Azure Power

Fiscal Fourth Quarter & Year End 2019 Earnings Conference Call

June 11, 2019 at 8:30 a.m. Eastern

CORPORATE PARTICIPANTS

Nathan Judge – *Senior Vice President of Investor Relations*

Inderpreet Singh Wadhwa – *Founder, Chairman and CEO*

Pawan Kumar Agrawal – *Chief Financial Officer*

PRESENTATION

Operator
Hello, and welcome to the Azure Power Fiscal Fourth Quarter and Year End 2019 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 telephone keypad. 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 your host today, Nathan Judge. Please go ahead, sir.

Nathan Judge
Thank you. 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 fourth fiscal quarter of 2019 ended March 31, 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 Inderpreet Singh Wadhwa, Founder, Chairman and CEO; and Pawan Kumar Agrawal, Chief Financial Officer. Inderpreet will provide a business update, and Pawan will discuss our fiscal fourth quarter financial performance, and we'll finish our prepared remarks by reiterating our fiscal 2020 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 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.

Also, on May 3, 2019 we announced the retirement of our Chairman and CEO, Inderpreet Singh Wadhwa, for personal reasons. He will continue as Chairman and CEO until a new successor is named, or December 31, 2019, whichever is earlier. Even after the new CEO joins, Inderpreet will continue to work in capacity as an advisor until December 31, 2019. The long transition period is to ensure leadership consistency at the top and to ensure there are no impacts to the business and all our stakeholders.

There are no changes to our business plan and strategy. We remain committed to our plans. We will continue to operate at the same level of diligence and high execution standards that we have upheld since our inception. We are one of the leading solar power companies in India, with a well-diversified portfolio and strong counterparty credit offtake across 24 states. We remain available to answer any questions you may have, and we assure you of our continued commitment to our mission, vision and our relationship with our stakeholders.

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

Inderpreet Singh Wadhwa
Thank you, Nathan, and a very good morning, everyone. For the first time since our inception, we have reported profit on a full year basis. Our portfolio of 3,356 megawatts is one of the largest solar portfolios in India, with fixed price contracts for 25 years, with one of the most diverse and strongest counterparty

profiles in the Indian solar market. I am pleased to report that we exceeded the top end of our megawatt operating guidance by approximately 3%. This is a testament of our strong execution on the ground.

We also made another record this year by installing 95 megawatts of our 260 megawatt Gujarat project, almost five months ahead of the commercial operations date in our power purchase agreement, owing to our integrated development, EPC, finance and operations platform and several innovations that we have done and rolled out in our development and construction techniques. We were operating cumulative capacity of 1,441 megawatts at the end of the fiscal year, and then completed another 150 megawatts in the month of April, bringing our total operating capacity of projects to 1,591 megawatts as of today.

We have commissioned approximately 422 megawatts since the beginning of this calendar year, the most we have ever commissioned in a five month period, and all of these were ahead of schedule. As a result of our strongest execution ever, our annual fiscal revenues in local currency terms were significantly higher. The translated revenue was at US$ 143.5 million, at the fiscal year end closing exchange rate of INR 69.16 to one US dollar and this met market guidance on revenues. We've also recorded our first profitable fiscal year, with EPS of $0.03.

Regarding our portfolio expansion, we won 1,485 megawatts during the fiscal year, a healthy 79% growth over the prior year. Our total portfolio stands at approximately 3.3 gigawatts and our contracted 1.8 gigawatt pipeline has a tariff, which is 10% weighted average terms above the lowest bid in the Indian solar market.

Tariffs in the last two years in India have ranged between 3.5 to 4.8 US dollar cents and seem to have stabilized, as solar is now the cheapest source of energy for new projects in India. We do not see any significant drop in tariffs at this time, and in the same time frame we believe that solar panel prices continue to drop and have fallen almost 30% in this period, where the tariffs have been largely stable for our projects in India, thus giving us an opportunity to make higher returns than our hurdle rates.

We remain well funded for our project equity from our last equity raise and do not anticipate additional fundraise from public equity markets to complete our contracted pipeline. Once our entire contracted pipeline is completed, we expect the annual run rate revenue will be approximately US$ 375 million or so. And we have materially de-risked the portfolio, as every project in our pipeline has now a contract in hand, and most have already secured critical interconnection approvals that should allow us to build projects ahead of schedules.

We continue to benefit from economies of scale of our platform, and are driving operating costs lower as well as significant reduction in our interest costs, thus ensuring meaningful expansion of our EBITDA and our cash flows. Specifically, our annual operations and material costs per megawatt are down almost 22% over the last two years. Our focus on cost control and operational efficiency gains has resulted in a 155% increase in our EBITDA over the same period.

