Azure Power

Q1 Fiscal 2021 Earnings Conference Call

August 14, 2020 at 8:30 a.m. Eastern Time

CORPORATE PARTICIPANTS

Ranjit Gupta – *Chief Executive Officer*

Murali Subramanian – *Chief Operating Officer*

Pawan Kumar Agrawal – *Chief Financial Officer*

Nathan Judge – *Investor Relations*

PRESENTATION

Nathan Judge
Thank you, and good morning, everyone, and thank you for joining us. On Thursday evening, the company issued a press release announcing its fiscal results for the first fiscal quarter of 2021 ended June 30, 2020. 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, CEO; Murali Subramanian, COO; and Pawan Kumar Agrawal, CFO. Ranjit will start the call by going through recent key highlights and comment on recent market trends in auctions. Murali with then follow with an update on our projects under construction and an industry update. Pawan will then provide an update on the quarter and then we will wrap up the call with Ranjit reiterating FY'21 guidance as well as our longer term 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, presentation materials and annual report are certain non-GAAP measures that we reconcile to the most comparable GAAP measures, and these reconciliations are also available on our website, in the press release, presentation materials and annual report.

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

Ranjit Gupta
Thank you, Nathan, and a very good morning, everyone. Despite our hope that progress would be made in quashing COVID-19 during the time since we last spoke, the pandemic continues to worsen. Our heartfelt best wishes to everyone during this difficult time and we pray that a vaccine or cure can be found quickly. Murali and I completed our first hectic and rewarding year at Azure about four weeks ago. We strongly believe Azure is moving in the right direction, is in the right market, has the right team, and the right shareholders to power its growth to the next level. As mentioned in the past, we continue to be focused on returns much more than megawatts and hope to see results of actions we have taken, over the last four quarters, in the coming year.

Even before I talk numbers, starting on page 3, I would like to spend time on our Sustainability efforts. On the Sustainability front, we are pleased to report that Azure recently received recognition as the most sustainable company in the solar energy industry by World Finance Magazine. We also received a rating upgrade from Sustainalytics. Azure is now ranked as the 10th best renewable company globally and in the top 5% of all utilities by Sustainalytics. This was a notable increase from our rating in November and has been a real testament to the team's efforts to provide disclosure on all the good work being done on the ground. We are not stopping there. We are actioning a plan that we expect will drive an even better rating by year end including a more comprehensive Sustainability Report by the end of August and implementing new policies on Freedom of Association, Human Rights and Diversity & Inclusion. We plan to join the Task Force on Climate Related Financial Disclosure, become a UN Global Compact signatory, and we are contributing to the Carbon Disclosure Project. Given our better standing with ESG rating agencies combined with recently improved average daily trading volume and a market cap over $1bn, we believe we will increasingly be eligible for ESG indices. All of this should enhance our visibility with investors that are looking for strong Sustainable companies to invest in.

Looking at the company, we are pleased to announce a very strong quarter despite challenges of the pandemic. The cash flow to equity (CFe) from our operating assets grew 45% year to year to $21.7 million. We benefitted this quarter from lower costs which has been a strong focus of ours since we joined a little over a year ago. Corporate overhead was down 30% compared to the same quarter last year even though we are operating 21% more MWs on a DC basis. We continue to be confident about future growth and expect that CFe will be about $170 million to $210 million annually once our 7.1 GW portfolio is completed.

Also today, we are increasing the mid point of the present value of equity for our 7.1 GWs by $100 mn, or about $2/share, to $1.75bn to reflect falling interest rates. This compares to our current market cap of around $1bn. We now expect that we will be able to realise interest rates of about 9.5% for new projects given recent pricing and transactions compared to our previous assumption that we would realise an average rate of 10%. Declining base rates and tightening bond yields for our Green Bonds and investment grade Indian renewable companies bodes well for lower financing costs. Currently, we are seeing lenders offer us terms for around 9 – 9.5%, at least 50bp lower than rates we saw at the beginning of the year. In fact, we recently closed a foreign debt, fully hedged, facility that has an interest rate of approximately 8.5% in INR terms, just received a sanction from a large Indian lender at an interest rate of 9.5%, and refinanced about $40mn of debt with an interest rate of 9.7%. As a reminder, there is a significant uplift to our equity valuation for lower interest rates. We are also reducing our long term net debt projections by about $100 million to reflect the additional cash generation related to our expectations of lower interest rates.

