Azure Power

First Fiscal Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Nathan Judge, *Investor Relations*

Inderpreet Singh Wadhwa, *Founder, Chairman, and CEO*

S. K. Gupta, *Chief Financial Officer*

Bob Kelly, *Member, Board of Directors*

PRESENTATION

Operator

Good day and welcome to the Azure First 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 0. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your touchtone phone. To withdraw your question, please press star, then 2. Please note today's event is being recorded.

I would now like to turn the conference over to Nathan Judge. Please go ahead, sir.

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 first fiscal quarter of 2018, ended June 30, 2017. 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; S. K. Gupta, Chief Financial Officer; and Bob Kelly, Director on Azure Power's Board and the former chief financial officer of SolarCity. Inderpreet will provide a business update, and S.K. will discuss our fiscal first quarter financial performance. Inderpreet will wrap up by reiterating our guidance for fiscal year 2018, and 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 available on our website. These statements are important and integral to all our remarks. There are risks 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.

Also contained in our press release and presentation materials are 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 introduce Inderpreet Singh Wadhwa, Founder, Chairman, and Chief Executive Officer.

Inderpreet Singh 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 is 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 culture as a company are four values — excellence, honestly, social responsibility, and entrepreneurship. We strive to uphold every one of these values in everything we do. We work very closely with local communities. Our projects create several local jobs and provide a sizable amount of discretionary cash flows for the local communities.

At the end of this quarter, we had a portfolio of 1,069 megawatts of high quality operating and committed solar assets, with 771 megawatts operational at the end of the quarter ending June 30th. Our contracts remain to be with the strongest utility counterparties in India, with over 50 percent of our portfolio with Government of India entities like NTPC and Solar Energy Corporation of India, which have been rated as AAA and AA+ by the domestic rating companies of S&P and Moody's in India.

As a direct result of our careful selection of our counterparties, we are pleased to share that there have not been any curtailment on any of our power plants. We note that all of our PPAs are performing with strong payment history, with no challenges to our PPA rates. Most of our customer contracts are for a term of 25 years at fixed prices, which is to say that our tariffs are not subject to variable commodity pricing. In some cases, the contract prices are at or below prevailing alternatives for our customers, thus making solar power an economic choice for our customers.

We continue to have ready access to capital markets and are pleased to announce that we have issued India's first solar green bond. The U.S. $500 million bond has a coupon of 5.5 percent, one of the lowest rates for an Indian renewable energy company to date. We believe that the successful offering of the bond is a validation of the strength of Azure Power's platform, our superior contracts, better-than-average counterparties that include a majority of contracts with high-rated sovereign entities, strong management, extremely good governance standards as well as long-term committed shareholders have been recognized as part of the credit rating we have received from Moody's and S&P. The issuance received the highest debt rating for a renewable energy company out of India by the domestic rating agency Fitch. Fitch rated our debut bond at BB- and Moddy's rated our bond at Ba3.

Our bond offering covers 621 megawatts of our projects. The $500 million bond is a non-amortizing bond with a maturity in 2022. We have demonstrated ready access to low-cost capital for our projects in international fixed income markets. We expect significant reduction in interest rates for these projects, which are currently between 10.75 to 12 percent in rupee terms. The coupon on the bond is 5.5 percent in dollar terms, and including the hedging cost is expected to be approximately 9.4 percent. We expect to use the proceeds from this bond offering to repay the existing debt for the 621 megawatt of projects, also to fund capex for under-construction projects, and the remaining bond proceeds to be used for future growth.

We will see a further improvement of our liquidity from an upfront cash release as well as from access to cash which is currently restricted in our projects. We also expect to record a one-time charge in our next quarter financials pertaining to the unamortized ancillary costs of borrowing and repayment of existing debt for the 621 megawatt of projects.

We continue to believe that solar power is the most important source of energy for India's future. According to a recent study by CRISIL, S&P's domestic agency, solar power is the most affordable source of power, substantially cheaper than thermal power alternatives and even other renewables such as wind. Solar brings so many advantages, including greater reliability, and it is clean and sustainable. India in particular is well suited for solar given the high solar radiation levels and the matching of seasonal demand peaks. More importantly, solar does not need long stretches of expensive transmission; solar can deliver power where it is needed. Solar continues to increase its market share and is now the cheapest source of energy in India. We believe that at the current solar prices, the long-term demand for solar power will continue to increase.

