Azure Power

Q2 Fiscal 2021 Earnings Conference Call

November 11, 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 Tuesday evening, the company issued a press release announcing results for the second fiscal quarter of 2021 ended September 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 to review the overall long term positive outlook for solar in India. 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 with additional discussion on the performance of operating assets, a deeper dive into our falling cash G&A expenses, recent improvement in DSO, and then we will wrap up the call with Ranjit updating FY'21 guidance and reiteration of 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. Last time we spoke, I had hoped that we would get some relief from the pandemic and a vaccine would be found. Looks like there has been some positive news on the vaccine front, and we are all seeing light at the end of the tunnel. Here's wishing that the next call is held in an even more positive environment vis a vis our fight against COVID-19.

Given the breadth of our operations, Azure had embarked on an aggressive awareness campaign internally to ensure we remain safe from COVID-19. Through continuous monitoring and management support, we ensured reduced incidents and report no severe health impact on any of our team members. We formulated and implemented strong quarantine / isolation protocols across our operations and provided a dedicated Doctor-on-call to support all our team members and their families who were impacted by the pandemic. Our COVID 101 awareness flyer series continued to disseminate meaningful information and knowledge which enhanced capacity and preparedness of our staff during the pandemic. We have also continued to work with our communities to help them through our CSR outreach. Job training is an important focus for us across our operations. We are also moving forward to getting ourselves ISO-45001 certified.

Azure continued to operate well despite the challenges faced with COVID-19. During the quarter, we reported that cash flow to equity, or CFe, for operating assets rose 50% year on year to $14.7 million. Starting this quarter, we will also begin highlighting EBITDA and leverage statistics for our operating assets. This will enable investors to better see how our operational assets are performing and have a greater ability to value the company. EBITDA from operating assets for the quarter rose 20% year to year to $40.7 million and the Net Debt/Last Twelve Month EBITDA was 5.9x.

We also made great progress this quarter in getting make up payments from our past due customers and our Days Sales Outstanding fell to 114 days from 139 days in the previous quarter, which is the lowest level we have reported since 2018.

With regard to the PPAs for the 4 GWs pipeline for which we have LOAs, given the size of capacity combined with other factors, we now expect that the PPAs will be signed in tranches of 500 – 1,000 MWs at a time rather than 4 GWs at once. We are making progress and do expect that we will receive PPAs for the first tranche by around January/February 2021. As many are aware, construction costs have fallen, the foreign exchange rate move has been favorable in recent months, and we continue to expect that we will realize our original expectations of 20% equity IRRs or more on this 4 GWs.

As we have discussed before, there is an added advantage for the 3 GWs coming online after the inter state transmission system, or ISTS, cost waiver expires in mid-2023 for renewable energy. With expiry of this waiver, distribution companies will begin to incur about 1 to 2 cent per kWh for transmission costs that were previously avoided. However, for our entire 4 GWs pipeline, we will retain this waiver and distribution companies that buy power from this 4GWs will not incur this expense providing a significant pricing advantage. After mid-2023, the power generated from these MWs will likely be some the lowest delivered new power in the Indian market. In addition, we would note that many DISCOMs are well short of meeting their renewable purchase obligations (or RPOs) for the next several years. It is pertinent to note that the draft amendments to the Electricity Act increases penalties on DISCOMs that do not meet their RPO obligation. Hence DISCOMs will need to buy renewable power and our tariff, with an ISTS waiver, will be one of their lowest cost options.

We also released our second Sustainability Report in less than 9 months; the most recent one is for Fiscal Year end 2020. We have continued to expand our disclosure including scope 3 emissions and participation in the carbon disclosure project. We have implemented several new policies including diversity and inclusion, equal pay, an enhanced Health and Safety Policy, ESG, a commitment to continue to not emit non-GHG air emissions, and to reduce lost time incidents by 5% annually among others. We are also increasingly engaging with suppliers to encourage better carbon reporting and efforts to reduce their environmental impact. We continue to remain a net carbon neutral company and are making good progress in reducing our water consumption with an aim to be water neutral by 2023.

