

# What Does Warren Buffett See in Solar?

## Shining a light on the solar industry

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Everyone wants to see inside Warren Buffett's head. One of the world's most successful investors, the CEO of Berkshire Hathaway is a rock star among those who check the markets before their breakfast. His annual shareholder letters are famous, generating the kind of hoopla among his followers as a just-released Harry Potter novel does among children. Even U.S. President Barack Obama listens to Buffett, or at least he quotes him often. In fact, headline writers have come to call Buffett the 'Oracle of Obama', a play on the Nebraska native's nickname of the 'Oracle of Omaha'.

What's the best way to gain insight into Buffett's thinking? Probably by watching his companies. And now, among his big insurance, chemical and utility holdings is a renewable energy company that is making some eye-catching moves. In its first 12 months in business, MidAmerican Renewables has acquired some of the largest solar projects in the world.

What do these aggressive moves by a Buffett-backed business say about the solar market? Will others follow? And why did MidAmerican Renewables choose these particular projects?

### **First, Some History**

When MidAmerican Renewables entered the market in 2012, it came with significant financial backing. Its parent is Berkshire Hathaway's MidAmerican Energy Holdings Company, a company with US\$11.2 billion in annual revenue and \$48 billion in assets. The enterprise includes a natural gas pipeline venture, U.S. and U.K. electric utilities and an international energy development firm. MidAmerican's utilities own and operate generation, including renewables. But the company wanted to pursue solar, wind, geothermal, and hydroelectric projects through a non-utility, competitive business. Thus, MidAmerican Renewables was born.

MidAmerican Renewables quickly showed its financial heft in the solar marketplace, going from 'a non-player to one of the largest solar investors in a very short time frame', said Dan Bedell, an executive vice president of Principal Solar, a Texas company that also acquires large-scale solar.

MidAmerican Renewables has acquired three large solar photovoltaic projects:

- The 550 MW Topaz Solar Farms in San Luis Obispo County, California. Purchased from First Solar January 2012. Construction began in November 2011 and MidAmerican expects to complete it by early 2015. A study by the Brattle Group and California Polytechnic State University found that it will contribute \$417 million to the local economy. The project holds a 25-year power purchase agreement with Pacific Gas and Electric (PG&E). Topaz uses thin-film PV.

- The 290 MW Agua Caliente project in Yuma County, Arizona. MidAmerican Renewables acquired 49 percent of Agua Caliente in January 2012 from NRG Energy, which remains the majority owner. NRG purchased the project from First Solar in 2011. First Solar is building the \$1.8 billion project and expects to complete it by 2014. Agua Caliente, which also holds a PPA with PG&E, received a \$967 million loan guarantee from the US Department of Energy.
- The 579 MW Antelope Valley Solar Projects. This is actually two co-located projects in California's Kern and Los Angeles counties. MidAmerican Solar brought the projects in January 2013 from SunPower. It will provide power to Southern California Edison (SCE) under two long-term power purchase contracts approved by the California Public Utilities Commission. The project has secured final conditional use permits and completed state environmental review. Construction began in early 2013 and is scheduled to be complete in 2015.

### **Why Now, Why This?**

Given Buffett's alliance with Obama, some critics say MidAmerican is pursuing renewables to boost the US President's green agenda and undo some of the tarnish caused by the Solyndra, the California thin-film solar manufacture that went bankrupt after receiving a \$535 million US Energy Department loan guarantee. But Buffett doesn't mix politics and investment. His oft quoted investment doctrine is, 'Rule No. 1: Never lose money. Rule No. 2: Never forget rule No. 1.'

Berkshire Hathaway is motivated by the 'green you see on dollars, not the kind you see on projects', Bedell said. 'There very may well be beneficial political overtones, but without the financial analytics behind this move, it's a non-starter. Yes, Warren Buffett has been an outspoken supporter of the Obama administration. But at the same time he is a non-partisan investor'.

Indeed, when asked why MidAmerican bought the large solar projects, Paul Caudill, president of MidAmerican Renewables solar division, first talked about corporate commitment to reducing carbon footprint. 'One of our core principles is environmental respect', he said. But then Caudill quickly moved on to the business fundamentals of risk, capital and market dynamics.

'We see solar and wind assets as very, very solid long-term investments,' he said. Not risk free, he added, but good plays for MidAmerican in terms of managing risk and deploying capital.

### **Why is Solar a Good Risk Now?**

First, the investments made by MidAmerican are backed by long-term utility contracts. 'The power purchase agreements provide us comfort. We are a long-term investors, so we like to have counterparties that have the same goals that we do,' he said.

Second, solar prices have dropped to the point where they are attractive 'just on their own merit,' Caudill said. MidAmerican Renewables focuses on states where energy prices are

high. Right now gas prices are at a 'very, very low ' levels, he said. 'You can almost be assured energy prices will rise. When I say energy price I'm talking about electricity prices to consumers'. With electricity prices rising and solar prices falling, solar becomes an increasingly appealing proposition.

And last, 'we are starting to get enough operating experience with both thin-film and polycrystalline higher efficiency modules. We're comfortable that the risk is very manageable,' he said.

While the company has focused on the western U.S. so far, it is exploring several other markets, both domestic and international.

MidAmerican Renewables sees opportunity 'in a number of states that might not be traditionally the ones you think of in terms of solar, like California, Colorado and Arizona', he said. Caudill won't say exactly which states the company is eyeing. But he did cite the US Southeast as a possibility, and the US Northeast as less likely.