On the construction front, we have completed 680 megawatts at 14 different sites, or nearly 900 rooftops have been commissioned across 17 states since the beginning of our fiscal year 2019. This is the most we have completed in approximately a year, thus demonstrating the scale of our operations, as the portfolio has grown.

Looking at the industry and regulatory news, we have received several re-affirmations of pass through of both safeguard duties and GST taxes. Recently, a state regulator approved safeguard duty relief for two of our projects. The Central Electricity Regulatory Commission has given favorable orders, allowing us to pass through the GST for four of our contracts. There is likely to be some mismatch in the timing between when these duties are incurred and claims are processed, however, we continue to believe that this will not have a material impact on our results.

Further, this past month in India we witnessed one of the largest democratic mandates bestowed on BJP and India government through the re-election. Now, the continuity of the government ensures that we do not expect any change in the country strategy or commitment to the 100 gigawatts of the plan. This is certainly a positive for our business. We continue to see a more accommodative monetary policy in India as well. The Reserve Bank of India has reduced the repo rate three times now over the past several months and most recently, in the last couple of days, a 25 basis point reduction was seen. This bodes well with regard to us raising additional debt at lower cost for projects in the pipeline.

As the premier solar developer in India, we are one of the few companies that have a fully integrated business model, which develop projects from beginning to end. This allows us to earn superior returns, while at the same time lowering risk for our stakeholders. Over 90% of our contracted pipeline projects are outside government solar parks. This competitive advantage is well positioned to take advantage of the increasing trend of projects being bid outside government solar parks in India. In fact, in the 2019 fiscal year, only about 17% of capacity allocated were in government solar parks, and the rest was outside, thus allowing us a much larger pool of projects to pick from.

On the projects we bid for, we have a consistent track record of winning projects at tariffs above our peers. In FY19, we were able to capture a 10% premium to the lowest bid in the market on a weighted average term on the portfolio that is yet to be constructed. We're able to do this through our proprietary bidding technology that gives us superior competitive bidding intelligence.

Even though we win projects with some of the highest tariffs in the industry, the credit profile of our customer contracts is better than most of the industry. Of the 1.5 gigawatt projects won in fiscal 2019, 85% of our projects are with counterparties that are domestically rated at investment grade. We continue to see stable tariffs, as solar continues to be the lowest cost source of electricity in India. We’re able to accomplish this, assisted by an improvement in module costs of over 30% since the end of 2017.

With that, I would like to pass the call over to our CFO, Pawan, who will review our fourth fiscal quarter performance and our guidance for fiscal year 2020. Over to you, Pawan.

Pawan Kumar Agrawal
Thank you, Inderpreet. Turning to our fiscal fourth quarter and fiscal year 2019 performance, our effective strategy and strong execution resulted in our first ever GAAP profitable year since our inception in 2008. We reported a profit of US$ 3.2 million for the quarter, or EPS of $0.08 and US$ 1.3 million or EPS of $0.03 for the full year. We had 1,441 megawatts in operations as of March 31, 2019, or about 58% more than what we had at the end of fiscal year 2018. This was on our guidance range of 1,300 to 1,400 megawatts, demonstrating our strong development expertise.

We commissioned 272 megawatts during the fourth quarter, the most that we had ever done in a three month period. Our total contracted portfolio increased to 3,356 megawatts, which was a 79% increase from the end of the prior fiscal year. Our fiscal year 2019 revenue was US$ 143.5 million, which was a 29% increase from fiscal year 2018. The increase was on account of commissioning of plants during the current fiscal and the full year impact of the revenue from plants which were commissioned during the previous fiscal.

However, this strong performance was somewhat offset by a 6% deppreciation in the rupee versus the US dollar, and we ended up reporting US$ 143.5 million, which compares to our guidance range of US$ 143 million to US$ 151 million. Our year end FY19 revenue would have been US$ 152 million or above the high end of our guidance, had the forex rate remained stable at March 31, 2018 levels of 65.11.

We reported earnings per share of $0.08 for the fourth fiscal quarter and $0.03 for fiscal year 2019. In the fiscal year 2019, we acquired a minority interest in one of our projects. For the current fiscal year, we attributed profits amounting to US$ 1.5 million, towards the non-controlling interest. Excluding the impact of the profit attributed to the non-controlling interest, our EPS for the last fiscal year would have been $0.08.

Electricity generation during the year ending March 31, 2019 increased by 497 million kilowatt hours, or 40% to 1,733 million kilowatt hours compared to the year ended 2018, reflecting additional megawatts commissioned. Project cost per megawatt operating for the year ended March 31, 2019, decreased by 12% to US$ 590,000, reflecting a decline in solar module prices and efficiency gains. Our portfolio revenue run rate, which is the revenue that the contracted portfolio should generate once operational for one full year increased by US$147 million or 64% to US$ 375 million as of March 31, 2019 as compared to March 31, 2018.

