# Azure Power

## Fiscal First Quarter 2020 Earnings Conference Call

## August 12, 2019 at 8:30 a.m. Eastern

**CORPORATE PARTICIPANTS**

**Nathan Judge** – *Investor Relations*

**Murali Subramanian** – *President*

**Ranjit Gupta** – *Chief Executive Officer*

**Pawan Agrawal** – *Chief Financial Officer*

## PRESENTATION

### Operator
Good day and welcome to the Azure Power fiscal first quarter 2020 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 star then two. 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, Nicole. And good morning, everyone. And thank you for joining us. After last night's close, the company issued a press release announcing its financial results for the first fiscal quarter of 2020 ended June 30, 2019. A copy of the press release and the presentation are available on the Investors section of Azure Power's website at azurepower.com.

With me today are Ranjit Gupta, our recently joined CEO; and Murali Subramanian who also just recently joined as President; and Pawan Agrawal, Chief Financial Officer. Ranjit will start the call with some comments about his initial thoughts on creating value for shareholders and capital allocation. This will be followed by a business and industry update by Murali and an update on the quarter by Pawan and we'll finish our prepared remarks by reiterating our fiscal 2020 guidance. After this, we will open up the call for questions.

As way of introduction, Ranjit was the CEO and Murali was the Chief Operating Officer and both were co-founders of Ostro Energy, a startup that grew into one of the leading Renewables Energy companies in India with a portfolio of over 1,000 megawatts. Prior to Ostro Energy, Ranjit and Murali were Senior Executives at other private companies including Orange Renewables and Indiabulls Power. They began their careers at Schlumberger, in various field and management positions.

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 in 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 reconcile to the most comparable GAAP measures, and these reconciliations are also available on our website and in the press release and presentation material.

It is now my pleasure to hand it over to Ranjit.

### Ranjit Gupta
Thank you, Nathan. Very good morning, everyone. Murali and I joined Azure about three weeks ago, and have begun a review of the business. While we continue our review overall, we are pleased with our core assets and our team members. However, we do see many opportunities at Azure to enhance shareholder value.

We expect to provide a candid assessment of where we stand, and a roadmap to create value with subsequent initiatives in due course. In the meantime, we want to provide the principles of how we look at capital allocation and shareholder value creation. At our core, we are a shareholder returned focused management and the relationship with investors is of paramount importance to us.

It is very clear to us that only when returns meet minimum threshold, will we invest in projects for future growth. That threshold must be above our cost of capital, and must be accretive on a cash flow per share basis. We will endeavor to invest our capital wisely. If we cannot earn a return above our cost of capital on future growth, we expect to explore means of returning capital to our shareholders.

In our careers working together, Murali and I have led several companies in the Energy sector, where we created significant value for our shareholders, by following a risk mitigated approach to project selection, and being disciplined with our allocation of capital. We are dedicated to creating long term value, and the majority of our compensation vests over a long time period, and is directly linked to value creation.

In the few weeks we have spent at Azure, we believe there is an opportunity to improve returns on our operating and under construction projects. We see many opportunities to increase the company's return on invested capital by optimizing the current operating assets through efficiency gains, implementing industry best practices and cutting unproductive costs.

On under construction or development projects, we believe that through better capital structuring, we will be able to drive further efficiencies and enhance shareholder returns. On an overall basis, we need to reduce leverage and we have to finance projects more conservatively going forward. We are blessed with a tremendous opportunity for organic growth with the potential to invest at returns that are attractive. The reality is that solar is now the lowest cost source of electricity in India without subsidies.

India needs more power and solar is one of the best options to fill this need. There are 100 million-plus people in India currently without a readily accessible and reliable power supply, and the average user in India uses only a tenth of what is used in the US. In addition, there is a significant opportunity to displace polluting and expensive backup diesel generation in the rooftop segment, providing clean, sustainable power to the grid at prices that cannot be matched by any other generation today.