Whilst many are aware of the tremendous organic growth opportunities for solar in India, on page 5, we would like to provide a brief recap for the many new investors that have recently invested in AZRE. Electricity per capita usage in India is some of the lowest in the world as many only recently received access to the grid and what they do get is unreliable and not readily available. As solar capacity is the lowest cost source for new electricity, solar makes the most sense to satisfy substantial future demand growth. These are coupled by supportive government targets that aims to have 450 GWs of renewable energy capacity in place by 2030, or nearly 30 GWs of new capacity additions every year. In fact, we see about 25 GWs of new capacity being auctioned by the end of next year. Today, in India, there is only construction capacity to build about a third of what the government intends to auction. This provides a tremendously attractive runway for significant additional growth with returns that would be well above our current cost of capital.

As we complete two quarters of Work from Home, I take this opportunity to thank all Azure stakeholders for their patience and support. At any organization, its team is its biggest source of strength, and I can proudly say that the team at Azure has done an incredible job over these last two quarters. We currently have over 3,000 staff and labor at our various sites working through the dangers of this pandemic. Apart from the various initiatives our HR team has undertaken to ensure cohesiveness & engagement in these changed times, the company has embarked on an ambitious online training program which is specifically developed for our team members as we seek to upskill ourselves to take Azure to greater heights.

With that, I will pass it over to Murali.

Murali Subramanian
Thank you Ranjit.

On pages 6 & 7, we provide an update on our projects under construction. Overall, we continue to expect that our projects will be finished by the expected revised COD and that they will remain within our initial budget expectations.

We finished 25 MWs in Assam which is part of a larger 90 MW project. We want to thank the many that worked tirelessly to finish this project despite the tremendous challenges they faced including torrid rains of the monsoon season in addition to the pandemic and related restrictions. We expect to have another 40 MWs finished by the end of this fiscal year with the remaining 25 MWs in the fall of next year.

On our largest project to date, Rajasthan 6, we are making progress despite the many challenges. As of now, we expect to have about 300 MWs completed by this calendar year end and the remaining 300 MWs completed by March. As it relates to our Rajasthan 8 and 9 projects, each of which are 300 MWs with 25-year fixed tariffs with SECI, we expect they will come online around the third quarter of next calendar year. Additionally, on the energy generation side from operating projects, we have achieved our targets for revenues despite COVID related restrictions and greater than expected rainy days.

Looking at industry and regulatory developments on page 8, we still see significant demand for new renewable energy in India and regulators reported that the country had a power supply deficit of 0.3% for the first half of this fiscal year. During the quarter, there was nearly 2.9 GWs of new tenders released and ~2 GWs of solar capacity auctioned.

Unfortunately, distribution companies are taking time to sign PSAs with intermediary procurers such as SECI and at the moment, about 9 GWs of capacity are without contracts. However, we do see increasing pressure on Discoms to sign PSAs to meet their RPO and various proposed amendments to the Electricity Act that would give teeth to the enforcement of RPOs. Power demand has also finally picked up after 5 months of contraction, with September demand this year registering a Y-o-Y growth of about 4.5%.

We have also seen the introduction of a new renewable energy platform called the green term ahead market for short term bi-lateral transactions in renewable power. Electricity trading in India is still very nascent: this platform will provide an avenue for resource rich states to sell RE power at market driven prices, and enable RPO deficient states and buyers to meet their RE targets.

As an update on the proposed Basic Custom Duty (BCD), we currently expect that it will be in a range of 10 – 20% which would be in addition to the safe guard duty. We have been expecting a final decision for some time but there has been some hesitation given that India is very reliant on China for module imports and the BCD may result in higher electricity bills for customers. We do not expect any material impact to our returns on our projects as they are protected by change in law provisions.

Efforts to privatise DISCOMs continue and the ministry of power recently issued documents that outlined the criteria for potential bidders interested in buying a majority stake.

We also wanted to highlight several positive proposed changes to the Electricity Act and Electricity Rules that would benefit us and the renewable energy sector in India. One set of proposals would give us greater certainty of revenue including formalizing renewable energy in the Electricity Act as "must run" capacity, making curtailment less likely, enhancing security payment and establishing a new regulator to focus on contract disputes with an aim of shortening the time to resolve issues. If the proposed amendments are adopted, we will be able to get expedited recovery of cash outlays for items that are considered pass through due to change in law, such as safe guard duty.

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

Pawan Kumar Agrawal
Thank you Murali.

Turning to page 10, as of September 30, 2020, we were operating 1,834 megawatts on a PPA or AC basis. Our portfolio of 7,115 MWs remained stable from the previous quarter. Our construction costs were mostly flat year on year.