As many have seen, we received the Letter of Award for the 2 GW greenshoe capacity we had optioned for as part of an auction we won in December. It is clear that the delays associated with getting the LOA will delay the timing of signing of the PPA. SECI has taken the initiative to bundle power from these projects with current auctions to prevent tariff shopping by DISCOMs. Once the power sale agreements with DISCOMs are consummated, our PPAs will be signed soon after. There is strong political will to get this in place as it will give a tremendous boost to the domestic solar cell and module manufacturing base in India. The implementation of SGD, the proposed BCD and other non-tariff restrictions such as ALMM are all designed to boost India's solar manufacturing base. The 12 GWs of manufacturing linked tenders, which includes our 4 GWs, are a cornerstone of the Central Government's plans to propel India's solar manufacturing into a global leadership position

The tariff of our 4GW power also makes economic sense as well. As a reminder, the 4 GWs have an ISTS transmission charges and loss waiver that is otherwise scheduled to expire in mid-2023 around the time when our first GWs of the 4GWs will begin producing at full utilization. Without the ISTs transmission waiver, DISCOMs will incur about INR 1 - 2/kWh of transmission costs, depending on the state receiving the power, which makes the delivered price of power from our 4GWs competitive. If 1 – 2 rupee/kWh is added to the recent auction of a record low tariff of around INR 2.36/kWh, the realized cost of power would actually be around 3.4 to 4.4 rupees/kWh, 16 - 50% higher than the INR 2.92/kWh tariff for our 4GWs. In addition, we would note that many DISCOMs are well short of meeting their renewable purchase obligations (or RPOs) for the next several years. We expect them to buy renewable power that is available and a blended tariff from SECI with an ISTS waiver as one of their lowest cost options. We will continue to update investors as things develop.

As part of our commitment of pursuing the lowest cost source of capital, the process of selling assets continues. The process is ongoing and although we do not have anything to announce as yet but we continue to believe that we will be able to sell the assets well before additional equity is needed and will update the market as soon as any material change occurs. We continue to expect that we will not issue any new shares before fiscal year 2022 unless this becomes the cheapest source of capital.

As part of our efforts to improve the depth and diversity of our Board, we are pleased that Ms. Supriya Sen has joined our Board recently as a non-executive independent Director. The amount of experience she has with raising capital for green energy projects, her extensive work with nonprofits helping children in Cambodia and Singapore, and her focus on governance and sustainability will all be a welcome addition to our board. As of date, we currently have 10 board members of which 6 are deemed independent and of which two are female.

Looking at page 4, as we have said many times since we joined a little over a year ago, we remain very committed to creating shareholder value. Supporting this commitment are two basic principles to which we strictly adhere to. 1) All projects must earn a return above our cost of capital and 2) we will pursue the lowest cost of capital.

We do want to reiterate our commitment to capital discipline. Put simply, we will not do any project that does not earn a return over our cost of capital. The delay in receiving PPA for the 4 GWs has opened up a gap in our construction timelines and we have been recently bidding for new projects. However, we will not win projects just for growth's sake or to create work. Rest assured that we will only win projects that, with conservative assumptions, will deliver returns that exceed our cost of capital. In fact, we chose to not chase after MWs in a recent auction that reached a record low ground mount solar tariff of INR 2.36/kWh, or about $3.1 cents, as the expected returns did not meet our minimum threshold.

We recognize that any particular project has a large impact on the company wide cost of capital and even one bad project can undermine investor confidence resulting in a much larger reverberation to our company.

In addition, we will only bid on projects that have the best counterparties. NTPC is AAA rated and is central government owned. SECI is also central government owned and has an AA+ rating. Gujarat and Bangalore have the highest ratings of any state DISCOM and typically pay their bills within 15 days or less. There is significant growth potential with just these parties and we will be assured prompt payments.

As we resume bidding for new projects, we have been focused on where we have advantages to our competition. We have identified several sites where we can reduce our construction costs including through expansion of existing operating projects to leverage common infrastructure and capitalize on operating and maintenance synergies. In addition, our access to lower cost capital is superior to most of our peers which we believe will increasingly provide a greater competitive advantage going forward.