Capacity additions of solar in the past 18 months have outpaced every other renewable source of energy in India, and the government and the industry at large remain committed to the 100 gigawatt target for solar power generation in India. We also note that the demand for solar power from commercial and industrial rooftop customers has been accelerating, and often the cost of solar is less than half of the price these customers would pay to run a diesel gen set or to buy power from the local utility grid and commercial and industrial zones.

Attractive solar tariffs are having a knock-on effect on other higher cost of energy alternatives. As of May 2017, almost 13.7 gigawatts of delayed coal-powered projects have been cancelled, and there is limited growth for wind at current feed-in tariffs. There have been no cancellations or curtailments in our projects.

Turning to our first fiscal quarter performance, we commissioned 120 megawatts, including a large 100-megawatt project in Andhra Pradesh, which is situated in one of the world's largest solar parks in Kumool in Andhra Pradesh. We continue to report strong growth with operating megawatts more than doubling to 771 megawatts as of June 30, 2017. We had 1,069 of operating and committed megawatts at the same time, 11 percent more than the same date in the prior fiscal year. The increase in capacity has helped us achieve our highest revenue of $29.1 million for the quarter, an increase of 84 percent over the comparable quarter a year ago. We were also able to increase our adjusted EBITDA by a higher 89 percent for the fiscal year ended March 31, 2017, compared to the prior fiscal year.

On the cost side, we saw 89 cents per watt, which is a 1 percent reduction over the same period last year. Primarily the reason for a lower drop in the cost structure is the 100 megawatt project that we've built in Andhra Pradesh required domestic module sourcing and was also built inside a solar park, where historically we have leased land and amortized our land costs over the life of the contract, whereas in the solar park, we have to pay upfront fees for the purchase of land — lease rights of land, but that payment is made upfront. We've also now started to overload our projects. In this particular project, we have added 18 percent additional solar capacity over 100 megawatts, so essentially a 118 megawatt construction on this project. That gives us a much higher yield and better LCOE. But we are in line with market with regards to benefitting from the fall in prices of Chinese solar panels in the projects going forward as well. We are also pleased to report a profitable quarter with a net income of $3.2 million in this fiscal quarter.

I will now turn the call over to S. K. Gupta, our CFO, to discuss the financial performance of our first fiscal quarter.

S. K. Gupta
Thank you, Inderpreet, and a very good morning to all of you. During our first fiscal quarter of 2018, revenue grew by 84 percent to $29 million over the corresponding quarter of last year, as we commissioned new projects. We continued to deliver EBITDA expansion and reported EBITDA growth of 89 percent compared to 84 percent growth in revenue in the quarters due to the platform and economies of scale.

Looking further out, we continue to expect that we will be able to expand our EBITDA margin and grow cash flows at a faster pace than revenue. Our interest expense during the quarter increased by 26 percent from the same period in the past fiscal year, primarily due to increased volume for new projects.

With regard to taxes, we recognized $100,000 only during the quarter, all of which was non-cash. We continue to expect that our cash tax liability in 2018 will be lower than the fiscal year 2017 due to the benefit of accelerated depreciation on one of our projects.

Our balance sheet continues to grow as we add new projects to our portfolio. Property, plant and equipment increased to $730 million, and net debt was at $470 million for the quarter ended June

30, 2017. Our liquidity has remained strong. We ended the quarter with U.S. $177 million of cash and cash equivalents, including restricted cash. We had undrawn project debt commitments of $246 million at the end of the quarter. We also have $109 million of working capital facilities that we can draw on if necessary.

Beyond these sources of committed liquidity, we would also highlight that one of our largest existing investors, CDPQ, has a ROFO on our assets, where we can grow our projects without existing shareholder dilution.

Also, we expect that our liquidity will improve significantly due to the bond issuance we completed in August 2017.

Now, I'll turn it over to Inderpreet once again to read to us with fiscal year 2018 guidance. Inderpreet?

Inderpreet Singh Wadhwa
Thank you, S.K. We are confirming our FY '18 revenue guidance of $118 million to $125 million. The midpoint of this range would be about 88 percent higher than the past fiscal year. In addition, we remain on track to have 1,000 to 1,200 megawatts operational by end of the fiscal year, March 2018.

With this, we will take questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. At this time, we will pause momentarily to assemble our roster.

Today's first question comes from Maheep Mandloi with Credit Suisse. Please go ahead.

Maheep Mandloi
Thanks for doing questions. Could you talk about how big is the RFP pipeline for Azure Power right now, and have you seen any changes to the RFP activity, given recent news flow on GST or the PPA negotiations for other companies?

