

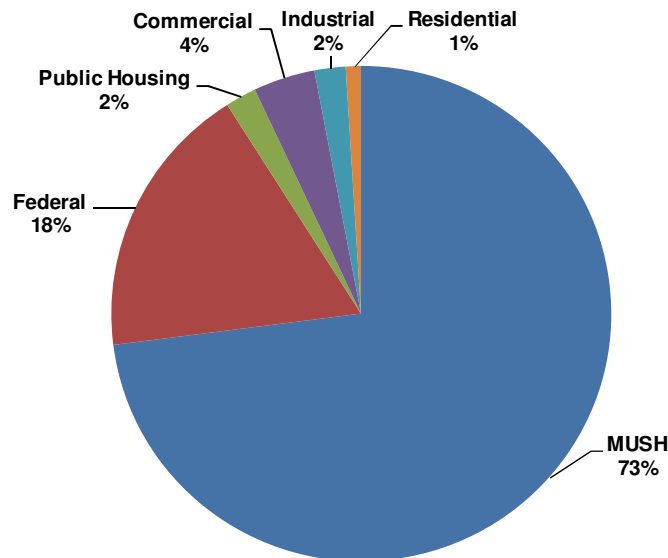
Section 1

EXECUTIVE SUMMARY

The Energy Service Company (ESCO) market, as defined and documented in this report, exceeded \$5 billion in 2011. Driven by public policies that encourage a greater emphasis on energy efficiency to reduce costs and improve operations and the impetus to employ newer technologies that provide more for less, this market is expected to continue growing at a pace that exceeds general economic growth for the next decade.

ESCO activity takes the form of direct contracting between providers of energy efficiency equipment and government agencies, public institutions, and commercial customers – typically via performance-based contracts wherein funding for individual projects is based on a promise of “guaranteed savings” to facility owners/managers. Energy conservation measures most often range from more efficient lighting upgrades and newer heating, ventilation and air conditioning (HVAC) components to the installation of sophisticated and increasingly intelligent Energy Management Systems (EMS) that provide facility owners/managers greater control over energy use.

Chart 1.1 *ESCO Market Segmentation: 2011*



(Source: Pike Research)

While the ESCO industry as we currently know it has been active for approximately 30 years, it continues to evolve in response to business opportunities and economic trends. The companies that provide ESCO services fall into four major categories by business structure:

- Independent ESCOs
- Building Equipment Manufacturers

- Utility Companies
- Architectural and Engineering Companies

Perhaps the biggest change in terms of the ESCO competitive landscape has been the rapid disappearance of many utility-affiliated companies; these companies have either ceased operations or have merged with or been acquired by competitors. However, a select few utility affiliates remain among the largest ESCOs.

Consolidation continues in this market as highly competitive players aim to increase market share. Additional catalysts for recent M&A activity include the incorporation of regional players into national business models, the desire to acquire specialized talent, and an interest in pursuing new “convergence” services that offer a new dimension to traditional ESCO products and services. Moreover, newer service offerings, such as demand response and energy management software, with increasingly intelligent metering and control systems that afford customers greater flexibility and control over their energy usage, are opening new opportunities for ESCOs. At the same time, non-traditional companies are looking to add energy efficiency as a service offering.

These trends have resulted in an industry structure that is dominated by a group of very large companies that specialize in the use of Energy Service Performance Contracts (ESPCs) – designated by the U.S. government as Super ESPCs. These companies have passed a prequalification process that allows them to enter indefinite delivery/indefinite quantity (IDIQ) contract arrangements with federal agencies over the next decade – up to \$5 billion apiece, totaling \$80 billion in potential contracts.

The federal market has been highly active in recent years, driven by a continuing series of laws, policy pronouncements and funding opportunities. Particularly important for ESCOs is the 2009 executive order issued by President Barack Obama that mandates that all federal agencies must achieve a 30% reduction in energy use by 2015.

