Azure Power

Fourth Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Nathan Judge – *Investor Relations*

Inderpreet Singh Wadhwa – *Founder, Chairman, Chief Executive Officer*

Sushil Bhagat – *Chief Financial Officer*

PRESENTATION

Operator

Good day, and welcome to the Azure Power Fiscal Fourth Quarter 2018 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press start then two. Please note this event is being recorded.

I would now like to turn the conference over to Nathan Judge, Investor Relations. Mr. Judge, please go ahead.

Nathan Judge

Thank you. Good morning, everyone, and thank you for joining us. After the close on Friday, the company issued a press release announcing its financial results for the fourth fiscal quarter of 2018, ended March 31, 2018. A copy of the press release and the presentation are available on the Investor section of Azure Power's website at azurepower.com.

With me today are Inderpreet Singh Wadhwa, Founder, Chairman, and Chief Executive Officer, and Sushil Bhagat, Chief Financial Officer. Inderpreet will provide a business update and Sushil will discuss our fiscal fourth quarter financial performance. Inderpreet will finish our prepared remarks by reiterating our fiscal 2019 guidance. After this, we will open up the call for questions.

Please note our Safe Harbor statements are contained within our press release presentation materials and are available on our website. These statements are important and integral to all our remarks. There are risk and uncertainties that could cause our results to differ materially from those expressed or implied by such forward-looking statements. So, we encourage you to review the press release we furnished with our Form 6-K and presentation on our website for a more complete description.

We also contain in our press release and presentation materials, our certain non-GAAP measures that we reconciled to the most comparable GAAP measures, and those reconciliations are also available on our website and in the press release and presentation materials.

It is now my pleasure to hand it over to Inderpreet Singh Wadhwa, Founder, Chairman, and Chief Executive Officer.

Inderpreet Wadhwa

Thank you, Nathan, and good morning, everyone. Slide 4 summarizes our mission and core values, which are critical to our long-term success. Our mission continues to be the lowest cost power producer in the world, and this is not the same thing as having the lowest selling price of power in the world. Core to our criteria as a company are four values: excellence, honesty, social responsibility, and entrepreneurship. We strive to uphold every one of these values in everything we do.

We have created a leading solar platform in India, which is one of the fastest growing and largest solar markets in the world today. Our portfolio now stands at 2,146 megawatts as of June 15, 2018, of which we have 1,953 megawatts of utility scale projects and another 193 megawatts of commercial and industrial projects.

In 2018, we entered into the rural electrification market and we electrified 320 households in the eastern state of Jharkhand in India. There are about 29 million households in India without electricity today, and this represents a very large market for our Azure M Power solution that we launched last fiscal year. We have secured over 1 gigawatt of projects for our pipeline with high tariffs in India, ahead of schedule, weighted average tariff is about 3 rupees per unit or about $0.046 per kilowatt hour. These projects are expected to be executed over the next two years, thus ensuring high visibility for our 2019 projects.

We have a history of strong execution and growth. We have delivered $118 million approximately in our revenues last fiscal year and, with the projects under construction and committed pipeline, we expect to deliver a further 129% growth on top of this to approximately $270 million in revenues. And, almost three quarters of this run rate revenue comes from our operational and projects that are already under construction. So, we believe there is very little risk to achieving this revenue target.

Even though we have seen significant top line growth, we have remained committed to reducing costs. Since 2011, we've been able to reduce our project costs by 85%, and we are particularly proud of the 86% reduction we have achieved in balance of system costs during the same time. We believe that balance of system costs are a clear indicator of our execution strengths as we have a direct impact and control over these costs. We have about six patents pertaining to balance of system projects in process and we have one of the largest solar research and development teams in India. We believe that we are cost leaders in the India solar market with continued reduction in module pricing and balance of system costs through innovation for our pipeline projects. We expect to deliver higher returns to our shareholders.

We have been very successful at winning quality contracts over the past year. Importantly, the contracts we have won over the past year are with strong counterparties. We now have 74% of our off-take contracts with counterparties that have credit ratings of A to AAA by domestic rating agencies, which is up 25% from FY17.