Inderpreet Singh Wadhwa
Yeah, I think on the PPA negotiations, we've not seen anything on the sovereign front, where largely our contracts lie, so we've seen some discussions on wind projects, and I think largely that's been going on because of the wind auction this year. You may recall, there were feed-in tariffs that in India for wind projects before the first auction was conducted earlier in the year, so when the distribution companies that saw the auction prices come down significantly below the feed-in tariffs, they started questing the feed-in tariffs contracts, which were not executed for all practical matters. So we've not seen any risks to PPAs for solar projects that we have signed.

In terms of the pipeline, I think we had mentioned that we've been looking at the addressable market for us in the range of 5,000 to 6,000 megawatts, and we continue to see that going forward as well. There has been just a slight delay, and so I would call that maybe a little bit of lumpiness in the business, and which has been the case historically as well. This is nothing new in India. The government continues to remain committed to hit the targets that they've talked about. We will see some of these auctions coming in very soon. We already have some of the bids in place as we speak, and we are anticipating some of these results also to come out in the coming weeks. So we don't see any significant risk to the overall pipeline as we have explained in the past.

Maheep Mandloi
Got that. And just could you talk about the anti-dumping petition? I know everyone's focusing on the one in U.S., but the one in India brought with the domestic manufacturers, does that impact your portfolio, or how does it change your strategy if it's in place later this year or next year?

Inderpreet Singh Wadhwa
Yeah, so I think when — as you would appreciate, that these matters take due course of time to unfold, and the petition has been filed, but also to put things in context, India has self-manufacturing somewhere between 1 to 2 gigawatts and module manufacturing somewhere between 5 to 6 gigawatts — are the numbers, and, you know, we have an ambitious plan of way more than that. So it's very clear that the imports are key to the success of the national solar mission. Our current portfolio is completely insulated from any such measures. Procurement for the current portfolio is largely in place. The orders are underway, and deliveries will happen before any results of this investigation have concluded. So from that perspective, if there is any such measure that increases the price of solar panels, that will only impact future projects and the future projects will take into account the such increased costs.

Having said that, we also believe that the reduction in solar panel prices, even going into the future, are likely to offset any significant impact to our customers on energy prices, and the fact that solar is already cheaper than the alternatives, there will not be any significant impact to the growth of the solar market in India.

Maheep Mandloi
Thanks for taking the questions.

Operator
And, ladies and gentlemen, as a reminder, if you would like to ask a question, please press star, then 1 at this time.

Today's next question comes from Jon Windham of Barclays. Please go ahead.

Jon Windham
Hi. Thanks for taking the questions, guys. Maybe, Inderpreet, if I could just get some color around the nature of the pipeline you have. Have you seen any recent move more towards distributed generation, or is it more on the utility side? And maybe as a second part of that question, can you just talk a little bit about the competitive market, about the domestic developers and the international developers, any changes you've seen there in the last three months?

Inderpreet Singh Wadhwa
Sure. So I think in terms of the competitors, we've not seen any change in the competitor landscape, but by and large, the same players that have been in the market for a while and have been doing well on various fronts, so no significant change on the competitive landscape.

With regards to the pipeline, we continue to see the pipeline across what I would call the three different areas. One is projects that are distributed in nature. We see a lot more of those coming up, and largely because the government also realizes that they are behind on their rooftop targets that they have set, so we are seeing a lot more activity on distributed generation, and we believe that we have quite an edge there and strength there, that we will continue to win in that space given our track record in that market.

We also continue to see projects both inside the solar park and outside the solar park, and if you would recall, historically, we've made much better returns in projects outside the solar park, and we continue to see those projects to come forward in the coming months. In fact, there was a non-solar park auction in the state of Tamil Nadu, that concluded with much higher tariffs than what you have seen on the solar park side earlier, and I think this was something — sometimes in July, and we saw tariffs ranging in 3 rupees, 47 paisa, versus 244 what you saw in the solar park. So our thesis continues to hold that projects outside solar park will give better returns. We decided not to sign a contract with Tamil Nadu as we continue to focus on strong counterparties, and historically projects in Tamil Nadu have not been paid on time, and there have been curtailments in the wind projects and some solar as well. So we continue to maintain our discipline on picking the right counterparties, but we don't see any slowdown of momentum either of projects on distributed side or solar parks or non-solar parks, so we continue to see that interest going forward, and we continue to participate in projects coming forward.

Jon Windham
Okay. Great. Thanks for that. And nice work on the quarter.

Inderpreet Singh Wadhwa
Thank you, Jon.

Operator
And once again, ladies and gentlemen, if you'd like to ask a question, please press star, then 1.