Today, there are government mandates to increase solar power many fold in only a couple of years. Given the sheer magnitude of attractive growth opportunities in the Indian market, it provides us the luxury of being able to selectively choose the best projects without having to run after growth that doesn't add value. This offers a significant upside to current and future shareholders. But, this growth can only be realized on a sustainable basis if we can demonstrate to our investors that we are strong stewards of your capital.

We also subscribe to the ethos that transparency breeds trust, and trust results in value creation. As a part of this review, we are looking at ways to enhance disclosure and guidance to investors to provide greater transparency. We will evaluate what other metrics we can transparently provide on our completed and development portfolio, which will enhance the trust between the company and investors.

In addition, we expect to provide a sustainability report within the next year to increase awareness of our cultural focus on improving the lives of those in our community and the natural advantage we have of providing clean, sustainable energy for generations. As mentioned earlier, we are undertaking a review and will provide a roadmap and initiatives for creating value in the near future. In the meantime, we will be asking for feedback from stakeholders to help improve our plans on what we should do to create shareholder value.

With that, I would like to pass it over to Murali.

**Murali Subramanian**
Thank you, Ranjit. Good morning everyone, ladies and gentlemen. Looking at the overall portfolio today,

the 3,351 megawatts as of June 30, 2019 are diversified across many geographies and customers. Most of the projects are located in some of the highest irradiation zones in the country.

In addition, the credit profile of our customer contracts is better than most of the industry. Almost 82% of our projects are with counterparty that are domestically rated at investment grade. The government of India related counterparty represents 62% of all our contracts. To provide a perspective of our historical performance and opportunities for growth, today we have 3,351 megawatts contracted with some of the best counterparties in India.

We have 1,659 megawatts operating and 172 megawatts under construction, as we just put 50 megawatts into service into operations in July in Rajasthan, the remaining 1,520 megawatts of our contracted pipeline are in various stages of development, and we expect our under construction and committed projects to be commercially operational by end 2021. This is expected to grow our revenues from $158 million realized over the past 12 months to $376 million in the following 18 months once our 3,351 megawatt portfolio is completed or approximately calendar 2021.

We continue to benefit from economies of scale of our platform and are driving operating costs lower as well as significantly reducing our interest costs, thereby ensuring meaningful expansion of our EBITDA and our cash flows. Specifically, our annual operations and material cost per megawatt are almost half since our IPO about three years ago. EBITDA has risen 284% over the same period.

Focusing more on counterparty credit, there have been some high profile changes. To mention the positives first, The Ministry of Power Government of India has mandated distribution companies to open and maintain adequate letters of credit to strengthen payment security for generating companies starting August 2019. The Ministry of New and Renewable Energy has also reiterated 'Must Run' status to renewable energy projects, and that PPA tariff must be paid to generating companies in case of curtailment. We view these as big positives for improving credit quality of our contracts.

There has also been some news lately about some states pursuing options for renegotiating tariffs on facilities that are operating. We have no intention of reducing our tariffs on any contract. There is significant amount of case law supporting these contracts and these states are under pressure from the central government to honor the Renewable Energy contracts in the state.

Looking at the industry and regulatory views, we have received several reaffirmations of pass through of both safeguard duties and GST taxes. However, the recovery period for these are likely to take longer than we originally anticipated.

I would now like to pass it over to Pawan, our Chief Financial Officer.

**Pawan Agrawal**
Thank you, Murali. We had 1,609 megawatts in operations as of 30th June, 2019, 59% more than what we had at the end of the first fiscal quarter of 2019. Thus looking to the end of quarter, we commissioned another 50 megawatt in July, putting the total operational capacity today at 1,659 megawatts, effectively, a total of 218 megawatts commissioned since the beginning of this fiscal year.

Focusing on project cost per megawatt, operating for the year ended 30th June, 2019. Our cost per megawatt decreased by 9% to $580,000 and this includes the impact of safe guard duties which represented about $50,000 per megawatt. As a reminder, we do expect to recover safeguard duties overtime either through a reimbursement or through an increase in our tariff. We continue to work through this and once we have better clarity, we'll provide more color to the market.

