Azure Power

Fiscal Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Nathan Judge – *Investor Relations*

Inderpreet Wadhwa – *Founder and Chief Executive Officer*

SK Gupta – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, everyone, and welcome to the Azure Power Global Fiscal Third Quarter 2017 Earnings call. This call is being webcast live on the Investors' section of Azure Power's website at azurepower.com. At this time, all participants are in a listen-only mode. As a reminder, today's call is being recorded.

Now it is my pleasure to hand the conference call over to Nathan Judge, Investor Relations. Sir, the floor is yours.

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 third fiscal quarter of 2017. 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 Wadhwa, Founder and Chief Executive Officer; SK Gupta, Chief Financial Officer; and Bob Kelly, Former Chief Financial Officer of Solar City and on Azure Power's Board of Directors as an Independent Director. Inderpreet will provide a business update and SK will discuss our fiscal third quarter financial performance. Then Inderpreet will remind everyone of our guidance, which we are reiterating, and then 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.

We encourage you to review the press release we provided today with our Form 6-K and presentation on our website for a more complete description. Also, contained in our press release are certain non-GAAP measures that we reconcile to the nearest comparable GAAP measures, and those reconciliations are also available on our website and in the presentation materials.

It is now my pleasure to introduce Inderpreet Wadhwa, Founder and Chief Executive Officer.

Inderpreet Wadhwa
Thank you, Nathan, and good morning, everyone. We start every presentation with our Slide 3, which 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. Core to our culture as a company are four values: excellence, honesty, social responsibility, and entrepreneurship. We strive to uphold every one of these in everything we do.

We continue to be successful in winning new projects with strong counterparties at attractive returns. We recently announced that we won a 50-megawatt project from Solar Energy Corporation of India. The Power Purchase Agreement has a 25-year fixed fee agreement with a tariff of roughly $0.065 per kilowatt hour and an additional viability gap funding of $9.4 million. This contract price inclusive of the viability gap funding is approximately 18% above the lowest solar bid in India during 2016, and this number is much greater if you look at the pricing that was discovered in an auction last week. With this win, the company's portfolio consists of both operating and committed megawatts, has reached 1,071 megawatts across 15 states in India as of December 31, 2016,

Importantly and purposefully, we have chosen to do business with the strongest utility counterparties in India. Majority of our contracts are with National Government-owned counterparties in India like NTPC and Solar Energy Corporation of India. We have 292 megawatts of contracts with NTPC that has received an AAA domestic credit rating by Crisil, an S&P rating agency, and 255 megawatts with Solar Energy Corporation of India, which has seen its debt rating recently upgraded to AA+ domestically by ICRA, a Moody's company.

As a direct result of our careful selection of our counterparties, we are pleased to share that there has not been any curtailment on any of our power plants. Most of our customer contracts are for an average 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 the prevailing alternatives for our customers.

We continue to have ready access to capital markets and all of our projects that we will construct in the calendar year 2017 have secured financing. As we look out into the calendar year 2018, we continue to see heightened interest in financing for our projects at increasingly attractive rates.

There has been a lot of focus on falling tariffs. We have seen tariffs fall, but it is also important to consider that the costs are falling at a steeper rate than our tariffs. We continue to expect that returns on our projects will remain attractive and above our cost of capital. In addition, we believe that our in-house engineering procurement construction and O&M expertise allows us to better manage our costs than companies that rely on third parties. We would further note that financing costs are coming down, and as a result, refinancing and bond opportunities for our strong assets improve project returns further.

We are pleased to start this year 2017 with the early commissioning of our largest power plant in our portfolio and also the largest power plant in North India, a 150 megawatt project, Punjab 4. Not only did this plant come on-line ahead of schedule but also below budget. As a reminder, we have signed a 25-year Power Purchase Agreement at a tariff of approximately $0.083 per kilowatt hour with Punjab State Power Corporation Limited. The 713 acres of land that was leased from the local communities is expected to create discretionary long-term cash flows for the communities for the next 33 years. In addition, the project is providing approximately 1,000 local jobs.

