Azure Power

Fiscal Fourth Quarter and Year End Earnings Conference Call

June 19, 2017 at 8:30 a.m. Eastern

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 morning and welcome to the Azure Power Fiscal Fourth Quarter and Year End, March 31, 2017, 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 this event is being recorded.

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

Nathan Judge
Thank you. Good morning, everyone, and thank you for joining us. Today the company issued a press release announcing its financial results for the fourth fiscal quarter and full year of 2017 ended March 31st. 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 fourth quarter financial performance. Inderpreet will then wrap up by highlighting steps the company is taking to enhance shareholder value and provide our guidance for fiscal year 2018. 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 can 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 today, 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 likely 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. Over to you, Inderpreet.

Inderpreet Singh Wadhwa
Thank you, Nathan, and good morning, everyone. Now, starting from Slide 4, it 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 is our core values, encompassing excellence, honesty, social responsibility, and entrepreneurship. We strive to uphold every one of these things in everything we do. We work closely with our local communities, and our projects create several local jobs and provide a sizable amount of discretionary cash flow for these communities.

The company has a portfolio of 1,069 megawatts of high quality operating and committed solar assets, with 651 megawatts operational at the year end, March 31st. However, today we have 771 megawatts operational. Our contracts are with the strongest utility counterparties in India. Fifty-two percent of our portfolio are from government of India entities like NTPC and Solar Energy Corporation of India, which have AAA and AA debt ratings by the domestic rating companies of S&P and Moody's.

As a direct result of our careful selection of our counterparties, we are pleased to share that there have not been any curtailments on any of our plants. We would note that all of our PPAs are performing, with strong payment history and with no challenges to our PPA rates. Most of our customer contracts are for a tenure of 25 years at fixed prices, which is to say that our tariffs are not subject to variable commodity prices. 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 the capital markets and are pleased to announce that all of our committed and under-construction projects are financed. We also recently announced that we received a loan from the State Bank of India and World Bank under the Grid-Connected Rooftop Solar PV Program, to help fund our growth in the Azure Roof Power platform. This loan that we have received is for a 15-year tenure at an interest rate of 8.35 percent per annum in rupee terms, which we believe is one of the lowest interest rates availed by a solar power company in India. The World Bank has allocated over $625 million overall for rooftop projects in India to help the country achieve a 40-gigawatt rooftop goal by 2022.

Turning to our fourth fiscal quarter performance, we commissioned 139 megawatts, including our large 130-megawatt project in Karnataka, and since the end of the quarter, we have commissioned another 120 megawatts, including 100 megawatt Andhra Pradesh 2 project.

We continue to be excited about our commercial and industrial rooftop business, as we believe our integrated business model provides us with competitive advantages in the segment over our peers. And, in addition, the returns are usually above the utility ground mount segment in these projects.

This quarter we have introduced the brand Azure Roof Power, which will be the brand for our offering to commercial, industrial, government, and institutional rooftop customers. With over 100 megawatts of high quality operating and committed solar assets across 14 states as of June 2017, Azure Roof Power has one of the largest rooftop portfolios in India. Azure's Roof Power customers include large commercial real estate companies, leading global chain of premium hotels, distribution companies in Smart Cities, warehouse owners, train corporations, and water supply companies.

During the fourth fiscal quarter, Azure Roof Power's portfolio nearly doubled from the previous quarter with the signing of a 46-megawatt project with Indian Railways. This project power purchase agreement is a 25-year fixed-fee agreement with a tariff of 4 rupees and 63 paise per unit. After considering the available capital subsidy on this project, the levelized tariff over 25 years works out to be about INR 6 rupees and 19 paise, or roughly 9½ U.S. cents. We won this project around the same time India saw new low tariffs in one of the solar parks at approximately 4 U.S. cents. Based on our analysis, our terms on the Indian Railways project are significantly higher than what we would have achieved with the lowest solar park option price.

We believe solar power has a significant advantage in India with great potential for growth. It is now at a price that is lower than the average spot price of coal power in India and thus the cheapest source of power in India. In fact, we saw over 13 gigawatts of planned coal-fired power plants cancelled in May of this year. Solar brings so many advantages, including greater flexibility and reliability, and it's clean and sustainable.

India, in particular, is well suited for solar given the high solar radiation levels and matching of seasonal demand peaks, and, importantly, solar does not need long stretches of expensive transmission. We can deliver solar energy where it is needed. And not only do we see the opportunity to participate in the 100 gigawatts of new solar capacity that the government has planned to be implemented by 2022, but also the much larger opportunity of 365 gigawatts of capacity that India needs in the long term.