'The markets there (the US Northeast) are frankly not areas we have focused on heavily. The market for renewable energy credits has been somewhat up and down there, not very stable. That's been something that I've personally watched over the years,' Caudill said.

He sees future solar development shifting toward smaller projects and away from the mega-size of MidAmerican Renewables' first three solar projects. 'Land is just not available,' he said, adding that he sees some 'very exciting opportunities in the 20 MW-40 MW range. 'We're working on some. We are looking at grid tied and distributed generation projects of a much, much smaller scale and capacity than Topaz, Agua Caliente and Antelope Valley.' So far, the company has not pursued international solar projects, but it is open to the idea. MidAmerican Renewables has taken a look at projects in South America, specifically Chile, as well as the Middle East. But 'we're not spending a significant amount of time right now in the international market. We have looked at different opportunities, but have not decided yet to branch out that far away from home', Caudill added.

### **Timing Is Everything**

Industry observers say that MidAmerican Renewables acquired its first three projects at a sweet spot in their development, a good balance of risk and cost: not too early, not too late. Had they been in an earlier stage, perhaps without permits or PPAs, they would cost less, but carry a higher risk of failure. Conversely, a later stage solar plant is pricey, but low risk.

MidAmerican Renewables bought its first projects 'not in early, early development, but also didn't wait until they are up and running', Principal Solar's Bedell said. 'If you wait until they are up and running, you pay full price. If you buy it early you get quite a discount, so there is a lot of risk'.

Indeed, Caudill said they were attracted to the projects not only because they held PPAs, but also access to transmission, generation interconnection agreements, and permits. 'An early stage development might have one or two of these. These were pretty far along in terms of their development.'

As MidAmerican Renewables continues to expand, however, it is not limiting acquisitions to projects at this development stage. It will consider earlier stage projects as well, 'if the right opportunity presents itself,' he said, and will do so 'in a thoughtful, deliberate way'.

So far, the company has confined investment to PV but it is not shutting out concentrating solar power or other solar technologies in the future, he said. 'We have made very clear we are open to business within the solar markets. We are not really shutting down any opportunities at this stage,' Caudill added.

### **Reputation Matters**

MidAmerican Renewables also liked the first three projects because they arose from the work of companies with proven track records, according to Caudill.

First Solar, for example, manufactures advanced thin-film modules and develops and constructs projects internationally. In addition to Topaz and Agua Caliente, First Solar developed the 550 MW Desert Sunlight Solar Farm in Riverside County, California, which was purchased by NextEra Energy, GE Energy Financial Services and Sumitomo Corporation of America. It also developed the 230 MW AV Solar Ranch One in Los Angeles, California, now owned by Exelon. It also has projects underway in Australia, Asia and Germany.

NRG Energy is one of the US giants in the competitive generation sector. A Fortune 300 company, it operates a 47 GW portfolio, most of which is fossil fuel power plants. But the company has branched into renewables with about 2 GW of solar projects, making it one of the US largest solar developers.

### **The World Is Watching**

When a Buffett-backed company moves aggressively into a market, investors worldwide take notice. Companies react. So how is MidAmerican Renewables affecting solar? The company is encouraging large institutional investors to look more closely at solar both in the US and internationally, according to Bedell, and has created a 'follower effect', he said.

'MidAmerican Renewables early mover status is encouraging other traditional capital sources to put more money into solar investments', he said. 'We've already heard rumblings of others following.

The follower effect is occurring because 'Warren Buffett has earned a stellar reputation for thorough due diligence and for investing in undervalued assets,' according to Bedell.

The followers are focusing first on the U.S. because it is considered a low risk capital market, he added. Today's post-recession, low-cost capital gives large investors 'very low leverage pricing, making their equity investment quite profitable over a shorter time period,' Bedell said. This comes on top of an attractive federal tax credit for solar and accelerated depreciation options. 'An educated investor can offset a substantial amount of tax liability,' he said.

While the U.S. is a prime focus now, Bedell sees institutional investors like MidAmerican casting a wider net in the future. 'As the European financial market stabilises and solar continues to decrease in cost, more institutional investment dollars will move into emerging markets.'

Meanwhile, Caudill sees the US solar market continuing to grow 'at a managed pace'. 'I don't want to say we're bullish, but I don't think we would have committed to the resource as we have without feeling that its growth is sustainable,' he said.

So MidAmerican Renewables is likely to continue its foray into U.S. markets, action that not only builds its holdings, but also attracts the attention of other large players, who know that a Buffett-backed company doesn't make investment decisions lightly. MidAmerican Renewables may be acting on Buffett's first and second rules about always making a profit. But at the same time it is shining an even brighter light on an industry that already enjoys a glow going into 2013.

'Warren Buffett is one of the smartest investors in world - if not the smartest. He's a visionary who recognises that the transition to sustainable energy sources is vital - and that the US must lead it,' said Rhone Resch, president & CEO of the US-based Solar Energy Industries Association. 'With his significant investment in solar, Buffett and MidAmerican are in terrific company, along with leading firms such as GE, GM, Google, NRG, Apple, IKEA, Walmart, Walgreens, etc. Smart investors and corporations deploy/invest in solar not only because it's the right environmental choice - it's the right economic choice.'

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