Azure Power

Second Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Nathan Judge – *Investor Relations*

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

Sushil Bhagat – *Chief Financial Officer*

PRESENTATION

Operator
Hello, and welcome to the Azure Power Fiscal Second Quarter 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 touchtone phone. To withdraw your question please press star then two. Please note, this event is being recorded.

I now would 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 Tuesday, the company issued a press release announcing its financial results for the second fiscal quarter of 2019 ended September 30, 2018. A copy of the press release and the presentation are available on the Investor section of the Azure Power's website at azurepower.com.

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

Please note, our safe harbor statements are contained within our press release, presentation material, 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 in the press release and presentation materials.

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

Inderpreet Wadhwa
Thank you, Nathan, and good morning, everyone. Slide 4 summarizes our mission and core values, which are critical to our long-term success. Our mission is to be the lowest-cost power producer in the world, and this is not the same as having the lowest selling price for power in the world. In fact, our 2 gigawatt pipeline has a tariff 17% above the lowest solar bid in the market. Core to our culture as a company are four values: Excellence, Honesty, Social Responsibility and Entrepreneurship. We strive to uphold every one of these values in everything we do.

So far, with two quarters in, we are ahead of our internal plans across the board, including capital raising, committed pipeline and operational megawatts. On the capital front, we have raised over $680 million this fiscal year. And most notably, in the past couple of weeks, $186 million of equity was raised in the follow-on offering. Combined, this was the most capital the company has ever raised in a similar time frame, and further, we believe it was the most capital raised by any Indian solar company during the same period.

Our strong balance sheet has enhanced our competitive advantage and bidding for new projects, which, in turn, should result in higher returns for our shareholders. On committed pipeline, we added 924 megawatts of high-quality projects. 86% of the total projects in our pipeline are with customers that have domestic credit rating of A to AAA, and almost 62% are with sovereign entities in India. Our 2 gigawatt committed pipeline has good tariffs that are 17% on a weighted average term above the lowest bid in the market, illustrating our ability to consistently add additional value for shareholders through our disciplined and value-accretive bidding strategies.

We are also pleased to note that every project in our portfolio now has a letter of award, which we believe eliminates the contracting risk of our portfolio and improves the visibility for completion of these projects for our investors. On operating projects, we are pleased to highlight that our largest project under construction, the 260 megawatt project Gujarat 2, which is outside a solar park, continues to run ahead of schedule. The Phase 1 of that project includes 95 megawatts that was completed in record time, almost five months ahead of schedule. This would not have been possible without our integrated business model and our culture of excellence. Also during the quarter, we moved almost 522 megawatts into construction, and these projects are making good progress. We feel confident that we will have between 1,300 and 1,400 megawatts operational by fiscal year-end.

From where we stand today, the company’s operations have never been stronger, and the outlook is so attractive. We have one of the largest pipelines in one of the fastest growing markets in the world, and our 3 gigawatt portfolio is contracted for 25 years with superior set of counterparties and fixed tariffs well above the lowest bid in the market.

The lowest tariff in the market has been stable for over 18 months now, even though module prices in this period have dropped by almost 30% , resulting in returns for future projects that are as good as our current portfolio, and in some instances, even better. The lower module prices and productivity gains could result in returns exceeding original expectations, which are already some of the best for solar development projects globally on certain of our projects.

Our integrated business model is providing clear differentiated advantages. We have been able to procure almost 1,300 megawatts of interconnection rights even before all the PPAs have been signed, something that is unprecedented and reduces development risk meaningfully. We have also been very successful with procurement of land outside of solar parks for our pipeline ahead of schedule, which is largely being developed outside of the government-backed solar parks, thus resulting in higher return and lower costs.

We continue to set new standards for productivity gains and cost reduction across the solar industry. The combination of superior execution of transmission development, land procurement and access to capital is allowing us to deliver projects in record time. Our balance sheet and access to capital is strong, which allows us to further differentiate ourselves versus the competition as projects are improving in size and capital requirements.