On page 11, overall, we were very pleased with the quarter and results came in ahead of our internal expectations following efforts that we have put in over the last few quarters to focus on improving generation and reduce operating costs. Revenues for the second fiscal quarter were $47.6 million dollars, which was about 6% above the high end of our guidance. Our plants continue to operate very well and PLF was 18.8%, or at the higher end of our 18 – 19% guidance range and about 200 bp higher than the second fiscal quarter of the prior year. This higher PLF, a 5% increase in DC capacity, and recovery of about $2mn dollars related to SGD and GST, drove a 23% increase in revenue from the same quarter last year.

Costs were essentially in line with our internal expectations, save for stock appreciation rights, or SARs, which added about $7 million to G&A due to 87% increase in the share price during the quarter. On this, we would note that most of that is for SARs that cannot be exercised until 2024 at the earliest and only then would cash be paid. We also had a tax benefit related to SARs of about $2.4mn. We expect that tax expense will be around $12 million for the full fiscal year of 2021 and tax expense will be around $6mn for the third fiscal quarter. Excluding Stock Appreciation Rights impacts, the second fiscal quarter results would have resulted in a net loss of about $700,000, which was a meaningful improvement from the approximate $10mn loss in the same quarter last year.

Turning to page 12, we remain 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 excluding stock compensation expenses, of at least 10% in FY'21 versus FY'20 despite about a 35% increase in MWs operational by end of this fiscal. As you can see, we are driving continued operational leverage and we expect that there will be even more improvement in our margin going forward.

If you look at G&A excluding stock compensation expenses, our corporate G&A is running a little over $1 million per month so far this fiscal year. We are doing more to reduce costs, and we recently moved our head office to a more economical location saving about 2/3rds on our office space expenses.

One of the new areas of emphasis this quarter is on providing greater disclosure around operating assets. We believe this is very important for investors to properly value the company given the steady state of profit and cash flow generation once a solar project is operational. On page 13, you can see that EBITDA from operating assets increased about 20% YoY and that Cash Flow to equity rose about 50%. Net debt for the operating assets was about $964 million and EBITDA for the last 12 months was about $163 million resulting in a Net Debt/EBITDA ratio for operating assets of 5.9x. This ratio is much more reflective of our balance sheet than the net debt to EBITDA ratio for the overall company which includes debt for projects under construction or just recently commissioned but have yet to produce much EBITDA.

Which leads us to a review of our overall balance sheet on page 13. We had about $106mn of cash and cash equivalents and our Net Debt stood at $1.08bn. As a reminder, for those that are calculating our debt ratios, the hedging assets included in Other Assets should be included as this is directly linked to the foreign exchange hedging we put in place related to our Green Bonds.

I want to take a moment and discuss our Days Sales Outstanding on page 15. We were pleased to see a notable improvement in our DSO this quarter. DSO fell to 114 days from 139 days in the last quarter after two past due DISCOMS, Gescom and Andhra Pradesh, made about $6mn of makeup payments on past due bills. We continue to work on getting payment from the other Discoms in Karnataka as well as Andhra Pradesh and hope to have some good news in the coming quarters.

Before I pass it over to Ranjit to discuss guidance, I would like to mention that AZRE was recently included into two leading solar stock indices which should enhance trading liquidity and increase investor awareness of your company. Now, over to Ranjit to provide some commentary on FY'21 and long-term guidance.

Ranjit Gupta

On page 16, as Murali noted, the completion of about 600 MWs could slip into the early part of the next fiscal year reflecting delays related to COVID. However, as COD dates are also being adjusted to reflect the pandemic, we don't expect to incur any penalties related to these delays. We now expect to have about 2,300 – 2,500 MWs operational by March 31, 2021. In addition, we are changing our revenue guidance to a range of INR 15.3 – 15.8 billion given the delays in completing projects. We would note that the shifting of revenue to the following quarter is related only to delays in projects coming on-line on account of COVID 19. We have seen our operating portfolio perform as expected in H1, and it is expected to continue to deliver the expected revenue in H2.

For 3Q 21, we expect revenue to be between INR 3.6 and 3.8 billion and the PLF to be between 19.5 – 20.5%.

Turning to page 17, our long-term outlook remains unchanged except for some movement of cap ex from fiscal year 2021 into 2022. We would note that our fiscal year 2022 cap ex has a place holder for potential additional megawatts we may win given the delays in signing PPAs for the 4 GWs. 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