There are still over 230 million people without power in India, and with India's commitment to electrification of every household in the country, in our opinion, we believe that the majority of new megawatts that we will be building in India going forward will be using solar energy.

On the industry front, recently there have been new lows set for solar power PPA tariffs in India in a few solar parks. We see increased global interest in the solar power sector in India and consistent contract quality improvements. We continue to be disciplined about our approach to winning new projects and playing to our close strengths of local development. We are sustainably winning high return projects, and our integrated business model gives us a competitive edge.

Most of our peers are global, and the cost of capital is what they bring to the table.Our development is local. We have been in the Indian solar market since the beginning, and over this time, we have put together a leading team that provides us with a skill set that many of our peers do not have. We have better local development expertise and superior execution.

At the moment, there are over 3 gigawatts of new capacity bids being across India, and there are more options to come. Twenty gigawatts of total solar capacity is expected to be auctioned in the country by 2018.

There are several other tailwinds that are supporting our growth, including the strengthening of the Indian rupee versus other global currencies. In the last 12 months, the Indian rupee has appreciated 2 percent compared to the U.S. dollar, which is the strongest move in seven years. Not only does a stronger Indian rupee make our projects cheaper and more competitive to other domestically sourced fuels, but it also makes our equity more attractive to foreign investors. We have seen stronger inflows into emerging market funds and an increased amount of foreign direct investment into India.

India is also on track to simplify their sales tax rules and has announced details of the new goods and service tax, better known as GST. The GST rate on solar modules has been set at 5 percent. Other items are still under evaluation, and we expect the GST to be applicable on or around July 1 of this year. Overall, we do not expect GST to have a material impact on our business. Further, all our PPAs for under-construction projects allow for the pass-through of any impact of GST to our customers, and we expect that future auctions will take into consideration the impact of GST.

On India's domestic content requirements, in February of this year, WTO rejected India's final appeal and upheld its previous ruling against domestic content requirements provisions for solar projects in India for private procurement. Solar Energy Corporation of India, or SECI, cancelled tenders that had DCR. Thus, SECI did not sign the PPA for our Andhra Pradesh 4 50-megawatt project, which had a DCR content requirement. We did not incur any material costs related to this project. We believe that these projects will be the reauctioned without any technology restrictions.

Further, the Indian Solar Manufacturers Associations have sought imposition of anti-dumping duty on solar panels imported from China, Malaysia, and Taiwan. The Indian solar manufacturers have sought anti-dumping duties a few years ago, and the Finance Ministry of the government of India did not implement any duties. We will continue to monitor the situation, but we do not expect any impact on our business from this matter at this time.

Going forward in the current fiscal year, we will be adopting early the updated tax accounting standard under ASC 740. We believe with the early adoption, our tax expense is expected to be lower, and, accordingly, our profit after tax is likely to increase as it will result in recognition of deferred tax assets on intra entity transfer of assets which is likely to be higher than the prepaid taxes we would have recognized earlier. And this pertains to our expenses that are incurred on account of taxes from engineering, procurement, and construction services in the company. Generally, though, our tax expense may vary significantly between quarters, as it will be impacted by deferred taxes and timing of accelerated depreciation, among other things.

So moving to our full fiscal year 2017 results, the company continues with a strong execution track record and nearly doubled our operating megawatts to 651 megawatts as at March 31, 2017. We had 1,069 megawatts of operating and committed projects as of March 31, 2017, 31 percent more than the same date in the prior fiscal year. The increase in capacity has helped us achieve our higher revenue of $64.5 million for the full fiscal year, an increase of 59 percent over the prior fiscal year. We were also able to increase our adjusted EBITDA higher by 71 percent for the fiscal year ending March 31, 2017, compared to the prior fiscal year. We generated 618 million units of energy in fiscal year 2017, which is 69 percent higher than the same period last year, and we estimate that if our entire portfolio was operational today, that it would provide us annual revenues of approximately $170 million.

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

S. K. Gupta
Thank you, Inderpreet, and good morning to all of you. During our fourth fiscal quarter 2017, revenue grew by 72 percent to $20 million over the corresponding quarter of last year, as we commissioned new capacities. We continue to deliver EBITDA expansion and reported adjusted EBITDA of 90 percent compared to a 72 percent growth in revenue during the period. Looking further, we continue to expect that we will be able to expand our EBITDA margins and grow cash flows at a faster pace than revenue by controlling costs and garnering the benefits of scale on an integrated platform.