Revenues rose 40% year-on-year, however our G&A rose faster primarily due to management transition expenses. Excluding these non-recurring expenses, G&A would have been around $5.5 million which is around what we expect to incur each quarter for the remaining of this year. On our balance sheet, cash and equivalents ended the quarter at $160 million.

Property, plant and equipment increased to about $1.3 billion, a 48% increase from the same quarter in the prior year as we brought new facilities online. Net debt was $997 million as of 30th June, 2019.

Now regarding guidance, we are reiterating our guidance for fiscal year ending 31st March, 2020 and the company continues to expect to have between 1,800 megawatts to 1,900 megawatts operational by the end of fiscal.

In addition, the company continues to expect revenues to be between us to INR12.8 billion and INR13.4 billion which will translate to $185 million to $194 million using the 30th June, 2019 exchange rate of 68.92 rupee for every US dollar.

With this, we'll be happy to 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 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.

Our first question comes from Maheep Mandloi of Credit Suisse. Please go ahead.

**Maheep Mandloi**
Hi, I'm Maheep Mandloi from Credit Suisse. Thanks for taking the question. Ranjit, probably two questions for you to begin with. Could you just probably first talk about, I mean first all the color on the road map you provided is really helpful. But one thing which probably which we were looking for is if any color on new technologies or any plans to diversify away from solar, if you could touch upon that?

And the second point just, if you could just talk about the returns you expect in the market from new solar or other technologies?

**Ranjit Gupta**
Hi, Maheep, thanks for the question. As far as a diversification from solar is concerned, it's still early days. It's you know we have been in the job only three weeks, still coming to grips with our portfolio and at the moment we have lots to do as you as you heard. We have more than 1,500 megawatts to develop and construct over the next 12 to 18 months, so there's a lot going on. So at the moment, we have not had any opportunity to see whether we want to diversify out of solar. But if we do, then we will certainly let you folks know.

As far as the solar returns are concerned, that question is very pertinent in today's environment. The good thing is if you have seen how the tariffs have moved over the last few months. There has been stability in the market. There is still a bunch of new auctions being planned. And the number of participants in these auctions is steady. The tariffs are holding steady, so, the returns that the industry is looking to make remain decent. And of course, the returns will depend on the counterparty. The returns will depend on where you set up the project and several others issues related to equipment pricing and so on. But overall, given the fact that there is a lot of new auctions coming up and the fact that there are not too many or not any new participants. The same old industry that is participating, the returns remain stable.

**Maheep Mandloi**
Thanks for that color, Ranjit. And then maybe just switching gears towards probably the broader environment in the country; Murali, probably this questions for you. On the counterpart risk or tariffs, we heard the Indian government is looking to impose additional tariff barriers on sales and models in the future? I know it's pretty recent. But if you could throw any light what that proposal could look like? And how should we think about the impact of any such proposals on the projects in the pipeline or new bids out there?

**Murali Subramanian**
So the government may be considering any tariff imposition, but we are still not aware of any plans that the government has; there could be the odd press article about it. Whenever it happens they will not impact our project, because in case of all our projects as we mentioned the existing duties or the safeguard duties in the GST taxes, they are on a pass-through basis and so as far as our existing PPAs go. As far as the new upcoming capacity which we may choose to participate in auction, for sure, the entire industry will be affected by this, and it will accordingly be taken into account in the tariffs. So we don't see any significant impact one way or the other.

**Maheep Mandloi**
Got it. And then, just last question from me and I'll jump back in the queue. I don’t know if you could talk about the rate reductions in the country? How do you see the cost of financing evolving in the country in light of that? Any color on that will be helpful.

**Pawan Agarwal**
Yes. Maheep, Pawan here. So definitely, as you would have been noticing like since January there has been series of rate cuts and this was just fourth in the series, 25, 25, 25, and now 35 basis points. So as far as Central Bank is concerned and as far as interest rate environment is concerned definitely there is a declining trend. But having said that, to be very, very honest, the domestic market in terms of funding and liquidity still remain tight. And only the good projects and good borrowers are able to tap the liquidity.