Azure Power has been involved with the Indian solar power sector from nearly the beginning, and we developed India's first private utility scale solar project in 2009. Our operations have grown significantly, and we now have 27 large-scale solar projects operating. Our rooftop initiative has also garnered a lot of traction and we now have 700 rooftops under implementation across the country. We believe solar is most competitive and economical for our customers at the point of consumption.

Our success is tied with the communities we serve, and we are firm believers of inclusive growth for the communities where we build projects. We prefer to hire and train staff locally and lease land from communities. The jobs and discretionary cash flows that our projects create for communities, which are often in remote locations, foster support for our projects and growth for the local communities.

Our integrated platform continues to drive a competitive advantage for us. We continue to develop projects with strong counterparties at good tariffs. Our proprietary value engineering initiatives continue to drive project cost reductions steeper than tariff reductions. The industry leading in-house operations and maintenance practices result in high availability and continuous yield improvements for our projects.

These strengths coupled with lower financings costs result in greater shareholder value and better long-term success for us. Over the past four years, our growth has outpaced the market and we expect that trend to continue.

The company looks to continue strong growth aided by an extremely supportive industry and regulatory backdrop. We believe that the industry has reached the critical inflection point where solar is more attractive than other types of generation and will grow faster than alternatives in the future. The price at which we can deliver solar electricity is far cheaper than imported alternatives. With over 300 days of sunshine in India and among the highest insolation level of leading global solar markets, solar offers the highest growth potential in India.

During the fiscal year 2016, for the first time ever, the solar installations in India have outpaced all other renewables. The solar power represents about half of all new renewable generation added so far in fiscal year 2016 compared to wind, which represented 44% of new renewable capacity added.

On the regulatory front, the Government of India is requiring utilities to purchase power from companies like Azure with an aim of increasing the amount of solar installed to 100 gigawatts by 2022 from just only 9.1 gigawatts installed today. This translates to an industry wide CAGR of 49%.

Recently, the Government of India also took another step to reinforce its commitment to green energy by ratifying the Paris climate change agreement and committing to 40% renewables by 2030, which is up from the current 15% share.

The economy continues to do well and inflation continues to be low. In fact, in 2016, the US dollar Indian rupee exchange rate only depreciated around 2%, which was one of the slowest declines in the past seven years. We expect this supportive environment to continue.

The demand for new power generation continues to be strong in India. By 2020, India needs to add 134 gigawatts of new generation capacity. The need is a result of historical power generation deficit of about 5%, robust economic growth, and the electrification of 300 million people who do not have access to electricity.

We continue to see strong demand for new solar. At the moment, there are over 4 gigawatts of new solar capacity bids being assessed across India. In addition, there is more to come. Twenty gigawatts of new solar capacity is expected to be auctioned in the country between today and 2018, which makes India one of the fastest growing solar markets in the world. We believe that Azure will be able to grow in-line with and possibly faster than the market by executing on our differentiated strategy.

We are among a few companies that have the longest track record in Indian Solar auctions from the beginning. The list shrinks even further when you consider that we are local in development and have access to public capital markets. Put simply, we believe we have a differentiated offering in one of the fastest growing global solar markets in the world.

We continue to benefit from declining financing costs as well. We have already seen debt costs fall by around 200 basis points in long-term project finance costs since 2011. A further 25 basis point reduction the Reserve Bank of India announced in October is likely to provide further additional savings for us.

We believe that the commercial and industrial rooftop opportunity in India is now reaching a critical inflection point for growth. In fact, most commercial and industrial customers see significant savings on their electricity bills by adding rooftop solar generation. Importantly, over time we expect no government subsidies in the growth of rooftop solar power generation. The economics are very compelling compared to the alternatives of diesel backups and expensive grid power.

Azure today has 52 megawatts of rooftop solar projects across 11 states and over 700+ rooftops under implementation, which we believe is amongst the largest portfolios of rooftop commercial and industrial projects in the country today, and we expect significant growth in our rooftop projects in 2017.