Our interest expense during the quarter fell 6 percent from the same period in the prior fiscal year, principally due to the conversion of three CCDs which occurred when the company completed its initial public offering in October 2016. Not only did we convert them to lower interest expense and debt, it increased the amount of equity on the balance sheet.

With regard to taxes, we recognized income tax expense of $9.9 million during the quarter, which is higher than the tax expense in other quarters in the fiscal year 2017, partly due to increase in taxable income on profits generated by our subsidiaries that provide engineering, procurement, and construction services and the delay of accelerated depreciation tax benefit from the fourth quarter — fourth fiscal quarter, and which shifted to the first fiscal quarter of 2018. We expect that our cash tax level in the fiscal year 2018 will be lower than fiscal year 2017 as we recognize the benefit of accelerated depreciation in fiscal year 2018.

Our balance sheet continues to grow as we've added new projects to our portfolio. Property, plant and equipment increased to $631 million and net debt was $407 million as of March 31, 2017. Our liquidity remains strong. We ended the quarter with $220 million — $220 million dollars of cash and cash equivalents at the end of the quarte once restricted cash is included. This compared to $74 million in March 31, 2016. We also have $108 million of working capital facilities that we can draw if necessary.

We also delivered a strong partnership with CDPQ, which differentiates us from our peers. CDPQ has a ROFO on our assets where we can grow our portfolio by bringing in CDPQ as strategic minority equity partner in our running projects, without any existing shareholder dilution. We have also secured financing for committed and under construction projects for calendar year 2017.

Now, I'll turn it back to Inderpreet regarding our fiscal 2018 initiatives to enhance shareholder value and our fiscal 2018 guidance. Inderpreet?

Inderpreet Singh Wadhwa
Thank you, S.K. We have many initiatives in 2018 that we believe will enhance shareholder values. As we have shared before, we utilize four main levers to improve returns and enable sustainable growth, and here are some of the highlights of the actions we are taking in the current fiscal year in each of these categories.

As mentioned before, we are excited about the rooftop and the distributed regeneration opportunity in India. We have recently announced our Azure Roof Power program for commercial and industrial customers, and we will scale up this business. This growth segment provides diversification and offers superior returns. We believe that we have strong competitive advantages in this segment of the market and expect that this segment will provide strong growth in the coming months and years.

Next, we have reduced our balance of system costs by 84 percent since inception of the company, through value engineering. In fiscal year 2018, we are going to further improve our balance of plant system costs through larger block implementations, new material implementations, and capacity optimizations. We currently have four patents being reviewed, including our proprietary NOCC system, which provides us real-time information and allows us to maintain over 99 percent of availability for our plants.

Further, with our superior asset quality, strong counterparties, and as financing for Indian solar continues to mature, we are seeing better and better financing costs. We are taking advantage of lower rates through refinancing. We also believe we can grow our portfolio by bringing in minority-interest investors at the project level without diluting current shareholders. We'll continue to bring down the cost of financing in both our new and operating projects this year.

We have discussed the advantages of our O&M platform in an earlier update. By having our O&M capability in house, we can implement improvements in our systems sooner than our peers who rely on third-parties. We have developed a proprietary cleaning technology that is providing a step function improvement in the throughput of the plants while using 50 percent less water, with fewer man hours than manual cleaning. We plan a broader rollout this year of this kind of pending technology. Our recent adoption of theIV Curve Tracer technology allows us to better find and fix problems in our projects, and we also expect broader adoption of this technology in all our projects this year.

These are some of the key highlights of the initiatives that are planned this year to improve the shareholder value.

Moving on to our guidance for the current fiscal year, we are issuing the FY ‘18 revenue guidance of $118 on the lower end to $125 on the higher end in terms of million dollars of revenue. The midpoint of this range would be about 88 percent higher than the fiscal year that has just ended. In addition, we remain on track to have operating capacity between 950 to 1,050 megawatts by the end of calendar year 2017. We now also expect that we will have 1,000 to 1,200 megawatts operational by end of fiscal year March 2018.

With this, our formal comments end, and 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 1 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 2. At this time, we will pause momentarily to assemble our roster.

Our first question comes from William Grippin with Barclays. Please go ahead.

