs may have already led to many lower-priced PPAs not being financeable, which may lead to future distressed M&A opportunities.

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