One recent success was with the Delhi Metro Rail Corporation, which is a joint venture, 50/50, between the Government of India and the Government of Delhi with an AA+ rating. We are executing a 14-megawatt project, the largest Delhi Metro Corporation has ever allocated to one company to power the metro stations in and around the capital city of New Delhi. Our 25-year tariff of $0.082 per kilowatt hour provides Delhi Metro Corporation significant savings compared to the local utility. We are able to utilize our EPC platform to bring on the first of the three phases ahead of schedule, on line and below budget.

The government has set ambitious targets for rooftop solar capacity, and we expect to grow in-line with the market. We believe that Azure has an advantage on account of a strong and integrated platform for utility scale projects and access to unique and global capital for rooftop projects. Recently we announced a tie up with Overseas Private Investment Corporation in the US for a rooftop financing facility of $20 million for 15 years financing, which has a current interest rate of 4.79%. This can be leveraged to provide a more attractive offering to our commercial and industrial customers. In fact, we expect that the returns on our rooftop projects will be higher than our utility-scale projects.

Regarding our third quarter 2017 results, the company has had another good quarter. Our operating megawatts grew to 512 megawatts AC and 523 megawatts DC as on December 31, 2016, which is an increase of 106% over the corresponding date last year. We now have 1,071 megawatts of operating and committed projects, which is 33% more than at the same date in the prior year. The increase in capacity has helped us achieve higher revenue of $ 14 million during the quarter, an increase of 46% over the corresponding quarter of last year. We were also able to increase our EBITDA by an even faster 49% during this quarter ending December 31, 2016, compared to the prior year. We generated 142 million kilowatt hours this quarter, 55% more than the same period last year. We estimate that if our entire portfolio was operational today, it would provide annual revenues of $163 million.

Overall, a great quarter and we're looking forward to a great year. I will now turn the call over to SK Gupta, our CFO, to discuss the financial performance of our fiscal quarter.

SK Gupta
Thank you, Inderpreet, and a very good morning to all of you. Revenue for the quarter grew by 46% to $14 million over the corresponding quarter of last year as we commissioned new projects. In addition, they were in-line with our expectations and followed a seasonality trend very similar to what we have seen in the last several years. As we highlighted in our last quarter call, our revenues during the winter months reflect fewer hours of daylight and greater fog cover during the shoulder hours on some of our projects.

Looking at costs, our cost of operations rose by 68% to $1.2 million due to maintenance costs for newly commissioned projects as well as the implementation of improved O&M methods for better plant productivity. On the G&A side, expenses rose only 31% period over period, due to an increase of lease expenses for projects under construction as well as increase in personnel expenses.

All combined, we continue to deliver EBITDA expansion and reported higher adjusted EBITDA growth of 49% as compared to 46% growth in revenues. Looking further, we 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 balance sheet continues to grow as we add new projects to our portfolio. Property plant and equipment increased to $548 million and net debt, which is total debt subtracting cash on hand and current investments, was $297 million as of December 31, 2016.

Our liquidity remains strong. We ended the quarter with $124 million in cash and current investments at the end of the period. This compared to $46 million on March 31, 2016. In fact, we are well capitalized for our growth in 2017 and beyond.

Much of this liquidity reflects our successful IPO in October in which we raised $136 million. As the first listing of Indian energy assets in the United States on the New York Stock Exchange, we believe we have an important, competitive advantage over our peers that should render many long-term benefits to us. We have better access to capital and at a lower cost. This in turn should lead to market-share gains while at the same time generating better returns. One evidence of our access to capital is that we have already secured financing for all of the projects we plan to construct in calendar 2017.

The company has drawn $78 million of project debt during the quarter and has undrawn project debt commitments of $131 million at the end of the quarter.

Now, let me turn it over to Inderpreet regarding our guidance.

Inderpreet Wadhwa
Thank you, SK. The company continues to perform in-line to slightly better than expected. As a result, we remain comfortable with our previously issued FY'17 revenue guidance of $64 million to $68 million. In addition, we remain on track to have our operational capacity between 950-1050 megawatts by the end of calendar year 2017. We plan to provide guidance on FY 2018 when we report our fiscal year's ending March 2017 results.