William Grippin
Hey, good morning, guys. I just have a question on the guidance. I think the revenue guidance is a little bit lower than I would have expected, given what you guys are targeting as far as operating assets by the end of the year. Could you just talk a little bit about what your assumptions are going into that revenue number as far as average portfolio tariff capacity factor, et cetera?

Inderpreet Singh Wadhwa
Sure. So I think in terms of the tariffs, we have published in the Appendix of the presentation, all the projects that are under construction and will be operational in the timeframe we are talking about, so tariff guidance is very clear, and it’s in there for the projects that are in the pipe.

In terms of the plant load factor, you have the historical numbers where we were not doing the capacity optimization on these projects, but the projects that we are constructing now, we expect capacity optimization of at least 18 to 20 percent over what we have done historically. And then what we had discussed in a previous update is that there is a stabilization period of roughly one quarter when you would start realizing the full potential of the generation, and that’s why we guide to the portfolio run rate as well. So some of these projects come in online during the year as we progress, but the full potential of the revenue you would realize a quarter later.

William Grippin
Got it. Thank you. And then my second question is just I’m wondering if you could give us an update on what you guys are thinking as far as refinancing some of the floating-rate debt with green bonds and if you’ve made any progress there.

Inderpreet Singh Wadhwa

So we continue to evaluate these opportunities very actively, but there's no formal announcement to be made at this point. What we have disclosed in our 20-F filings, you will see progressively that the interest rates on projects have come down, so that should give you a sense of where we are moving. I think we have seen closer to 10 percent in the projects that we have recently refinanced, and I think those disclosures are available in the 20-F as well. And we see continued improvement in the interest rates for these projects going forward as well.

William Grippin
Great. Thanks, guys. That's all I had.

Inderpreet Singh Wadhwa
Thank you.

Operator
Our next question comes from Philip Shen with Roth Capital. Please go ahead.

Philip Shen
Hi, thanks for the questions, Inderpreet and S.K. In terms of the PPAs, we know that there are these numbers out there which highlight the low end of the PPAs being one, call it the 4 cents U.S. per kilowatt hour, and we know that you guys consistently bid higher than that. So I was wondering if you could comment on where your bids are coming in these days with PPAs. And then also, how do you expect your project returns to evolve in spite of being better than the low end? As we get through fiscal '18 and then fiscal '19, how do you expect your IRRs to evolve with the lower PPAs coming online?

Inderpreet Singh Wadhwa
Yeah, so I think what we've said earlier as well, Phil, is that we continue to be extremely disciplined about our portfolio and our returns, and which you have seen again in the last quarter, the projects that we have won with the Railways is closer to 9 cents, whereas you mentioned the lowest are at 4 cents on projects like these. We are actually exceeding the returns that we've seen in some of our earliest projects last year as well, so we continue to take advantage of our local development platform and where the advantages of those platforms are. What you are seeing, the lower end of the spectrum in the bidding is in the solar parks, where foreign investors who don't have the local developing capability would be willing to do projects at relatively lower returns. And we don't intend to follow that model, and we are very clear and will continue to do that, but what we're also continuing to see is significant reduction in capex costs, both on our balance of plants as well as on the modules, and you probably know better than most folks out there, how the manufacturers are moving their ASPs in the market, and we see that trend continuing as well.

So in the last 12 months, we've seen close to 29 percent reduction on module prices, and we've seen 1½ to 2 percent improvement in efficiency as well, so it's not just that the costs are going down. We also see the efficiencies are moving up. And we will continue to maintain that drop, that our costs will fall steeper than our tariffs as we have done in the past, and I think we'll continue to see the same trend in this year.

Philip Shen
Can you put some numbers on that last point, Inderpreet, in terms of your costs could fall faster than the tariffs? Perhaps remind us where your overall system cost structure is at the end of the fiscal year that you just reported, and then how much lower could it go as we hit the end of fiscal '18?

Inderpreet Singh Wadhwa
Right. So I think for obvious reasons, we don't talk about that forward-looking cost numbers. What we can tell you where we ended up, I think, we were at about 76 cents for the previous fiscal year, which I believe, if I'm not wrong — I don't want to speculate. You can calculate — we mentioned both the numbers in our prospectus and 20-F filings, but it's about maybe 17, 18 percent it's up so far year over year at auction in our overall costs, and tariffs actually, if you look at the project we won in the last quarter at 9 cents, it is relatively like higher than where the tariffs were on those projects at the beginning of the year. So that is up slightly if you look at that particular contract — have gone up while our costs continue to move, but even if you do the weighted average math on the portfolio, you will see that our tariffs have not come down in the same ratio as our cost structure has.