Although efforts to pass federal legislation to address carbon emissions have failed in Washington, energy efficiency has been elevated to a top priority. The American Recovery and Reinvestment Act of 2009 (ARRA) directed tens of billions of dollars into energy infrastructure and efficiency as a primary means of stimulating a stagnant economy.

Table 1.1 *ESCO Market Segmentation by Customer Type: 2011*

Segment	Units	2011	Percentage
MUSH	\$ Millions	3,805	73
Federal	\$ Millions	925	18
Public Housing	\$ Millions	103	2
Industrial	\$ Millions	205	4
Commercial	\$ Millions	103	2
Residential	\$ Millions	51	< 1
Total	\$ Millions	5,141	100

(Source: LBNL, Pike Research)

The majority of ESCO work is conducted for public entities at the state or local level. Municipalities, Universities, Schools and Hospitals (along with other public entities) compose the MUSH market segment, which represents about 73% of all ESCO activity. Other sectors, such as commercial/industrial companies and public housing, represent much smaller components of the market and have traditionally been resistant to the

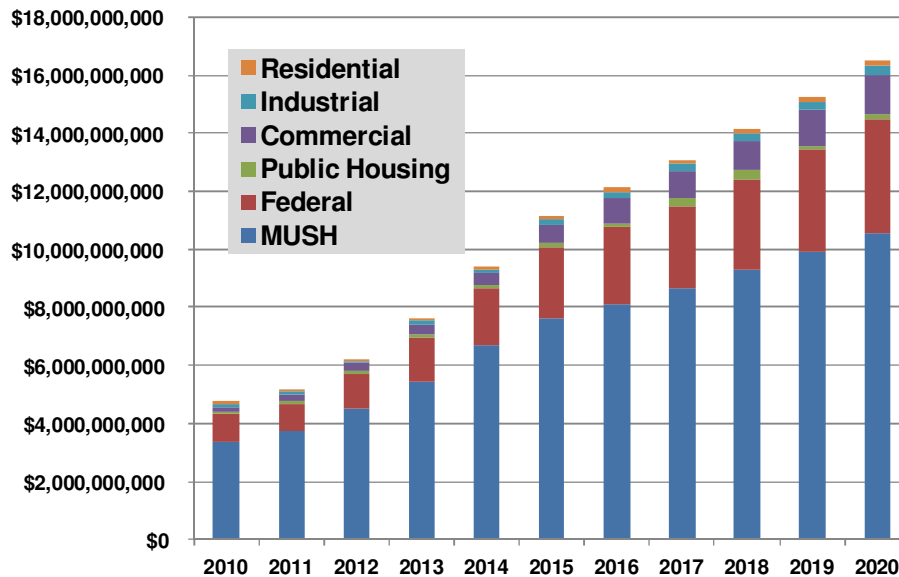
performance-contract model.

Certain provisions of the ARRA have directed more than \$6 billion into the MUSH segment via State Energy Programs and Energy Efficiency Block Grants. Additionally, these provisions have increased access to tax-subsidized financing mechanisms to ease the continuing credit crunch that many public entities face. However, many people have raised concerns regarding the level of effectiveness with which these provisions have been implemented and reported delays in expenditures.

Although recent market growth has been substantially impacted by the 2008-2009 recession, with lingering impacts expected in the near term, the ESCO market continues to grow – albeit at a much slower pace than many had anticipated.

The ESCO market revenues are forecasted to grow at a compound annual growth rate (CAGR) of 14% over the next 10 years, from 2011 to 2020. This forecast reflects a far more modest rate of growth than some, including Pike Research, had previously forecasted. The reasons for the revised numbers are detailed throughout this report. Under the scenario described herein, however, ESCO industry revenues should exceed \$16 billion in 2020, according to Pike Research analysis.

Chart 1.2 *ESCO Revenues, Historical Data & Forecast, United States: 2010-2020*



(Source: LBNL, Pike Research)