Looking at the current market today, we would highlight that construction costs have fallen pretty meaningfully in just six months. Module prices have come off around 10% and we are now expecting our total project costs will be around 8 – 10% lower than our December expectations. Along with falling project costs, declining benchmark rates and tightening bond yields bodes well for lower financing costs as mentioned earlier. So, whilst headline tariffs are indeed lower, they make sense as costs are falling as well.

As many of us continue to work from home, we have benefited from being able to talk to our investor and shareholder community a lot more than when we were able to travel. Please rest assured that every interaction is important to us and we strive to consider all suggestions and requests we get for enhancing value of your company. We continue to improve our disclosures which will enable you to better understand your company.

With that, I will pass it over to Murali.

Murali Subramanian
Thank you Ranjit.

On page 5, Azure's business has remained very stable during the COVID-19 pandemic and so far, there have been no material adverse impacts from the economic and financial market disruption. Our plants remain fully operational and have continued to see customers making payments as normal. The plants' performance for the quarter has matched expectations despite the temporary drop in electricity demand in the early part of the pandemic induced lockdowns (Apr & May), and despite the monsoon activity in Jun, and we haven't had any abnormal downtime related to non-availability of spares. Further, we have re-started our work related to our plan of digitalization of our operations, especially around drone-based panel monitoring, performance analytics, robotic module cleaning, and the like.

Activity has begun in earnest at our under-construction projects and we are seeing the workforce starting to return to sites. Compared to our last call, the activity has picked up significantly though we are not yet back to our targeted activity levels. However, we are making much better progress. The Ministry of Power has given a 5 month extension for completion of renewable energy plants and transmission projects, which is additional 2 months' extension from before. Another important development we expect soon is the alignment of plant commissioning dates with the dates power evacuation will be available which aligns construction progress of the plants with the commissioning of the evacuation infrastructure.

All the ground mount projects we are working on are expected to be completed by the expected revised COD dates and we don't expect to pay any delay related penalty for COVID related delays. Further, the timing of commissioning of our under-construction projects does not impact our revenues we expect during the 25-year PPA because revenues begin at the date of commissioning.

Looking at industry and regulatory developments on page 6, we still see significant demand for new renewable energy in India despite recent events. During the quarter, there was nearly 6 GWs of new tenders released and 5 GWs of solar capacity auctioned. We did see lower tariffs this quarter which directly reflected lower construction costs, as discussed earlier.

There was a six month extension to the ISTS waiver until June 2023 but the Central Government has indicated that this would be the final extension granted. Related to our 4 GWs pipeline, the order specially mentioned and reconfirmed that our projects would be exempt from any ISTS charges or losses even beyond June 2023.

The central government has also begun disbursements of the $12 bn liquidity infusion scheme to help state utilities pay their bills. The disbursement will go directly to the generators from PFC and REC, circumventing the DISCOMs. Fortunately, our customer profile is better than average so we are not likely to see much direct benefit from this but it should provide investors additional comfort that the Central Government considers timely payment important and will take steps to help, if needed.

On to duties, the Safe Guard Duty (SGD) was extended for another year at 14.9% for six months and then to 14.5% for the next six months. In addition, we expect that a Basic Custom Duty (BCD) could be imposed soon, and this would be in addition to the SGD. We do not expect any material impact to our returns on our projects as they are protected by change in law provisions.

I am happy to report that we started receiving payments against SGD deposited by us in the Rajasthan 5 project and the Maharashtra 3 project commissioned last year. We have also received payments for recovery of GST in the Telangana, Andrha Pradesh and Uttar Pradesh projects. These payments are a

testament to the robust regulatory framework in place in the Renewable Energy sector in India.

In fact, the Ministry of Power is implementing some changes to speed up the process of recovery even further. They are looking to apply a standard formula that reduces ambiguity and paperwork related to recovery which we expect will reduce our working capital requirements. In the new PPAs, there is already a standard formula available which enhances tariffs for every unit of extra Capex expended on duties that qualify for recovery under change in law. We continue to see lenders willing to increase loan sizes to fund SGD given higher certainty of recovery.

With that, I will turn it Pawan to discuss the quarterly results.

Pawan Kumar Agrawal
Thank you Murali.

Turning to page 7, as of June 30th, 2020, we were operating 1,809 megawatts on a PPA or AC basis, about 12% more than the end of 1Q 20 and on a DC basis, we added 21% more capacity compared to same quarter last year. This increase in capacity combined with about a 160bp improvement in our PLF, and recovery of about $1mn dollars related to SGD and GST drove a 16% increase in revenue from the same quarter last year.