Philip Shen
Great. One more for me. In April, I believe, Hareon announced that they would partner with you to develop about 118 megawatts in India and they would take a 45 percent interest in the JV. We've seen you do this in the past, which is work with certain suppliers. Can you talk about this relationship, and then how do you expect it to evolve?

Inderpreet Singh Wadhwa
So I don't think Azure has made any announcements to that effect, so we really don't have anything to add to that, but we continue to evaluate our partnerships and relationships on a regular basis and as and when we do something of that sort, we would make the announcement.

Philip Shen
Okay. Great. Thanks. I'll pass it on.

Inderpreet Singh Wadhwa
Thanks, Phil.

Operator
The next question comes from Maheep Mandloi with Credit Suisse. Please go ahead.

Maheep Mandloi
Hi. Thanks for answering the questions. Just I need a clarification on the impact of sales taxes. Does it mean that the PPAs allow you the flexibility to pass along the higher taxes, if any, which you have already contracted?

Inderpreet Singh Wadhwa
That's correct, Maheep. So all the contracts we have under construction, we have that provision that protects us from that change in taxes, so while the effect is quite minimal, but we do have the provision to pass that on.

Maheep Mandloi
Got that. And I know it's probably too early to talk anything about the petition by the Indian manufacturers, but just for us to understand, how many megawatts of modules are yet to be purchased for projects which will be constructed in the next year? Could you give any color on that?

Inderpreet Singh Wadhwa
For Azure?

Maheep Mandloi
Yeah, for Azure, yeah.

Inderpreet Singh Wadhwa
Again, we don't break it down in that detail, but I've said the majority of the procurement is done, so we don't —

Maheep Mandloi
Got that.

Inderpreet Singh Wadhwa
— anticipate any significant risks to our current portfolio. And, like I said, if there's anything that does come into play later, that would, again, be accounted for either in under construction projects, under change-in-law provisions which are very strong with our strong counterparty, or if there are new auctions, then those would take that into consideration. So we don't carry a risk which is open.

Maheep Mandloi
Okay. And in terms of the outlook for 2018 of 1 to 1.2 gigawatts, can you just talk to what is driving the upside on that guidance, and would it be more of a rooftop project or a utility scale project?

Inderpreet Singh Wadhwa
Yeah, so I think it's a little bit of both. So we are actively developing on both fronts, so we do see a clear visibility on some of those projects that we believe can be executed in this financial year, and so the key is the execution in the financial year versus just passing the threshold to the next — or the first quarter of next fiscal, so we have some line of sight on the additional contracts.

Maheep Mandloi
Thanks. Thanks for taking my questions.

Inderpreet Singh Wadhwa
Thank you, Maheep.

Operator
Again, if you have a question, please press star, then 1.

The next question comes from Onur Goker with IFC Asset Management. Please go ahead.

Onur Goker
Hi, Inderpreet. Thanks a lot for the presentation. Just a quick clarifying question. Looking at the fiscal year third quarter results, the presentation you gave in last year at that time for December, and the project cost per megawatt was 0.65 million, and now we're talking about 0.76 million for the full fiscal year, so it seems like the project cost per megawatt has actually gone up and not down. What is that due to?

Inderpreet Singh Wadhwa
Thanks, Onur, for that question, and I think what we've said earlier is we are in an annual business and not a quarterly business, so what you do see there is that the projects that we would have capitalized in the last quarter of the year had some domestic content in them, and that domestic content modules are priced higher than the open category as well, and then the other thing we

noticed in that third quarter was that there was a significant drop in the prices of panels in China, and we were able to take advantage of that drop in that particular quarter as well. So if you look at the cost that we've now talked about in the fourth quarter, this is a cumulative number, not just a quarter-only number, so some of those projects with domestic content were still under construction, but the key is year over year the cost is coming down.

Onur Goker
Thank you for that. And the second question is do these numbers, just for clarity, exclude EPC margins? Is that correct?

Inderpreet Singh Wadhwa
That is correct.

Onur Goker
And what are the EPC margins you're observing in your latest projects?

Inderpreet Singh Wadhwa
So we don't break down the margins by projects in the company, but we have given some guidance during the road show of being somewhere in the 18 percent range, and we believe we continue to maintain that or in some cases, even better.

Onur Goker
Thank you. That was all I had.

Inderpreet Singh Wadhwa
Thank you, Onur.

CONCLUSION

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