We continue to drive better margins, reflecting our ability to capture economies of scale, as we leverage our platform. Even though our revenue rose 29% year-on-year, our cost of operations rose only 26% and our general and administrative expenses increased only 11%. Full year EBITDA increased 33% from the prior year. Our interest expenses during the year was about US$ 70 million, which was about 6% lower than last year, reflecting lower interest rates and the absence of the costs related to the issuance of a solar Green bond in the prior year. An improving cost of debt has been achieved by tapping lower cost of debt in foreign markets and garnering the benefits of tightening spreads on domestic lending, as the market matures.

On our balance sheet, cash and equivalents ended the quarter at US$ 152 million. Including short term restricted cash, which is primarily designated for new projects, as well as working capital facilities, and undrawn debt, our total liquidity was US$ 393 million. Property, plant and equipment increased to about US$ 1.2 billion, a 47% increase from the prior comparable period, as we brought new facilities online. Net debt was US$ 853 million as of March 31, 2019.

Now regarding guidance, we are reiterating our guidance for fiscal year ending March 31, 2020, and the company expects to have between 1,800 to 1,900 megawatts operational by the end of fiscal year. In addition, the company continues to expect revenues to be between INR 12.8 billion and INR 13.4 billion, which will translate to US$ 185 million to US$ 193 million, using the March 31, 2019 exchange rate of 69.16 rupee for every US dollar.

With this, we will be happy to take questions.

Operator
Thank you. We will now begin the question and answer session. If you would like to ask a question, you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time we will pause momentarily to assemble the roster.

The first question comes from Maheep Mandloi with Credit Suisse.

Maheep Mandloi
Hi, Maheep Mandloi from Credit Suisse. Thanks for taking my questions. Just on the G&A and cost of operations, we saw some increase in the quarter, somewhat similar to what we saw last year on a seasonality basis. But could you touch upon the operating leverage which you expect just on these costs.
Inderpreet Singh Wadhwa

Hey, Maheep. Thanks for the question. I think, we actually, sort of even last time around talked about this a little bit is because there are certain year-end provisions that come in in the last quarter, you see a bit of a bump that is partly on account of that. But the way to look at this on a go forward basis is if you look at the annual number, and assume a certain increase based on what we have done historically, our G&A is not linear to our revenue growth, you will notice that. And while we don't give specific guidance on G&A for the next year, we believe that it will continue to be less than what it has been historically in terms of growth and EBITDA expansion should continue based on the trend we've seen in the past.

So I think that's really what it is. And I think we continue to believe that our business is more annual in nature, because of the 12 month to 18 month development cycle we have for our projects completion, and very hard to give quarterly estimates on G&A, because some of these things are more lumpy in nature.

Maheep Mandloi
And just switching on financing. I know you two spoke about the RBI and on the Banks' reduced rates, but in terms of the visibility which you're seeing out there today, what terms do you see out there for new project debt with either domestic banks or with green bonds out there? I just want to really compare it with the prior green bonds, which the prior green bond you showed at the 9.3%, and how should we think from that perspective?

Inderpreet Singh Wadhwa
Sure. To be clear, what I'm going to share with you is the statistics at the moment, but that doesn't necessarily reflect that we are drawing down our financing today, especially when it comes to the green bond. So we issued our last bond at 5.5%. We believe that some of the recent bonds issued by our peers are in the 6.5% range. But to me, those are not really apples to apples comparison, because the asset quality is very different on what they've issued, and there's also an element of other renewable energy contracts like wind in there.

We believe we will continue to benefit from even stronger balance sheet and a stronger credit over counterparties, because on an overall basis our mix of sovereign contracts has actually gone up, and as I mentioned in my remarks that almost 85% of our pipeline is with domestically investment grade. We believe that even though the interest rates may have moved from when we issued the last green bond, the strength of our contract quality will help us compress the spreads against the existing interest rates. So, we should continue to be in the 5.5% to 6% range when we look at green bond financing for our projects.

Domestic lending rates are getting better. I think in the last 12 to 18 months we've seen almost 75 bps reduction. But if you sort of go back like two, three years, we also saw some increase in domestic interest costs. That's why we actually tapped the green bonds as well. So, there's always some movement on the positive and negative, but net-net, I think we'd still be in the effective interest rate, in the domestic markets, between 9% to 10% for operational assets, because there's also construction finance, which may be slightly more expensive.

Maheep Mandloi
Thanks for the clarity. I'll jump back in the queue. Thanks.

Operator
And the next question comes from Philip Shen with Roth Capital Partners.

Philip Shen
I think last year you guys won just under 1.5 gigawatts in auctions for fiscal '19. Looking to fiscal '20,

what kind of potential do you see in terms of gigawatts additions and additional projects to your committed pipeline? Can you talk about some of the upcoming tenders you plan on participating in and discuss the potential for cancellations after auctions are completed as well? Thanks.