Costs were much lower this quarter than we have seen in a very long time. In fact, our O&M and G&A expenses were about a quarter less than the same period last year despite operating 21% more DC capacity. There are several things causing this. First, we are very focused on reducing our costs as we had outlined earlier this year. We do continue to expect to see a reduction in our corporate overhead, or G&A, of at least 10% in FY'21 versus FY'20. Second, due to Covid-19, some activities were deferred into future periods. Travel was significantly lower during the quarter, and legal expenses were less because there were fewer applications and court hearings. We do expect that we will see an uptick of about $1.4 million dollars in O&M and G&A from the first quarter of fiscal 2021 level as we have seen a resumption of activity back towards more normal levels. Also for Q2, we also expect that we will incur about $3 - 5 million dollars of additional compensation expense in 2Q'21 related to stock appreciation rights granted to our CEO and COO which is directly tied to the 30% increase in the stock price during the current quarter so far. Given all these variables, we are expecting G&A to be between $8 to $10 million dollars in Q2 of FY21 although this will be a function of the share price. As a rule of thumb, for every $1/share increase in the share price, our G&A will increase by about $500,000 dollars.

After adjusting for deferred expenses of $1.4 million, our non-GAAP EBITDA was around $42 million, up 26% from the first quarter of fiscal 2020.

Another item on our income statement this quarter was the $3.5 million one-time charge we took to refinance some international debt. This refinancing will lower the impact of gains or losses from foreign exchange on our income statement going forward. We expect losses from FX to be around $500,000 per quarter which reflects the cost of entering into hedges.

After taking into considerations the adjustments noted above, we reported a net profit of 2.7 million US dollars, or about 19% higher than last year.

Moving on to page 8 which reconciles the year to year change in our cash flow to equity from operating assets, our CFe rose 45% year to year to $21.7 million. Most of the increase reflected higher revenues but another large contribution was driven by lower costs on our platform.

On page 9, at the end of the June quarter, we had $105.5 million of cash on hand. Combined with the

$290 million of undrawn project debt commitments, we continue to have a strong liquidity position. Our plants under construction have full equity funding. We continue to expect that we will not issue shares before fiscal year 2022.

We would like to highlight the value of our hedges related to our Green Bonds as we believe many investors and analysts miss this substantial value of $98 mn. We have seen some net debt calculations that take our gross debt of roughly $1.2 bn and subtract $105 million of cash on hand. However, the $98 million hedging asset, classified as Other Assets on our balance sheet, should also be taken into consideration to bring net debt down to $1 bn. The hedging asset will go directly to offset our debt when our Green Bonds mature in 2022 and 2024.

Before I pass it over to Ranjit to discuss guidance, I want to take a moment and discuss our DSO on page 10. DSO did increase this quarter to 139 days from 126 days last quarter. However, as with previous quarters, all of the increase was due to two assets, 50 MWs in Andhra Pradesh and 130 MWs in Karnataka. Excluding these assets, which represent only about 10% of our operating assets, our DSO would have been 90 days. We continue to work on resolving payment issues with AP 50 and Karnataka 130 and, once we have these counterparties caught up, our DSO should improve meaningfully.

I would now like to turn it over to Ranjit to provide some commentary on FY'21 and long term guidance.

Ranjit Gupta

On page 11, we are reiterating our FY 2021 guidance at this time as over 90% of the revenues is expected to come from projects already commissioned and operating which have not been materially impacted from the COVID-19 pandemic . Our remaining revenue is subject to when plants under construction are completed, and completion timelines are currently more difficult to forecast due COVID-19 though we continue to make progress with our plants under construction Without any contribution from plants under construction in FY'21, revenues from operating facilities should be around INR 14.6 - 15 bn INR. For 2Q 21, we expect revenue to be between INR 3.2 and 3.4 bn and the PLF to be between 18 – 19%.

Turning to our long term guidance on page 12, a couple of things we would point out. Our cap ex budget for next year is likely to be lower than fiscal 2021 given the timing of signing PPAs. As a result, we have put in a placeholder for some projects to be built in FY'22 although, as stated earlier, we will only do good projects that make sense and this placeholder is not a commitment.

With this, we will be happy to take questions.

QUESTIONS AND ANSWERS