Our business is also more diverse now. We now have eight states that represent 10% or more of our megawatt capacities, which is up 33% from FY17. Our rooftop business continues to grow as well. Our operating under construction and committed capacity is now 193 megawatts, up 93% from FY17; our operations are across India, in 23 states and over 2,300 roofs. The tariffs in the segment are around $0.08 per kilowatt hour or 98% higher than the lowest bid in the market, thus resulting in some of the highest returns in our business in this segment. Our off-take credit quality is very high, with almost 89% counterparties having domestic debt rating of A or higher, which is up 17% from 2017.

We entered in the rural electrification market in 2018, and since then we have electrified 320 households across 11 villages. The benefits are many, some of which we expected and some we did not. We are saving consumers about 88% compared to alternative fuel costs, which is mostly kerosene in these areas. As expected, there are many health and social benefits as well. Families can now cook and children can now study at night. One benefit we were not expecting, though, has to do with elephants. Previously, homes were destroyed by elephants at night. Now there is electricity which lights up the village at night, and since our projects came online there have been no sightings of elephants in the village at nighttime. So, it's a big relief for people who live in these conditions.

We continue to be successful winning projects with some of the highest tariffs in the market. These projects offer attractive returns that are well above our cost of capital. Since the end of fiscal year 2017, we have secured 1,078 new megawatts with an average tariff of $0.046 per kilowatt hour on the pipeline, which is among the highest tariffs in the market for large scale projects, almost 23% higher than the lowest bid in the market. Eighty-eight percent of our contracts in the pipeline are with off-take, with counterparties that have a domestic rating of A or higher. This is a direct result of the strong platform that we have built over the past decade.

With regards to commissioning of projects, we've put 352 megawatts into service, up 54% from FY17.

And, these projects have an average tariff of about $0.076 per kilowatt hour. Including these commissioned projects, our total operating fleet now stands at 1,003 megawatts. In particular, we are pleased with our ability to be able to address the hurdles and find solutions with government for our solar park projects by completing our UP40 megawatt and AP50 megawatt projects ahead of our revised schedule. Our integrated business model not only enhances returns but also lowers our execution risk.

The industry backdrop in India remains very favorable. At a high level, the India economy continues to grow more quickly than most major economies in the world today. More and more people are getting access to electricity. Solar seems to be the preferred energy of choice for many reasons, including being a low-cost source of supply, having the highest amount of production during daytime when it is most needed, and delivering power where it is needed. Solar is even more economically attractive given the 60% jump in the spot power prices in India to about USD $0.075 recently compared to recent solar contracts that are in the $0.04 to $0.05 range.

It is also important to note that after many years of declines, tariffs are now rising in India. So far this calendar year, we have been able to bid more effectively and our weighted average realized tariff has been approximately 23% above the lowest bid in the market last year.

More solar capacity was added in India in the last fiscal year than any other source of energy. Specifically, solar capacity increased to 9.4 gigawatts of new additions, which is up 69% from FY17 and at the same time coal capacity additions were down 28% to 5 gigawatts in FY18.

Recently, the government announced that solar additions were likely to exceed previous targets, that they have now raised their goal for installing about 113 gigawatts of solar capacity by the year 2022, which used to be 100 gigawatts previously. The current expectations are for about 30 gigawatts of solar capacity to be auctioned this year and the next year.

There have been some recent solar policy changes in China that will result in oversupply of modules, which is likely to be available in markets such as India and will push down module prices closer to the cost of production, which is likely to benefit our returns in the pipeline projects.

There continue to be positive developments on the regulatory front as well in India. About USD $3.7 billion was allocated to state distribution companies to incentivize solar rooftop projects. In addition, the restructuring program called Uday to improve the health of distribution companies in India appears to be working, as these distribution companies are not losing nearly as much money now compared to a few years ago prior to this initiative.

There is also good news on the import tariff and anti-dumping front as well. In short, all of these have been either rescinded, terminated, or still under deliberation. More importantly, the government of India has reiterated its commitment that any duty, if implemented, would be on a prospective basis and the duties would be allowed to be a pass-through to the consumer under the change in the provisions of our contracts. Overall, we continue to expect this will have no significant impact on our business.

With that, I would like to pass it on to our CFO, Sushil Bhagat, who will review our fourth fiscal quarter performance. Over to you, Sushil.