With this, we end our formal presentation 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 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. At this time, we will pause momentarily to assemble the roster.

Our first question comes from the line of Philip Shen of Roth Capital Partners. Please ask your question.

Philip Shen
Hi, Inderpreet, SK. Thanks for taking my questions.

Inderpreet Wadhwa
Hi, Philip.

Philip Shen
I just want to start off with PPAs. You, I think in your prepared remarks, talked about how a recent win put you guys 18% above the lowest PPA rate, perhaps in the same auction. It appears PPAs are hitting as low as three rupees per kilowatt hour or about $0.045. Can you talk to us about do you expect to continue to consistently win above the lowest PPA rates, and can you update us on your approach to doing that? Thanks.

Inderpreet Wadhwa
Yes. I think what I said in my comments as well, that as recent as December—we are here now in February—is the contract that we won is fairly attractive—that is that we talked about a project with Solar Energy Corporation of India, and of course, the auction that you're referring to concluded last week at the price you mentioned.

We also believe that the prices of solar panels are coming down and the financing costs are coming down, so while people can't make their required returns on the prices that you see in the market today, but as we will continue to maintain discipline in executing on projects that offer better than market rates to our shareholders. This has been our strategy right from the start.

Even if you look at the 2016 auctions, I think the lowest auction in 2016 was INR 4.34, and Azure does not have a single project at that number. So, looking forward into 2017, we will continue to win projects at better-than-the-lowest prices in the market. So, we are quite confident that the way we have operated our business in the last few quarters, we will continue to follow the same discipline going forward and win at better auction prices.

Again, I would also like to mention that the auction that you're referring to there's a lot of support that is being offered by government in these auctions, which Azure does not need because we have very strong local development expertise on the ground, and we are not going to pay a premium for such auctions. And we will leverage our local development and our local construction experience on transmission, infrastructure and so forth.

Philip Shen
Great. That's helpful. You know, you mentioned in your remarks that there's no curtailment in your projects, and I believe you guys are—a lot of your projects, most of them, in fact, are exposed to states where there may be power deficits. Can you just talk to us about curtailment risk in general and then how you guys are positioned relative to that, not just in the near term, but also over the longer term? Thanks.

Inderpreet Wadhwa
Yes, I think consistent with our strategy, we evaluate counterparties that first have a need for power, have a structural deficit, has a desire to secure solar, and solar is competitive. So, if those things fall in place and the counterparty credit is strong, we will evaluate those opportunities and participate in those auctions. We are not going to chase every auction in the country.

And then especially, some of the auctions are done by counter parties that don't have a very strong credit and they may on paper appear to offer higher returns, but at the end of the day, they are surplus in power or if they have great stability issues, they end up with backlogs in projects. And we continue to do due diligence on a regular basis and assess and then make these decisions in participating in auction. Again, the majority of our contracts are with central government counterparties, which have the highest credit in the country.

Philip Shen
Okay, fantastic. Local press in India is suggesting that the UDAY program may not be working that well. Can you give us your perspective on this and what the potential impact may be on your business if the UDAY program does not work out as planned?

Inderpreet Wadhwa
I think the majority of the contracts we have has no bearing on the UDAY scene because they are central counterparties. Generally, for the health of the DISCOMs in the country, it is a good program that the government has rolled forward. I think that it is too early to comment either way what the outcome of this program is going to be. But all I can tell you is it is better to take action than not to take any action in terms of

restructuring and improvement of the DISCOM health and government is very serious, and that's why the program was put in place.

We are also learning as it is being rolled out and I'm sure they will monitor it closely and make sure that this is indeed successful, much like the entire solar program for the country. So, the government is very serious and the program is in play, and I think it's too early to tell what the outcome is, but it will be better than taking no action, for sure.

Philip Shen
Great. I have one more here and then I'll jump back in the queue. Earlier this year, you guys announced 150 megawatts of projects in Punjab. Can you update us on how many megawatts you may expect to add in FQ4? Obviously, we have your guidance for the full year, but any thoughts on that for FQ4 would be helpful. Thanks.