It looks like our next question comes from Philip Shen with Roth Capital. Please go ahead.

Phillip Shen
Hi, Inderpreet. Thanks for the questions. I wanted to start off with how we should look at volumes of installations beyond this calendar year and beyond this fiscal year. When you look at the under-construction and, bigger picture, should we think about fiscal — the next fiscal year as having a similar volume of installations or the potential for something higher than that? I know you haven't given official guidance yet, but I just want to get a feel for how we should be thinking, you know, if there have been any changes for the next year or beyond the one you've got it for. Thanks.

Inderpreet Singh Wadhwa
So, Phil, thanks for the question, and we don't give guidance beyond the current fiscal year, and we're going to stay with that policy, but all I can tell you historically, if you look at our growth rates and just focus on that, is what you should think about as the business moves. We've done a great job with our IPO on our bond offering. We are well capitalized, so from a capital perspective, we are in a very good position to build the business forward. We continue to stay disciplined on our return philosophy and quality-of-contracts philosophy. What you have seen in the first quarter is a little bit of lumpiness, which is nothing unusual that we haven't seen in the past in India, and we have a good line of sight on projects I mentioned, close to 5,000 to 6,000 megawatts in the coming months that we will be participating in. And, as and when we win additional contracts, we will make announcements on more material ones, and that should give you a better sense on growth as well.

Phillip Shen
Great. Thanks, Inderpreet. In terms of your capacity factor or plant load factor, we haven't had a chance to calculate it yet, but our initial calculations were that the quarter plant load factor was close to 18½ percent. Can you comment on if that's right, or, if not, what might be the appropriate capacity factor? Thanks.

Inderpreet Singh Wadhwa
Yeah, I think what you heard me say earlier is that we've started implementing our overloading strategy that we had shared a couple of months ago, and I think starting with this project in Andhra Pradesh, we're adding 18 percent additional capacity that gives us the further boost on the plant load factors; however, the full year effect of that will come in the next financial year. And the way we've sort of guided that, all the new projects that are coming online, you can anticipate the effect of the overloading roughly two quarters out on those plant load factors, but the 18½ number is a good historical number to go with, and the number should only move up from this in next financial year.

Phillip Shen
Great. Thank you. One more, if I may, in terms of the module pricing, and apologies if this was already discussed, as I'm balancing another earnings call as well, but in terms of the module pricing, we've heard that pricing was for, call it, 27, 28 cents in India for back-half delivery of this calendar year, and given a healthy Chinese market, a pre-buy in the U.S., it seems like the ASPs have gone up in India to anywhere between 31 and 34 cents. Can you comment on the module ASP dynamics that you're seeing in India and then what we could expect to see for your purchase — for ASPs in Q3 and 4 and perhaps even beyond?

Inderpreet Singh Wadhwa
Yeah. So, again, you know, we don't guide to forward-looking ASPs. I think your research there from the market seems to be in line with what we see. Most of our contracts that we talked about we're executing are already locked in, and so those have been locked in in the low 30s. So beyond that, we have not forecasted the 28 cent number, and we'll continue to see where the market is and where the new projects line up, but we do see a little bit of stabilization of ASPs at this point in the market, both stronger demand and the GST, which has come in in India as well, so if you take the effect of both of those, the prices are more or less stabilized in the current quarter.

Phillip Shen
Great. Thanks, Inderpreet. I'll pass it on.

Operator
And, ladies and gentlemen, our next question comes from Kanika Mayar from IFC. Please go ahead.

Kanika Mayar
Hi, Inderpreet, this is Kanika here from IFC. Just a quick question on the latest bond offering. The cost, you said is 9.4 percent. Is that the equivalent INR cost, or is it still a dollar cost? And the other question I had is do you expect any pre-payment penalties which might add to that number?

Inderpreet Singh Wadhwa

Sure. Thanks, Kanika, for the question. We'll be able to provide color on the one-time costs on the repayment of existing projects in our next financial quarter. There will be early payment fees that we will have to pay, and also there will be a non-cash component of the ancillary costs that have been historically amortized over the life of the loan. So there will be both a cash and a non-cash impact on our interest expense in the next quarter, which we'll be able to share in the financials for next quarter. The 9.4 number is the estimated rupee financing cost for the bond transaction. The dollar coupon is 5.5 percent.

Kanika Mayar
Okay. Thank you so much.

Inderpreet Singh Wadhwa
Thanks, Kanika

CONCLUSION

Operator
And, ladies and gentlemen, this concludes today's question-and-answer session and today's conference. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day. Thank you for attending.