Sushil Bhagat
Thank you, Inderpreet. Turning to our financial performance, we continue to record a strong growth with the number of kilowatt hours generated during the financial year at 1,236 million kilowatt hours, which represents 100% increase compared to the previous fiscal year. We had 1,871 of operating and committed megawatts as of fiscal year end 2018, up 75% than the prior fiscal year. Including 275

megawatts of wins that we have secured after March 31, 2018, our portfolio would have been 2,146 megawatts, which is little more than the twice of number that has stood at the financial year end 2017.

Our operating projects cost per megawatt was up 3% for the fiscal year 2018 when compared to the previous fiscal year. However, the project cost per megawatt was higher due to high cost of domestic modules as required by our purchase agreement, but also contributed by land which was purchased and overloading, which was done to maximize generation compared to the previous year when lower-cost open source modules were used, leased land was used in the corresponding previous period. Adjusting for this, we estimate that the operating costs per megawatt would have declined approximately 10% year on year.

Our fiscal year 2018, revenue was $118 million, which was in line with our guidance and which represented an 84% increase from the previous fiscal year as we commissioned new projects. We were able to leverage our platform and capitalize on the economies of the scale, and increase our EBITDA at a faster pace at 93%. For the fourth quarter, the revenues were $35 million, representing a 71% increase YOY, while our reported EBITDA was $25 million. Our interest expense during the fourth quarter was $12.8 million, as we have been able to lower our costs of financing for the year.

Our balance sheet remains well capitalized and continues to grow as we add new projects to our portfolio. Property, plant and equipment increased to $869 million, up 38% from the prior fiscal year end. Net debt was $679 million as on the 31st of March 2018. Our liquidity position continues to remain strong. We are beginning to see significant cash flow from operations as our portfolio grows, and for the quarter we recorded $22 million from cash flow of operations. We ended the quarter with $186 million of cash and cash equivalent, including restricted cash. We also had undrawn project debt facilities of $52 million at the end of the quarter. And, we also have $122 million of working capital facilities, which we can draw on as and when we do.

We believe we are well positioned to finance the projects we recently won. As a result of reducing our loan balances, following the issuance of our Green Bond in August 2017, our borrowing capacity at the banks has increased. In addition, the Green Bond would release additional cash over its tenure, which can be used for funding of growth. We continue to have support of our large shareholder CDPQ, which has a ROFO on our assets, where we can grow our portfolio by bringing in CDPQ as a minority equity investor in our projects without existing shareholders' dilution. In addition, we believe we have a full range of other options for funding growth.

With this, I'll now pass it over to Inderpreet to discuss our initiatives to enhance shareholder value as well as guidance.

Inderpreet Wadhwa
Thank you, Sushil. We continue to record strong growth year-in and year-out. Since our IPO in October 2016, we have increased our revenues 150% to $118 million. We have more than doubled our portfolio from 965 megawatts to 2,146 megawatts. We have constructed over 657 megawatts and we have filed over 6 technology patents. We expect growth to continue. We continue to win contracts with among the highest tariffs in the market. We have secured our 2019 pipeline ahead of schedule. We should realize another $152 million of revenue growth, up 129% from the fiscal year we just reported once that pipeline has been completed and operating for a full year.

As we look out into this next fiscal year, we expect costs will decline even further as we realize efficiency gains on our balance of system costs and potentially benefit from the lower module costs given the recent developments in China, thus improving our returns further. We believe we are on track to meet our guidance previously shared with you and will deliver high growth in fiscal year ending March 31, 2019.

We continue to expect to have 1,300 to 1,400 megawatts operating by end of our fiscal year and revenues between $143 million to $151 million in the same time frame.

With this, we will now take questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two.

The first question today comes from Mr. Maheep Mandloi with Credit Suisse. Please go ahead.

Maheep Mandloi Hi I'm **Maheep Mandloi** from Credit Suisse. Thanks for taking the question. You plan to build more than 1 gigawatt projects over the next year. Could you talk about how many of those have already secured modules? And as a follow up, can you also talk about the pricing mechanism for these solar modules? Are those spec to the spot market or logged in a few months ahead of the COD? Thanks.