Many Indian solar companies have had limited success in raising capital this year, so our ability to raise more capital than most other Indian solar companies puts us in a very good standing. Our pipeline has some of the highest tariffs in the Indian solar market. Some of the highlights include a 600 megawatt project with Solar Energy Corporation of India and a 300 megawatt project with NTPC with tariffs of approximately $0.035 per kilowatt hour to be delivered in fiscal year 2021.

We continue to make good progress in our Azure Roof Power business, which focuses on commercial, industrial and government rooftops. We recently announced that we won 924 megawatts with a weighted average tariff of approximately $0.057 per kilowatt hour, 134% above the lowest bids in the Indian solar market. Momentum remains extremely strong in India, given that solar is the lowest cost of resource of electricity in India. Spot peak and average power prices have gone up recently, making solar even more attractive.

The average price of electricity in October was over $0.08 per kilowatt hour, compared to our recent contracts at around $0.035 per kilowatt hour. There have been instances recently where spot power prices in India have reached nearly $0.23 per kilowatt hour which were at levels not seen in nearly a decade.

In 2018, India became the second largest solar market in the world. And it is expected, by 2022, about 140 gigawatts of renewable capacity will be added online, most of which will be solar. Year-to-date, solar additions have risen about 38%, while wind has seen a 27% decline and coal capacity additions are only about a third of where they were this time last year. We are actively tracking 24,000 megawatts of auctions in process this financial year, and we expect additional wins given our strong development expertise and ready access to low-cost capital.

Recently, the safeguard duty was enforced in India on solar cells and modules for a period of 24 months at declining tariffs. We reiterate that we do not expect any material impact to our business as the contracts have changing of provisions to help mitigate duty risks. We are pleased to highlight that the 95 megawatts of Phase 1 of our largest constructed project to date at 260 megawatts, Gujarat 2, came online five months ahead of schedule, which was a record for the company, and perhaps, for the industry.

This project is with Gujarat State Electricity Board, which has a domestic credit rating of AA- and has a tariff of about $0.039 per kilowatt hour. We are pleased to start selling the lowest-cost solar power in the state of Gujarat, approximately 23% cheaper than the recent average pooling price of power in the state of Gujarat, thus making this an accretive option for the government to procure solar power from us.

We have a lot of experience of building projects in Gujarat. One of the Azure Power's first projects was developed in Gujarat, which was one of India's largest solar projects at the time of commissioning. The remaining phases of the Gujarat projects are also making good progress, and we expect to update the market if we are able to bring those phases online earlier than expected.

We moved 522 megawatts into construction during the quarter, which is the most the company has ever undertaken at one time, and we feel really good about accelerating construction in these projects. We continue to make good progress so far with all the projects are in states that where we have been operating for many years.

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

Sushil Bhagat
Thank you, Inderpreet. Turning to our second quarter of fiscal 2019 performance, we continued to record strong growth with a number of operating and committed megawatts increasing to 3,059 megawatts or 122% from the prior year fiscal second quarter. We had 1,018 operating megawatts as of fiscal second quarter 2019, about 27% more than the fiscal second quarter of 2018.

Our fiscal second quarter 2019 revenue was approximately $31 million, which was a 22% increase from the prior year same period. While the G&A increased 35% compared to the same period of the previous year, we had a onetime credit from our vendors in the prior period. Excluding this credit, our actual G&A was only up 9% from the prior period, which is in line with how we see our G&A growth based on the economies of the scale of our platform. EBITDA rose 21% year-on-year.

Our interest expense during the second quarter was approximately $17.3 million, which, when compared to the last year, was a 47% decline. This was because of the two reasons: One, the interest rates on our projects are lower compared to what they were last year; and second, we had some onetime green bond issuance costs in the prior period. Also during the quarter, the rupee depreciated by about 6% compared to US dollar, which resulted in a negative non-cash mark-to-market impact of about $3.3 million from our FX hedging. Excluding this non-cash impact from our results, we would have reported a 3 cent per share loss, which would have exceeded consensus expectations.

