LDK Says Inventory Discrepancy Allegations Have 'No Merit'
The company has silicon under control, according to CFO Jack Lai.

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In response to allegations of inconsistencies in the company's inventory of solar-grade silicon, LDK Solar said Thursday that an internal investigation revealed "no material discrepancies" and that the allegations "have no merit."

The company said it has hired an independent auditing firm to conduct its own investigation and hasn't been contacted by any regulatory authority about the allegations.

The allegations, made by LDK's former financial controller, Charley Situ, came out in a Piper Jaffray report Wednesday. Situ, who LDK said was fired Sept. 25, alleged "poor financial controls and a 250-ton inventory discrepancy; allegations were made to both the [U.S Securities and Exchange Commission] and the external auditor KPMG," according to the report.

LDK shares fell 23.9 percent to $61.55 Wednesday, even though the report by senior research analysts Jesse Pichel and Ming Yang also said: "We have spoken to the LDK [chief financial officer] about these claims and have found no reason/proof to dispute management's claim of 1,000 tons of polysilicon in inventory."

Prices rose to $57.57 per share after the company released the statement about the internal investigation, then fell back to $48.30 per share in recent trading.

While Piper Jaffray retained an "Outperform" rating on the company, a report after an investor call Thursday said while the company defends its financials and inventory, "we believe the investor call may have raised more questions than it answered."

CIBC World Markets downgraded its rating to "Sector Underperformer" from "Sector Performer," citing "unconfirmed allegations."

The allegations come at a time when a shortage of solar-grade silicon, polysilicon, is one of the industry's top issues. New entrants, including many Chinese solar companies, have struggled with high prices (see Could China Steal the Solar Throne?)

To cope, companies have been getting creative. Earlier this week, Trina Solar hired Dave Seburn from REC Silicon for a new position - vice president of polysilicon (see Has Trina Solar Found its Man?)

And companies like LDK have found ways to purify silicon that other companies consider waste.

Therein lies the problem, according to LDK. The alleged discrepancy resulted from a difference in accounting for this so-called "scrap silicon," which the company doesn't consider scrap. Instead, the company plans to use the impure silicon to make wafers and includes it in its inventory accounting.

Such accounting challenges can occur when companies grow as quickly as LDK, analysts said.

But Jack Lai, chief financial officer and executive vice president of LDK, said the company's got a good handle on its silicon.

"We have very good silicon control and very good visibility into our silicon planning for this year and the [next]," he said. "We believe our business outlook is very clear. Our revenue is very visible, we have delivered on schedule, we have signed big customers and our outlook is very promising."

Lai said the company has at least 1,000 tons of silicon in its warehouse for next year--as well as contracts with silicon manufacturers for another 2,000 tons, agreements to get silicon from customers buying its cells and a plan to buy an additional 75 to 80 tons each month.

The company expects to complete construction of its own polysilicon plant in 2009 and produce at least 7,000 tons that year - well on the way to fulfilling its need for 8,000 to 9,000 tons, he said.

Demand remains strong for LDK's cells, with the company sold out for this year and almost sold out for 2008 and 2009. "We're doubling capacity every year through 2009, all our capacity is on schedule and everything is going so well," Lai said.

Despite that, shareholders clearly are unhappy. One such shareholder even forced his way into Lai's office and threatened him Thursday, Lai said.

Michael Rogol, managing director of Photon Consulting, said measuring silicon inventories is more complicated than one might think.

"Accounting for silicon inventories is like accounting for crude oil reserves in that different inventories and different reserves have different risks associated with them," he said.

Some of the silicon has impurities that make it difficult or impossible to use as is, yet companies expect they will be able to use the silicon once they figure out how to remove those impurities, Rogol said, adding that LDK and Renesolar have been particularly successful in removing impurities.

"This issue is complex because LDK is very good at using silicon that other companies often can't use," he said. "What one company would call waste silicon and write off, LDK is sometimes able to turn into solar wafers. … That makes it harder to account for the silicon."

Rogol said when he visited LDK's silicon storage area in the past, he's been impressed by the amount of silicon it had. "It's one of the biggest silicon stores in the world," he said.

Rogol added that he's seen nothing to indicate a discrepancy so far.

"My experience with the company has been that everything they've shared with me has matched what I've seen when I've visited their plant," he said. "That does not mean they couldn't have a problem or couldn't have a discrepancy, but so far, I haven't seen any evidence that supports it."

Piper Jaffray and CLSA, Rogol's former employer, were among the underwriters for LDK's initial public offering in May. Others included Morgan Stanley, UBS Investment Bank and CIBC World Markets.