Inderpreet Wadhwa
Sure. Thanks, Maheep, for the question. We have locked in partly modules for one of our large projects that we are constructing this year, which is the project in Gujarat, the 260 megawatt project. And, the remaining contracts are under negotiation. So, from a timing standpoint, we are in a position to take advantage of the recent downturn that we see. And, even the ones that we have secured are done at very attractive prices. When we do the next earnings call, I think we will be able to share the all-in achieved cost targets for the Gujarat project. But, if you look at the other projects, their commissioning is towards the end of the financial year for this year. So, we have time to conclude the module contracts on those.

Maheep Mandloi Just switching gears to growth, you already have 2.1 gigawatts of contracted portfolio right now, which is well funded with the existing liquidity I just said. How much growth can be funded beyond this 2.1 gigawatt using the existing surplus cash, or rather how should we think about growth at this time?

Inderpreet Wadhwa
Maheep, I think, as we sort of mentioned in our last call as well, that what we are constructing at the moment we are adequately funded for those projects. And then, the cash from those projects can subsequently be used to build more megawatts. Then this is something that does work in perpetuity based on the cash flows we generate, or free cash flows we generate from these projects.

Having said that, we also believe that India is on a very high growth trajectory. And given that trajectory, and given that desire of the government to get 113 gigawatts by 2022, we believe that Azure has an opportunity to be extremely successful alongside this backdrop. And, to do that, we are deliberating internally what is the right growth for the business next year and the year after, so both 2019 and 2020. And, we expect to continue those deliberations when we talk about the next quarter results, so we'll be able to give you a better color in terms of how we are looking at capital for future growth beyond internal accruals.

So, at this point, I just reiterate the fact that projects we are building now are funded witth the balance sheet and project finance. And, projects in 2019 and 2020 we are deliberating internally, what's the best way of funding those.

Maheep Mandloi And, just the last question from me. Could you talk about what you're seeing on the cost of debt or interest rates in the domestic market in India, especially given the recent rate hikes and expected rate hikes this year? How's that impacting your debt for the projects which are yet to come online? Thanks.

Inderpreet Wadhwa
Yes, so I think we don't see any significant movement from where we sit. But, of course, we've not achieved financial approval here for every project that's in the pipeline. But, at least the ones that we have gotten into negotiations with our financial institutions, while there is a slight increase on the base rate, we are able to compensate that increase through a tighter spread on account of the off-take credit quality and our own track record of execution and delivery on those projects. We are also blending the traditional project finance with trade finance, which we are able to bring in at quite attractive rates compared to a long-term project finance.

So, we feel that what we have guided the market to in terms of the cost of finance will continue to meet it or perhaps in some cases even beat it going forward.

Maheep Mandloi Thank you.

Inderpreet Wadhwa
Thanks, Maheeb.

Operator
The next question comes from Philip Shen with ROTH Capital Partners. Please go ahead.

Justin Clare
Everyone, this is Justin Clare. I'm on for Philip today. So, in your prepared remarks, you mentioned that tariffs have recently been rising in India. I was just wondering if you could talk about the factors that are driving the tariffs higher and what your outlook is for the trend ahead.

Inderpreet Wadhwa
Sure. Thanks for that question, Justin. So, Justin, if you look at the chart I believe we have on slide 12 that talks about the projects where we've seen the tariffs move in the higher direction. So, I think the first and the foremost comment is that this is a function of projects being done outside of solar parks, so what we saw last year a lot of projects were being built in solar parks where you see inherently a lot of competition from companies that do not have on-ground development expertise or presence, and some of the options that have concluded in the first half of this year have been outside solar park where Azure historically has done really well because of the local knowledge and expertise and so forth. So, that is the one reason why we've seen this.

The other piece is also I believe that markets are taking into account the possibilities of interest rate hike and module price increase in these auctions as well. And, we believe that our insight into local development and balance of cost reductions and now module price as well, puts us into a unique position to build these projects at good returns. Going forward, we also feel that the fact we are cheaper than spot coal power prices in India, there will not be a lot of downward pressure on pricing through the rest of the year.

Justin Clare
Okay, great. Thanks. And then the next question I had here, in fiscal 2018 your plant load factor fell

slightly versus 2017. I think it was largely due to just lower than average insulation in the year. So, looking ahead, how should we think about the potential for improvement in the plant load factor in let's say fiscal 2019 and fiscal 2020?