**Operator**
Our next question comes from Philip Shen of Roth Capital Partners. Go ahead.

**Philip Shen**
Hi, everyone. Thanks for the questions. As a follow-up to one of the previous questions, Ranjit, I think you mentioned there's still a bunch of auctions being planned ahead. Was wondering if you could comment on the degree of participation you plan for Azure to participate in those auctions? And with that participation how much do you anticipate that you guys could win given the historical auction win rate that Azure has had?

**Ranjit Gupta**
Thanks Philip for the question. As far as auctions and participation in auctions are concerned like I mentioned, at the moment we still have a large portfolio of projects to develop and build. Almost 1,500 megawatts, we are almost doubling our capacity that we have built over the last 10 years. We are looking to almost double that capacity in the next 15 to 18 months. It's a very challenging task. So at this point in time right now we are not looking at taking part in auctions. However, we do need to have pipeline going, 18 months, 24 months, 36 months down the road and we will continue to evaluate auctions as they come out.

There are two good things at this point in time. One good thing is that we are in no rush because we have plenty of work ahead of us. And the second good thing is that the government is still committed to a large renewable energy program. So there not going to be any dearth of auctions. So whenever we are ready whether it is two months from now or six months from now or nine months from now, there will be auctions available. So we don't have to rush.

And like we mentioned on the call, our key metric for taking part in any future auction is going to be that, that particular return has to be better than our cost of capital and it has to be accretive to our earnings per share, so that is going to be the driving a mantra for us going forward. So just to reiterate very, very quickly; no plans right now, because we have plenty of work. And no worries right now because there is plenty of auctions happening.

**Philip Shen**
Great. Thanks for that color. That's very helpful, Ranjit. And as it relates to the projects that you have won, do you anticipate any of those projects dropping out of your pipeline, of your committed portfolio, because after your review you expect that the return may actually not be better than your cost of capital or cash flows may not be accretive? Of the remaining 1.5 gigawatts you expect to add, how much of that do you think could drop out of your pipeline? Thanks.

**Ranjit Gupta**
So, that's again a very, very good question, because we are in the midst of the review of the current portfolio that is operating and the portfolio that we are to develop the 1,500 megawatts. The question about not doing any of those that is very, very sensitive because obviously there is a capital return issue. There is a return on the project issue, the doability of the project issue and all of those things are very important. But apart from that, all the projects that you're doing have central government utilities, central government agencies as counterparties.

So whatever steps we take, if we decide over the next few weeks, over the next few months that there are some projects that do not meet our return expectations we will have to be very, very careful as to how we proceed to exit those projects and it will be a decision which will be taken holistically. Because we have already committed to those projects. So the decision will be holistic in nature. We have to look at the future also and we have to look at our present also before we take a decision on exiting any projects. But if there are dogs in this portfolio which we have to bid them we will seriously consider rechecking it.

**Philip Shen**
Great. Thanks Ranjit. Another question coming from your prepared remarks, you mentioned there could be some new disclosures. What kinds of new disclosures do you anticipate? If you can't speak to specific disclosures, perhaps you can talk about the types of disclosures that we have not seen so far that you're contemplating?

**Ranjit Gupta**
So, this is guidance from Nathan; our Investor Relations person who has said that, typically as Azure, we have not done disclosures that are in line with the industry. So, again it's just three weeks and we still have to get our arms around what all we have been disclosing in the past and how we can disclose more to the stakeholders. Like we also mentioned in the prepared remarks, the relationship with the investor is of paramount importance.

You folks are the ones who are providing the capital for our growth. And unless and until you folks are comfortable that we are putting your capital to good use, we will always struggle to raise the capital for our growth going forward. So, I'm not in a position right now to tell you what are the other things that we will add to our disclosure.  But if we are behind the industry in any disclosure norms, I can assure you that we will correct that and make sure that we are in the top percentile for disclosures.