Inderpreet Wadhwa
Yes. I think that we've not given guidance on quarterly capacity additions and we will continue to stay with that with the annual conditions, and we also believe that the business that we run is more annual in nature. These projects have 12- to 13-month development cycles and that's how we continue to add them. I really suggest that we focus at the guidance that the company has given for the year-end calendar.

Philip Shen
Okay. Thanks, Inderpreet. I'll jump back in the queue.

Inderpreet Wadhwa
Thank you, Philip.

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

Maheep Mandloi
Hi, thanks for taking my questions and congratulations on achieving that lower cost on new installations. Just, I think back on one of the previous questions on UDAY, just to confirm your projects or your project IRRs do not assume any benefits from the UDAY program, right, if I'm not correct?

Inderpreet Wadhwa
That is correct, Maheep.

Maheep Mandloi
Got it. And in your prepared remarks, you also touched upon interest in financing for projects of attractive rates in 2018. Could you help us understand that better, and especially in light of SECI's credit rating upgrade, if that has impacted the interest rates for you?

Inderpreet Wadhwa
So, Maheep, I think what we have seen in the market for our projects when we look back two, three years, the interest rates were in the range of 13% in INR terms for 15-year financing. And some of the projects we have financed in the last couple of months we've seen that sub-11% rate in the market for new projects, and these projects have to go through a construction cycle.

And then, post construction, we are seeing sub 10% interest rates for refinancing, and then we believe that that range will be even tighter for bonds. We have not issued a bond yet. We are actively looking at that, and once we have better visibility into the bond, we'll be able to share where we see those numbers. But what we have seen in the market is spread on post-construction sub-10%, before construction sub-11%.

Maheep Mandloi
Got it, thanks. Just looking at your cash balance probably exiting this year, how many projects do you think that can support and beyond the 1.071 gigawatts you've already contracted?

Inderpreet Wadhwa
Yes. I think, as you would appreciate, that this is a function of where the project costs will be going forward. So, I think, I would suggest you actually make your own estimates based on what you see on the book once we end the financial year. And, perhaps, we can try and take this discussion in a subsequent call and we will give you better guidance on where we will be next year once we finish this financial year.

So, I think a combination of these two, three discussions we will be able to arrive at where we will be. All I can tell you at this point is we are very well capitalized. We don't need any capital for these projects and even beyond. And what that number will be, we will be able to give you better guidance when we report our annual results.

Maheep Mandloi
Understood. Yes, thanks for that clarification. And just one last question from me. Are you seeing any opportunities to acquire any existing PPAs out there in the market, given you could leverage your lower system cost end and probably achieve higher returns on those projects, which were initially bid on?

Inderpreet Wadhwa
I think we've been very focused on organic growth. We believe the value we create for our shareholder on new projects is much better. And the tariff at which we build these projects are a lot more competitive than the alternative rather than looking at projects that are at older, higher tariffs, and may not have the same level of asset quality and discipline. It's probably not the most value accretive.

Having said that, we do have the expertise that may be able to turn around assets, so we will not use M&A as our main focus, but if there is something strategic in nature where we believe it is value accretive to all shareholders, we may consider that.

And, again, we will share with everyone once something of that sort happens, but our focus is to continue organic growth.

Maheep Mandloi
Got it. Thanks for taking my questions.

Inderpreet Wadhwa
Thank you, Maheep.

Operator
Again, if you have any questions please press star, then one. Our next question comes from William Grippin of Barclays. Please go ahead.

William Grippin
Hi, guys. I was just wondering if you could give us some more detail on the O&M improvements that you had

mentioned. What those are and what the possible impact on your costs are once that's fully implemented.

Inderpreet Wadhwa
So, I think in terms of the initiatives we are taking include better analysis of soiling loss in our projects. I think, that is, we believe, the number one loss area for improvement. So we are implementing proprietary techniques to improve detection of soiling loss and techniques for eliminating that loss from the system in a proactive fashion.