Inderpreet Wadhwa
So, I think in terms of the plant load factor, we'll start seeing higher in fiscal 2020 because of projects that we are constructing now and the projects that we'll be constructing next year are going to be concentrated in high solar radiation zones and also the technology overloading that we are doing in these farms will yield a higher result. Now, exactly what those load factors will be, we'd probably sort of start talking about those once we turn those projects on. But, we expect that the portfolio average to start moving towards 19%, 20%, 21% over the next two to three years.

Justin Clare
Okay, great. And then, one final question for me, with the results this quarter you provided estimated portfolio run rate for the revenue of $242 million. I was just wondering if that number included any consideration for the overloading of plants and if it didn't what's the potential revenue that's possible with overloading of those plants.

Inderpreet Wadhwa
Yes, so actually the $242 million number does include the effect of the overloading of those projects. And, in fact, one of the other prepared remarks we actually mentioned the number $270 million, which is for 2,146 megawatts versus the $242 million number is about 1,871 megawatts, which were at the end of fiscal year. But, since then, we have won some additional megawatts. But, both these numbers do include the effect of overloading.

Justin Clare
Okay, thanks very much. I'll pass it on.

Inderpreet Wadhwa
Thank you, Justin.

Operator
Again, if you have a question, please press star then one. Then next question comes from Joseph Osha with JMP Securities. Please go ahead.

Joseph Osha
Good afternoon, everyone. Two questions. First, just looking at your commissioning rate here, obviously the pipeline of committed capacity has grown a lot. I'm wondering, is there a practical upper limit to how quickly you can commission capacity and how should we think about that?

Inderpreet Wadhwa
Yes, Joe, thanks for the question. We generally plan for what we have won in the previous fiscal year. So, for example, the capacity for the project management and execution today already is designed to deliver what we've promised in our guidance. And similarly, if you look from a planning standpoint, we added about 350 megawatts last year. This year we're adding about 400 and some odd megawatts there in the current fiscal year. And, if you go with the 2.1 gigawatt portfolio, that 400 number will then jump to 600 for next year.

So, we are still going through the planning exercise for next year at the moment. But, we believe that the increase is not that significant from the prior year that we will not have, only have an upper limit or so. So, most of the hiring has to be done in supervision off-site and that's a very easy skill set for us to hire in India and train them within a three- to four-month period. So, we ramp up that team based on what we need to deliver in a given financial year.

Joseph Osha
Okay, so there would, just to be clear, obviously you're not saying this now, but there's nothing theoretically that would prevent you from commissioning 600 megawatts in a year if that was in place?

Inderpreet Wadhwa
Yes. And, that is correct, but I'd also sort of point out that, too, in India in a year about 7, 8 gigawatts have been commissioned. So, there's enough sort of talent available to scale up that part of the construction team and get consistently right from when we were a 2 megawatt company in 2009, and then the same questions were asked, can you execute 17 megawatts in one year. And, over the years, we've now delivered 350 megawatts in the last year, and we don't see any challenges in wrapping up the construction team.

Joseph Osha
Okay, great. And, thanks. Sort of a separate question, Philip's call touched on this a little bit. What has taken spot power to $0.075? Is that coal pricing? Is it policy? What has it moved so much?

Inderpreet Wadhwa
So, we haven't done an extensive analysis on that. Some of these things are seasonal and supply-demand generated, so it's a function of availability of power and demand for power and when there's a mismatch the prices go up. And, we believe it's seasonal, but some of the experts seem to suggest that this may stay between now and the election year next year because as the country moves towards an election the government tries and ensures availability of power as key to keep better fresh in people's mind that progress is real and to make that power available based on the demand out there. The costs might go up because of fuel source availability and so forth as well.

And, there's a cyclical trend here as well that two or three years ago the prices were closer to $0.08, $0.09, $0.10, and then they came down for a bit, which was also perhaps at some point linked to the industrial growth cycle. And, we believe that the growth is starting to pick up. If you recall last year or the year before, there were a few initiatives that led to a little tempered growth, the introduction of GST taxation in India, the demonetization process. So, that did soften some of the industrial demand, which we feel is now being picked up.

Joseph Osha
Okay, thank you very much.

Inderpreet Wadhwa
Thanks, Joe.

CONCLUSION

Operator
This concludes our question-and-answer session and also concludes our conference. Thank you for attending today's presentation. You may now disconnect.