On our balance sheet, cash and cash equivalent ended the quarter at about $148 million. However, the amount does not take into account the approximately $186 million of proceeds received from follow-on offering that closed 10 days after the end of the quarter. Property, plant and equipment increased to $906 million, which is a 16% increase from the prior fiscal year as we brought new facilities online.

Net debt was approximately $745 million as on September 30, 2018. And again, this does not include approximate $186 million of proceeds from the follow-on equity offering. Our balance sheet remains as strong. At the end of the quarter, we had $500-plus million of liquidity, which included $200-plus million of cash, $257 million of undrawn project debt facilities and $42 million of working capital that we didn't draw on.

Following the end of the quarter, we also raised $186 million of equity from a follow-on offering and another $146 million of financing. Adding it all up, we have about $800 million of liquidity in a challenging economic financing environment, and we are well positioned to take advantage of the upcoming bids. With the closing of our equity follow-on, we now have fully funded our equity needs for our pipeline and are very well on our way to completing the debt funding of this project as well at very attractive rates. We recently agreed to a financing deal at LIBOR plus 150 basis points.

With this, I now pass it over to Inderpreet to disclose the guidance.

Inderpreet Wadhwa
Thank you, Sushil. So overall, the company is ahead of our internal plans so far this year. We have had some notable successes, including winning more projects than planned at better-than-expected returns, completing large projects in record time and raising over $400 million against a challenging economic backdrop. However, we are disappointed with the disconnect between the intrinsic value of the business and the current share price.

Since our IPO, we have nearly tripled our revenues, EBITDA and our high-quality portfolio and have become one of the leaders in the fastest growing market in the world. The returns on our existing projects and expected returns on our contracted projects are above the levels we committed to the market at the time of the IPO.

Our committed pipeline should generate free cash flow after debt service of about $150 million each year once it is completed in two years' time, and we are increasingly confident of reaching our 5 gigawatt aspiration with returns that should meet and possibly exceed the levels we have indicated to the market, but we feel the pipeline growth credit is not reflected in our share price.

We will continue to evaluate options to drive the share price closer to the fair value in the ensuing quarters. With regards to our guidance, we continue to reiterate our guidance of $143 million to $151 million for revenues and are confident to have between 1,300 and 1,400 megawatts operating by fiscal year-end.

I would like to point out that when we issued our guidance for the fiscal year at the beginning of the year in February, the rupee-dollar exchange rate was about 64, and today it is around 73. We have seen heightened volatility on the exchange rate against rupee and dollar this year. We expect it to stabilize over the next couple of months. As we report our third quarter fiscal results, we will be in a better position to refine our outlook.

With this, we will now 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're using a speakerphone, please pick up the 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.

And the first question comes from Philip Shen with Roth Capital.

Philip Shen
Hi, everyone and thanks for the questions. I wanted to touch on guidance to start. In your guidance, just the back-half revenue would be about $81 million in the second half of the year. So we know that FQ4 is typically seasonally stronger than FQ3, but can you give us a sense for how you see the mix of revenue between FQ3 and FQ4, given seasonality and the ramp-ups that you might be expecting? Thanks.

Inderpreet Wadhwa
Hi, Phil, thanks for the question. So I think because a lot of these projects that are under construction will contribute some of that in the fourth quarter revenue, but seasonally, the third quarter and fourth quarter split in the range of 45%, 55% percent wise if you were to break it down, but we'll see perhaps a slightly bigger skew because of the projects that could be coming online in the last quarter. So I would guide you towards 60-40 at this point, 60% in the last quarter and 40% in the next quarter.

Philip Shen
Okay. Great, that's really helpful for modeling. Thank you. Shifting over to SECI. Recent responses to the SECI auctions have seemed to be lukewarm with multiple auctions postponed or reduced in the past quarter. Traditionally, SECI auctions seem to be a high priority, given their credit rating and flexibility. Is this primarily caused by the ceilings that they have set on the tariffs? Or are there any other issues that you see? And how do think that impacts your outlook in general and what's your overall view of what's happening with the apathy with the SECI auctions? Thanks.

