Loan Was Solyndra's Undoing

By YULIYA CHERNOVA

Solyndra Inc. was supposed to be a marquee example of how private and public capital, brought together, could vault innovative companies to commercial success.

Instead, the $535 million government loan guarantee so prized by the solar-panel maker may have ultimately contributed to the company's undoing, say investors with knowledge of the company's operations.

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Jonathan Silver, executive director of the Department of Energy Loans Programs Office, left, and Jeffrey Zients, deputy director of the Office of Management and Budget, testify during a House Energy and Commerce Committee hearing on Solyndra Wednesday.

The new factory built with Department of Energy funds foisted fixed costs on a company already struggling through an industry shake-out, they say. What's more, the debt paradoxically made raising more money difficult. Once the government demanded priority in the event of failure, private investors were less likely to prop up the company.

One Solyndra investor said that, in retrospect, "the worst thing that happened to Solyndra was the loan."

The Fremont, Calif.-based company is now in Chapter 11 bankruptcy protection. It is now the target of federal inquiries, including a congressional probe and a criminal investigation by the Justice Department centering on whether the company misled the government in applying for the loans. Republicans, citing emails, say the White House pushed to get the loan approved for political reasons, which the White House denies. Solyndra didn't return calls for comment on that point but has said previously it was cooperating with the investigation.

Behind the political firestorm lies a company with a business case that never quite added up, owing to a fundamental cost problem that quickly got worse after the infusion of taxpayers' money that began in 2009, according to investors, analysts and people familiar with the company.

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The company, founded in 2005, was blessed early on with influential backers. They would ultimately pump nearly $1 billion into the company.

Solyndra's largest backer was the family foundation of George Kaiser, a billionaire whose family had made a fortune from natural gas. Other venture-capital luminaries piled in, attracted with the help of Goldman Sachs Group Inc., Solyndra's financial adviser. Investors included Madrone Capital Partners, which manages money for the Walton family of Wal-Mart Stores Inc. and the Virgin Green Fund, which includes investments from Richard Branson.

The start-up's lure was a clever technology. Solyndra's name, with the play on "cylinder," illustrated its product—not a flat panel but multiple long and thin tubes covered in material to absorb the sun's rays. Other panels relied on a heavy, then-expensive material called polysilicon to turn the sunlight into electricity. Solyndra's product was lighter and potentially easier and cheaper to install.

As subsidies in Europe fueled demand and oil prices soared during 2008, the solar industry seemed poised to take off. But by 2009, the industry was undergoing severe growing pains, and Solyndra was hit hard. Polysilicon prices were in the midst of an 80% dive. That made Solyndra's product less competitive with rivals that used polysilicon.

Solyndra's costs stayed relatively high because of the tricky manufacturing process. In late 2009, Solyndra's tubes cost $4 for every watt of power output to produce, according to company securities filings. The problem was the company could sell them for only $3.24 per watt. One reason for the losses: the company often had to throw out defective or test panels, according to one former production executive.

As it was losing money, competition was getting worse. China's solar panels were dropping in price. U.S. rival First Solar Inc., was making panels at less than a quarter of Solyndra's cost then and today produces panels at about 75 cents per watt. In 2009, Solyndra lost $172.5 million on revenue of $100.5 million.

"The change in expectations was pretty dramatic," said David Miller, spokesman for Solyndra, about the pricing of its panels. He said analysis of what went wrong and what should have been done is easier in retrospect.

The company still exuded optimism. In a July 2009 press release, it said it had a "contractual backlog of more than $2 billion" in orders. The figure was based not on firm orders, however, but largely on "framework agreements" that allowed customers to walk away or renegotiate, according to a filing for an initial public offering from 2010. Its main customer, Phoenix Solar AG, renegotiated in its favor in early 2009, according to Murray Cameron, chief operating officer at the German installer.

In mid-2009, Solyndra had a choice: It could hunker down with its existing factory and try to slash costs to meet competition, drawing on additional private capital as needed, according to the people familiar with the company. Or, with a loan from Uncle Sam, it could gamble and build a brand-new, bigger factory in a bid to gain economies of scale and dominate the market.

The Obama administration was eager to help. The loan-guarantee program dated to the George W. Bush administration—it was created in a 2005 energy law—and now was swimming in funds from the economic-stimulus package.

Solyndra's founder and chief executive at the time, Chris Gronet, decided to go for the gamble. "Chris was really a hard driver," said the former executive involved in the production of the solar panels. "The faster you solve problems, the faster you build your infrastructure, the quicker you are to market. You spend money to solve problems."

There was another motivator—Solyndra's management and investors had an eye on an initial public offering.

"There was a perceived halo around the loan," said an investor with knowledge of the company. "If we get the loan, then we can definitely go public and cash out."

In December 2009, Solyndra made its initial IPO filing, with Goldman Sachs and Morgan Stanley as lead underwriters.

The company brought in 3,000 workers to build the factory taxpayers had funded, but it quickly realized it had far too much capacity. The old factory alone could be outfitted to produce each year panels with power output of 110 megawatts each year. And the new factory would add another 500 megawatts. Yet sales for 2010 ultimately reached only 65 megawatts.

"The mindset of the management was if we make it, people will buy it," said the former executive. But the new factory added heavy fixed costs such as payroll, lease payments, and utility bills. At the same time, projected revenue wasn't coming in, magnifying the monthly drain of cash, the former executive said.

In June 2010, only weeks after President Barack Obama visited the company, the Solyndra board gave up the IPO plans. The following month Mr. Gronet left his CEO post and became chairman. The new CEO, Brian Harrison, shut down the old factory.

That didn't work either, as the tricky cylinder manufacturing equipment continued to keep costs high. Messrs. Gronet and Harrison couldn't be reached for comment.

And Solyndra realized, too late, that it was a mistake to sell its product mainly through distributors, according to one of the investors and the executive. They say Solyndra could have better pitched its product's advantages, such as a lower installation cost, by speaking directly to customers.

In March, Mr. Harrison said the company made a mistake of not focusing enough on market development. He said it was important to communicate directly to customers, rather than to just resell through distributors.

The new panels also were harder to finance because their performance was difficult to forecast accurately, said Arno Harris, chief executive of solar-project developer Recurrent Energy. He said his team considered purchasing Solyndra panels several times but decided that neither the economics nor the technical design made sense for his company.

Earlier this year, private backers advanced another $75 million in a loan to Solyndra, and, unusually, got ahead of the federal government in the event of a liquidation. This August, Solyndra needed still more money. The government was in talks to restructure its loan but eventually declined.

With no options in sight, the company pulled the plug, filing for bankruptcy and laying off about 1,100 employees—leaving investors to rue what might have been.

"We had a perfectly good factory," said one of the investors. "That would have been a better size for the market."

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