

Bright Spot: Sun Shines on Solar Energy Investment



Renewable energy generation is a growing priority for countries across the globe. In 2015, 196 parties adopted the [Paris Climate Agreement](#) and in 2021 the [United Nations Framework Convention on Climate Change](#) (UNFCCC) indicated that a transition to sustainable energy is a deliverable for the UN Climate Change Conference taking place at the end of the year.

Solar energy is a key pillar of renewable energy and is becoming increasingly prevalent—in the U.S., the [National Renewable Energy Laboratory](#) reports that solar energy is now an \$84 billion industry.

Solar has cemented itself as a permanent fixture of the global energy portfolio. From large scale systems to distributed generation on rooftops, solar has moved beyond purely an incentive and regulatory driven technology. It is now being adopted as an effective form of energy production that will help balance rising electricity costs while providing long-term environmental benefits.

COMMERCIAL AND RESIDENTIAL INSTALLATION

The last year has seen an increase in adoption of both commercial and residential solar installations, creating opportunities for investors across both areas.

Commercial opportunities are being driven by increased focus on environmental, social and governance (ESG) as well as through peak load offsetting, which provides direct electricity savings on a long-term basis for commercial operations. As ESG investing around the globe continues to be a priority for companies and investors, commercial installers should see further growth—despite tighter pricing and margins.

The residential market is growing at a faster rate than the commercial market primarily due to the additional focus from homeowners on taking control of their electricity. Additionally, as a result of the COVID-19 pandemic, many individuals embarked on home improvement projects during lockdown—including installing solar technology. Long-term cost savings is still a key driving motivator behind the installation of a solar system. Even though some homeowners may not see cost savings on day one, there is an expectation that they will see lower electricity bills with solar than the status quo. Through these dynamics the market has crossed a tipping point with more homeowners now considering installing solar because of its increased visibility. In other markets, such as South Africa, load shedding (reduction) has driven homeowners' demand for solar to provide a backup system to the national energy supplier.

Private equity interest in residential solar is increasing because of the sustained growth and profitability of the companies operating in this space. Residential-focused solar businesses can be seen as more stable than commercial focused operations which are more project-based in nature. For example, recently in Europe, significant raw material cost increases such as the price of solar glass, combined with a near tenfold increase in shipping costs from China, has impacted commercial projects.

(continued next page)

PRODUCTS TO WATCH: ENERGY STORAGE MARKET

In addition to installers, solar power product companies (including panels, batteries, inverters, cables and more) and related software and logistics providers are benefiting from the market growth. Increasing technological development around batteries and energy storage solutions are helping shape the future of the solar market. As batteries become less costly and more efficient, the immediate economic value of a solar system becomes more evident, leading to increased adoption—even in areas with lower average costs of electricity. Many companies now offer solar focused storage solutions, including Tesla, Generac and Enphase. As the space becomes more competitive, pricing will go down, which will make the whole system more profitable, benefitting solar installers and developers. Increasing adoption of storage also brings the need for software and technology solutions to manage the energy being generated and effectively integrate the increasing distributed energy resources into the grid. While the storage market is rapidly changing with new product entrants and technology changes, the solar market and all end-users stand to benefit.

LINCOLN PERSPECTIVE

While energy policy evolves with the changing of governments around the world, the market for solar power is sustainable in the long-term. Tax credits and incentives have contributed to the growth of the market, but the industry has demonstrated growth globally over the years regardless of regulatory impact. As a result, the solar power sector is ripe with investment opportunity.

For private equity investors interested in solar power, Lincoln International identified three items to consider before creating a platform investment to generate returns from acquisitions.

- 1 Qualities of an attractive target**

When examining a potential investment, it is important that the target displays margin sustainability. Growth is common, but maintaining a focus on profitability is the true indicator of a strong investment. For residential installers, who are true sales and marketing engines, their most important attribute is the ability to access and sell to customers. True success comes from the ability to sell and market while managing customer acquisition costs to ensure profitability. Many players are focusing on increasing utilization of software across the various points of the value chain to increase efficiency, which is also creating a set of attractive software providers focused on this rapidly growing end-market. For commercial installers, investors should look for strong ongoing relationships leading to recurring business. While project-based revenue is positive, truly successful targets will have a pathway towards or a pipeline of future installations.
- 2 Diversify and grow**

When building a platform, PE firms should look for targets that exhibit business diversity— this can be in both offering and geography. Investing in companies with various products and services will create a holistic platform that can provide a broader range of capabilities. Additionally, there is opportunity for cross-border deals to enter and expand geographies. National expansion in the U.S. as well as across Europe and in Southern Africa present opportunities for cross-border investment.
- 3 Navigate the lending market**

Traditionally, the solar market has struggled to access lending ahead of mergers and acquisitions (M&A) transactions as banks and others deploying capital have been more risk adverse when it comes to solar. Some more public bankruptcies in the space have made lenders hesitant, creating a gap between the general lending market and the lending market for solar transactions. When working with lenders, it is critical to note that like any industry, bankruptcies in this space have stemmed from poor execution or business models—not the industry. Be sure to communicate the positive dynamics of the solar industry—from creating sustainable profits to the potential to long-term growth and ability to weather economic storms, most recently the pandemic.

For other perspectives, visit us at www.lincolninternational.com/perspectives.

Learn more and connect with Lincoln's Energy, Power & Infrastructure Group at www.lincolninternational.com/EPI