Inderpreet Wadhwa
Yes. So, I just maybe speak a little bit broadly, and then we can talk about SECI as well, and what I mentioned is that we see almost 24,000 megawatts of auctions that we are tracking. And SECI, of course, is an important and big part of all of that. But generally, the auctions continue to be oversubscribed. The ones that have concluded of late, there was an auction in UP by the state that was oversubscribed. There was also an auction down in Karnataka by the state, which was also oversubscribed.

Now coming back to SECI, there's this one auction that perhaps you are referring to that has had a challenge, which was actually for wind, and this is consistent with what we have been saying and seeing in the market that wind is not going to be competitive with solar and there are many challenges of finding the right wind sites and finding interconnection, whereas with solar you can build projects in many parts of the country.

Now with the SECI solar auctions, there has been a little bit of word on the sort of public domain in terms of tariff caps within the period of, I'd say, six to eight months, SECI has tightened the tariff caps trying to sort of capture the maximum value for the customer. And from an industry standpoint, there is a view that this is an open market, and this is a reverse auction, and why does the government have to tighten the caps? So there have been discussions on that, and SECI has sort of gone back and increased the caps back to close to the original levels.

So the tepidness that you see is largely on the wind side. On the solar, there was some discussion around tariff caps, and the size of the tenders are getting so large that SECI sort of wants to make sure that there is enough participation and the projects are not allotted closer to the benchmark, and there is some tightness on the tariffs. So there has been some of that.

Now couple that with India is moving into the election season, so several of the states are up for election this month and the next month, and then first quarter, second quarter next year, you'll have the federal elections. And when states get busy in elections, there are delays on approvals. There are delays on back-to-back sale contracts because SECI is not going to buy the power. They're actually going to sell the power to another customer.

So some of those delays have also led to extensions of auctions. But I'd also tell you the other side of this is the power prices in the exchange are going up, and we pointed out to some very high tariffs that we are seeing in the market, almost like $0.08, $0.10 a kilowatt hour. So the appetite of low-cost energy is very high, and it is just a matter of time that you will see additional auctions being concluded this year.

Philip Shen
Okay. Great, that color is really helpful. Thanks, Inderpreet. Shifting over to Rajasthan. I think there's some minor issue—well, I'm not sure if it's minor, but there are some potential issues with the solar park there with the developers securing land. And I believe you have 200 megawatts in that park slated for next year. So I was wondering if you could just comment a little bit about are you seeing any issues with that and just your general view of how that might impact your business? Thanks.

Inderpreet Wadhwa
And I think, again, so consistent with what I have said earlier, we believe that we are very strong on the ground on development and versus when government tries to do this, they generally face longer periods of resolving issues or getting things done. So there were some issues where in the park, the land was not completely acquired while rebids had been auctioned out, but that was with the first phase of projects in the park.

The 200 megawatt project that we are building is actually in the second phase of the project in the same park. So the issues that were faced in the earlier phase of the park are no longer a challenge now, so we've actually got the land and we've started our construction there. And we are making good, nice progress there. So I think the fact that we came in in the second phase sort of worked in our advantage.

Philip Shen
Great. Okay. That's it for me. Thank you very much and I'll pass it on.

Operator
Thank you. And the next question comes from Joseph Osha with JMP Securities.

Joseph Osha
Good morning, everyone or I guess good afternoon; it's morning out here in California. I'm wondering if we could talk a little bit about what's been happening in India in the financial system. It seems like the

amount of pressure around non-performing assets appears to be intensifying. I understand, of course, that you may not be as exposed to some of the state-owned banks, but I'm just wondering about how this environment is impacting your ability to raise debt financing?