**Philip Shen**
Okay, Ranjit.  Thank you very much for the color.  I'll pass it on.

**Operator**
Our next question comes from Joseph Osha of JMP Securities.  Please go ahead.

**Joseph Osha**
Thank you.  In your case good afternoon everyone.  Welcome to Azure.  There was one comment made during your prepared remarks, I was hoping we could expand on, and that was the observation that leverage needs to be reduced.  Wondering why the reason for that might be?  And then I have some other questions.

**Ranjit Gupta**
I would like Pawan to take that question.  Pawan?

**Pawan Agrawal**
Sure, Ranjit.  Thanks.  Joseph, see the idea is after the new management has joined in, the idea is to work toward deliberating and then having a leverage level which is optimal for a company in this sector. Very honestly, we haven't, as Ranjit and Murali also earlier pointed out that we, all of us, are collectively in the process of looking at in which the direction the company has been going so far and what all need to be slightly  or largely modified as the case maybe.

And we collectively believe that our leverage is currently on higher side and then we work toward  the new targets also where we are talking about raising debt at levels which is slightly less than what we used to kind of leverage in the past.  So very honestly, give us a couple of weeks more time and we'll be in a better position to give you more, definitive range of how much leverage we want to reduce.

**Joseph Osha**
Okay.  So the implication then would be not just that you might look at need to de-lever the existing portfolio, but we might see the way you all come at capital structure for new project also change.  Is that correct?

**Pawan Agrawal**
Yes.  That's correct.

**Joseph Osha**
Next question, obviously its early days yet.  I'm just wondering if we might hear some general thoughts about the philosophy of how capital might be returned to shareholders over time.  Just wondering if you have some experiences from your previous companies that you think might be germane to this situation?

**Ranjit Gupta**
That's a good question.

**Murali Subramanian**
Hi.  This is Murali again.

**Ranjit Gupta**
Yes, go ahead.

**Murali Subramanian**
Thanks Ranjit. So, the industry is witnessing a fairly rapid growth, and as Ranjit had mentioned in the past, we believe that there will be ample opportunity to deploy capitals into projects where the returns are good. However, if the industry goes into a situation where the new projects coming up do not have return which bear up to our requirement, then we will think of ways of returning this capital.

We've not had this situation in the past, only because over the last several years the country has only increase its capacity year-on-year and there is adequate opportunities to invest the money. But we will discuss and figure out ways and means of returning the capital if we come to a view that deploying more money isn't value accretive for our shareholders.

**Joseph Osha**
Okay. Thank you. And then, last question from me. You have an India now, perhaps one of the most powerful governments that has been in place in half a century. I'm just wondering what the situation with the Modi government now means for Azure and for some of the longer term goals that the Indian government has articulated in solar? And that it's from me. Thank you.

**Ranjit Gupta**
So, Joseph, this is a very important question. And the answer to this question actually has evolved over the last four or five years. When the Modi government came in earlier, it was very important for the government to push renewables because at that point in time, renewable power was still more expensive than conventional power. And that government did very well to bring in the auction regime on both the wind side and the solar side and to make sure that the capacities were auctioned and that prices were driven down.

Now in their second inning, really it's just the fact that solar and wind, in fact both the renewable energy as a whole, is cheaper than conventional power. So now it has gained momentum of its own really. This government is very, very focused on increasing the renewable energy capacity.

The targets that have been announced are 175 gigawatts by 2022 and 225 gigawatts by 2024, 450 gigawatts by 2030, so huge deployment of renewable energy has been planned by this government, but we strongly feel that now this momentum of the renewable energy industry has really become government agnostic.

And in the long term for players like Azure and other players who are long-term players, this is a fantastic place to be in, because of the fact that India still is a growing economy. People are still underserved as far as energy is concerned. And renewable energy is going to be the way of the future as far as providing energy security to the country is concerned.

**Joseph Osha**
Okay. Thank you very much.

**CONCLUSION**

**Operator**
Once again, if you have a question please press star then one. We will pause momentarily.

As we have no further questions, this concludes our question and answer session and concludes the conference call. Thank you for attending today's presentation. You may now disconnect.