We are also doing some research on yield improvements on existing assets. We believe that some updates on the DC blocks can improve the yield of these projects--losses you may have on account of shading and other matters where we can improve the yield on existing projects. So, without sort of going into too much detail, these are the proprietary techniques to improve yield on these assets we are implementing. So, some of these are software system investments. Some of these are hardware investments. So, a combination of these that we believe will help us improve the yield and these are value accretive.

So, the results of these you will see in the following quarters and years to come, so it's almost like making the investment now and getting the results better. And this is the advantage that our in-house O&M and EPC expertise gives us to be able to improve the yield.

So, they're all value accretive, and I think that's how we are making these decisions rather than what is the cost per megawatt. I think, over the next, maybe I would say year or so, you will see some of these costs to taper off, but more importantly, what you should see is our EBITDA is expanding. So, rather than just looking at the overall expense, you should look at the EBITDA expansion.

William Grippin
Okay, got you. That makes sense, thank you. And then last question would be, just wondering if you could comment on the proposed goods and services tax, and what impact that might have on PPA rates for you guys, if at all.

Inderpreet Wadhwa
Yes, sure. So, I think there is no impact on operational assets. The assets that are operational are already constructed. There's no impact there. The projects that would be under construction—so, it's actually when the GST is implemented and what megawatts are under construction for which procurement is still underway. Those would be the megawatts that would be impacted.

And, in our consultations with our counterparties, they're already clear that once the GST comes out, we will be able to seek a change in block-provision pass through on the GST additional cost, but there is also a camp that says, given the push in renewable energy, there may not be a significant increase to taxes associate with renewable energy. Renewable energy might get exemptions under the GST provision as well. So, we are waiting for that decision to be made and then, accordingly, if there is any impact, it will be a pass through to the counterparties.

William Grippin
Got it.

Operator
We have a follow-up question from Philip Shen. Please go ahead, sir.

Philip Shen

Hi. Thanks for the follow-up. A couple of quick housekeeping questions: tax in FQ3 was a little higher than we had thought. Can you give us your expectations for what your income tax expense might be in FQ4 and beyond? Thanks.

Inderpreet Wadhwa
Yes. So, I guess, I mean, we don't provide guidance on the tax expense quarter forward. Historically, we haven't done that and we don't plan to change that.

What I can tell you is, you can look at historical financials. That'll give you a sense of what our annual tax expense has been and how many megawatts we've added in that year, because this tax expense is a direct result of the megawatts we construct and the margins we make on engineering, procurement, and construction on these projects.

One of the things that I would like to highlight is that we have been looking at a new tax provision under the FASB accounting standard, ASC 740, wherein the EPC revenues that we make and the margins that we make, that tax expense can also be amortized in line with the revenues over 25 years from these projects. So, we are assessing that provision of FASB, and if we are able to apply that provision for our financials next year, you will actually see this tax expense drop and be amortized over the life of the asset.

So, at this point, what I would suggest is just look at our historical tax expense and megawatts constructed that year, and based on the margin on those projects, you can try and get to what that number will be. But, starting next financial year, we expect this to be a much smaller number than what it is today.

Philip Shen
Okay, great. And one other follow-up here: we estimated that your plant load factor was about 17.5% in a quarter. Can you confirm that this was indeed the case? And then what are your expectations for plant load factor in FQ4?

Inderpreet Wadhwa
So, I think we expect our plant load factors to be in line with what we saw at the beginning of the year. I think we had some discussions in terms of seasonality of projects earlier in the call today and perhaps the previous call as well. The new projects that we are constructing in 2017 will have an impact in, it will be less on 2018 revenues, but for the year, this year and next year quarters, it'll be in line with what you have seen historically.

Philip Shen
Okay, great. Thanks very much, Inderpreet.

Inderpreet Wadhwa
Thank you so much, Philip.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Nathan Judge for any closing remarks.

CONCLUSION

Nathan Judge
Thank you, Andrea, and thanks, everyone, for joining the call today. If you have any additional questions, please

feel free to give me a call or email me at ir@azurepower.com. Thank you.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.