Inderpreet Wadhwa
Yes. So, like I rightly said and we sort of reiterate that we are not impacted by any of the issues that you read about with the state-owned banks. Our exposure to state-owned banks is almost non-existent or negligible. We do a lot of work with private banks. We have done business with state banks earlier, but most of that was refinanced through our green bond offering last year. What's happening is really that the government is trying to get the state banks to acknowledge the stressed assets as per new regulations of the central bank, which is the Reserve Bank of India.

And these banks have historically delayed resolution of these matters in hopes that sponsors will find a way to make these projects work and a lot of these projects are, at least on the power side, on the coal power projects where either companies were not able to secure PPAs or were not able to secure fuel supply, or had issues with imports in terms of including the cost pass through to customers and so forth, but I do agree with you that these projects have stranded over a long period of time.

So with the RBI enforcement of stricter implementations of dealing with the situation has led some of the state-owned banks' inability to finance new projects. So there is tightening of liquidity on some of the state-owned banks, which, again, does not impact our business as we have a very diversified set of debt investors. But the good news is that once the issues are resolved on these stressed assets one way or another, either the sponsors will step in and resolve it or they will go through NCLT process, which is akin to sort of the bankruptcy process of the stressed assets in the United States.

The banks will then be able to clear their sort of balance sheets off of these assets and be back in business again. So really, the intent of the government is to—it's like you close your eyes, the problems aren't going to go away. So they say wake up and let's do something about it, and there are a lot of consultations, a lot of focus, a lot of meetings, and we read a lot of updates on a regular basis that there is a serious effort going on in resolving and bringing these banks back into business. So that's the idea.

Joseph Osha
Okay. So it sounds like you're comfortable with your continued ability to raise capital from your partners. Just following on with that, obviously, the rupee has moved. The rates have moved. Do you think it would be possible to contemplate another green bond offering in this kind of environment or close to this environment, or is that pretty much off the table now?

Inderpreet Wadhwa
No, I think in terms of our financing strategy and we sort of reiterated that we do bridge capital, we do project finance and we'll tap green bond markets, but tapping public markets much like equity markets, the debt markets also have to be value accretive to us. And if you just look at the bond we issued last year, it was at 5.5%. And this year, we've actually seen a couple of sovereign bonds issued out of India at 5.5%.

So the good news is that our bond was issued at where sovereign is today. So it shows the strength of the bond that we offered, so we have that ability to continue to do that going forward. But we actually feel that we are able to tap more cost, debt and spread than the bond market as we see the rates today, but we will continue to sort of monitor the public debt market rate. And then some of this is the function of interest rates going up in the United States.

So, a lot of these are linked with LIBOR. And if LIBOR moves up and we are be able to tap local rupee money or ECBs from project finance lenders at much tighter spreads, we prefer that. And when the time is right, we pull those assets and issue a bond. So there's no sort of guidance towards when we issue a bond, but we will continue to watch the markets and do that when we feel the time is right.

Joseph Osha
Okay. And then just last question on that point, given how much strength you have in the balance sheet at the moment. Is it possible that for the intermediate term, we could see you leave some of your projects perhaps a little less levered and put some of that cash to work while you wait for the financing markets to settle down a bit?

Inderpreet Wadhwa
We actually don't feel that it is that much of an issue. We just in this period, we talked about, we closed almost $150 million worth financing and we are in the process of closing something to the tune of similar numbers as well, and those are well within our expectations on financing of these projects. So we don't see that we have a challenge and hence, let's use equity instead of debt.

But having said that, we are going to be prudent on capital deployment, so we don't necessarily have to incur interest costs if we have money sitting on the balance sheet, which is idle. So we will be prudent about doing that. But broadly speaking, we will try and accelerate all our projects rather than just focus on a handful with the cash and the balance sheet. So we'll continue to raise project finance and continue to accelerate other projects, which are due to be commissioned two years out.

Joseph Osha
Okay. Thank you very much.

Inderpreet Wadhwa
Thank you, Joe.

CONCLUSION

Operator
And as that was the last question, that does conclude the question and answer session as well as the call itself. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.