Inderpreet Singh Wadhwa
Yes. Thanks for the question, Phil, and I'll probably just take the questions in the reverse order of how you asked them. The effect of tender cancellations and so forth, I think the governments have gotten used to a certain tariff level, which as I also had in my remarks, between 3.5 US dollar cents to let's say 4.5 US dollar cents. So anything that's sort of upside of that band, there will be resistance from the counterparties.

And they've always historically had this provision to cancel a contract if it's not signed. I mean, I shouldn't say cancel a contract, cancel a tender. The contracts are not cancelled, they're generally binding. So what we have seen is cancellation of tenders after the price discovery. And that's the right that the customer has always had these years. But we've seen a little bit more of that. But also, that was sort of adequately compensated with the number of auctions that happened, and despite that we were able to demonstrate a very high win on the projects in the last fiscal.

In terms of growth, the fact that the same government has come back into office and the same set of people are driving the renewable energy and solar agenda, we don't expect any slowdown on that process. As we speak, the auctions are coming in, the tenders are coming in. I think probably in that presentation we've mentioned some numbers that we are tracking, but we've been very disciplined about taking projects that give us the highest credit and highest returns, way above our cost of capital, and we'll continue to follow that model.

We've shied away from giving any megawatt guidance on a go forward basis on portfolio. We always talk about operational assets, which is again a factor of the discipline we follow, right? We're not going to be chasing megawatts. We're going to be chasing meaningful returns. And if that number happens to be better than last year, we'll do better than last year. If that number comes out to be below where we were last year, we'd be happy with that as well.

So we have enough work to do, but historically, we've seen ourselves in the 5% range of the overall market and will continue to be in line with market growth.

Philip Shen
Thanks, Inderpreet, for that color. As it relates to capex, apologies if I missed it, but for FY19, can you share your overall annual capex number. And we'll be able to back into the capex per watt, but perhaps talk about kind of where you guys were in fiscal '19, total capex and capex per watt, and then what those expectations are for fiscal '20 on a unit basis as well as total capex level. Thanks.

Inderpreet Singh Wadhwa
Yes, We've sort of published the number on the project cost per megawatt at the fiscal end exchange rate, we were at roughly $0.59 a watt on project capex. Now, I don't think I have the number handy with me, it will be somewhere in the 20-F, and we can circle back with you on the exact numbers with the team on how much we actually incurred during the fiscal year, the total amount. But the total amount will include both, we would have incurred some on development and then of course some capitalized on projects that got completed. So we can sort of give you those details separately.

I think going forward, we believe that there is still some reduction on the cost of panels. But we also believe that that reduction will probably be offset with the duties and taxes that have come into play for the projects that get built by July of next year. So pretty much anything we build from here on until the end of the fiscal year, the projects will have the element of duty. So from a capex standpoint, we don't see a significant variance between the two years. But that doesn't change the fact that our economics will be better, because the duties are a pass-through. So we will get the additional cash flow from those duties once the claims are processed.

Philip Shen
You mentioned you expect module pricing to come down, where is pricing today? We saw the 30% drop from May 31 last year through the end of the year, but I think module prices are pretty stable at this point, globally—correct me if I'm wrong for the Indian market. But, do you expect module pricing from today forward to drop some meaningful amount, and if so why?

And then shifting to a bit of a technology question as well, do you expect to embrace mono PERC technology at all, or do you still expect to focus on multi-crystalline panels? Thanks.

Inderpreet Singh Wadhwa
Sure. Yes, I think my comment, Phil, regarding the module pricing was more in comparison with the two fiscal years rather than sort of specifically month over month or quarter over quarter. So what we installed in the last fiscal was contracted several months ago, and what we are contracting now or have contracted recently that we'll be deploying now. So there is a meaningful drop between those numbers, and that setting is really where my comment was coming in. So we've seen year-over-year, roughly about a 10% to 15% drop in the contracts that we are doing.

In terms of technology, we absolutely would want more mono PERC, and even series 6, for that matter, for obvious reasons and improvement in efficiency. But we believe that the overall production of mono PERC and Series 6 allows the suppliers to supply in markets that are willing to pay a premium for that high efficiency, and as we've said before, India is not a market that pays premium. So we see largely projects in India continue to be with the multi-crystalline technology at the moment and the projects that we are doing this year are all likely to be on multi-crystalline technology.

But we continue to watch, and as the supplies increase, as the suppliers switch more and more of their lines to the new technology and higher efficiency technology, we will be able to do those installations as and when they make economic sense for our projects.

Philip Shen
Thank you, Inderpreet. I'll pass it on.

Operator
Thank you. And as there are no more questions, this concludes both the question-and-answer session as well as the call itself. Thank you so much for attending today's presentation. You may now disconnect your lines.