Azure Power

Q3 Fiscal 2021 Earnings Conference Call

February 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 Wednesday evening, the company issued a press release announcing results for the third fiscal quarter of 2021 ended December 31, 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. Murali with then follow with an update on our projects under construction, technological innovation, and an industry update. Pawan will then provide an update on the quarter with additional discussion on the performance of the quarter and then we will wrap up the call with Ranjit updating FY'21 guidance, providing initial FY'22 guidance and a discussion 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. It was around this time last year that COVID began spreading rapidly across the world. It has been truly unfortunate how this pandemic created so much pain and uncertainty. Fortunately, the light at the end of the tunnel is getting brighter with the vaccine being globally distributed as we speak. Here's to hoping that we can all claim victory over the virus on our next call.

Sustainability and ESG are key to the success of our business. At Azure, we start every meeting with a discussion of health and safety which is of paramount importance. We would like to start this call by highlighting our ESG accomplishments this quarter. We are very proud to announce that we obtained the ISO 45001 certification which demonstrates Azure's focus on Occupational Health & Safety. Given the remote locations of our projects, the extreme heat and difficult conditions for construction & operations, as well as the inherent safety risks that come with any large scale construction project, we believe this validates the additional efforts we make to our work place safe for our team members and contractors. In addition, in December, MSCI, a leading ESG rating agency, rated Azure Power as double AA for ESG which places us in the top quartile of all global utilities they cover. We believe that we will improve on this rating going forward as we work through some legacy issues that have improved this past year.

Despite the challenges faced during the pandemic, the company's operations have persevered. Today, we have 19% more MWs operating than we did at the same time last year. Our operating assets have performed extremely well and not only have we been able to continue collecting revenues, we even improved our collections with our DSO at 113 days at the end of the quarter compared to 119 days at the beginning of the pandemic. We have slashed costs and our cash G&A, excluding stock compensation expenses, fell by 15% from the same quarter last year. We had promised to reduce our cash G&A

expenses by 10% in FY'21 versus FY20 and I am happy to report that we are on track to deliver on our promise. At the end of Q3 FY21, we are operating with 25% fewer team members than a year ago. Growth and our actions to improve returns have resulted in a 26% year on year increase in EBITDA from Operating Assets and a 142% increase in Cash Flow to Equity from Operating Assets. Over the last three quarters since we started reporting CFe, we have seen a steady improvement in this metric due to our focus on sweating our assets, capex infusion in operating assets, reducing our costs and collection of long outstanding dues. Also, our CFe generation of $67 million over the past 12 months would have been around $75 million if insolation in 3Q and YTD had not been about 5% lower than the 20 year average NASA insolation data.

On the flip side, despite significant progress towards signing PPAs on our 4 GW for which we have a letter of award but no PPAs, we have not much to report. We still remain optimistic that we will have positive news to deliver shortly as there is a definite movement towards the finish line. The fact that India beat its peak power demand record twice in the last month indicates a strong recovery is underway which will enable discoms to invest in buying power for their future needs. As we announced before Christmas, we do expect a reduction in the tariff from what was discovered when we won the auction about 14 months ago. Frankly, costs have come down and productivity has risen significantly during this period.

The government continues its tremendous support to the Renewable Energy sector. The Hon'ble Prime Minister has reiterated the Govt. of India vision of having 450 GWs of Renewable Energy operational by 2030. Many structural changes are being proposed to the regulatory and policy framework to enable this growth. In the recent budget, approx. $40 billion have been set aside for upgrading infrastructure and technology of distribution companies to make them more efficient and improve their fiscal positions. In a pathbreaking change, the govt has spoken of putting a framework in place whereby the consumer could be in a position to choose their electricity supplier which means that there would be an opportunity for consumers to choose clean and lowest cost renewable energy. With further infusion of equity in SECI, the budget signaled the government's intent to strengthen its support for the RE business.

In my remarks exactly a year ago, I had spoken about four broad themes that we had started work on – Strategy, Transparency, Efficiency & Prudence. In the last four quarters we have worked hard on all four themes. Our transparency has manifested itself in our disclosures, streamlining of reporting structures, elimination of EPC margins and our constant outreach to the investor & stakeholder community. Efficiency & prudence have been demonstrated through reduction in our costs, pruning of our workforce, simplification of internal processes, focus on training & HR. We have executed our strategy which primarily focused on discipline in capital allocation. As tariffs have plummeted to below 3 US cents, in an environment where module prices are holding firm, we have stayed away from bidding aggressively, patiently waiting for the right opportunities that will earn our shareholders a return higher than our cost of capital. We have, time & again, demonstrated our commitment to capital discipline by chasing returns over scale.

With interest in Green Hydrogen growing exponentially, storage costs continuing to decline and increasing efficiency of solar modules, the stage is set for the next quantum leap in acceptability of renewable energy across the world. These are exciting times.

We continue to look for suggestions from our investors and stakeholders on how we can further improve our disclosures and make it easier for you to understand our business.

With that, I would like to turn it over to Murali.

Murali Subramanian
Thank you Ranjit.

On pages 5 & 6, we provide an update on our projects under construction. Whilst we have overcome many challenges and the level of construction activity has continued to increase, new supply constraints have arisen. High local demand for solar modules in the past six months or so in China, coupled with a rising yuan and rising raw material costs, resulted in the inability of several module suppliers to honour their price and delivery commitments despite signed supply contracts. Having said that, we believe we have been able to navigate the potential delay by leveraging our size and large backlog to secure modules better than most of our peers but getting modules remains a real challenge. On top of this, we are still are not at the level of construction activity we anticipated three months ago when we last provided an update. This has led to delays. We had anticipated that by fiscal year end, we would have 450MWs operational and the final 150 MWs finished by May. As of today, we have finished 300 MWs but another 150 MWs by fiscal end is an extremely tough target. We do expect that an extension to the COD will be granted and we will not owe any penalties for delays. Project construction work in Assam has picked up after poor weather and COVID related delays. We have sought a COD extension from the regulator & procurer and expect to hear from them shortly.

Whilst there have been delays, we have also not lost sight of ways to continually improve our business. In this fiscal year, we increased our block sizes, reduced the amount of cable needed by using junction boxes, and designed larger table sizes with reduced spacing. We have seen our yields improve as we increase the adoption of string inverters and aluminum cables and implement dry cleaning robots to prevent dust build up, improving our efficiency. We were practically the first mover in India to adopt mono-perc modules in a big way. Continuing with our quest to drive efficiency, we are planning to test a pilot of bi-facial modules combined with trackers. Worldwide industry has found as much as a 15% increase in yield compared to fixed-tilt mono perc modules. We have already started deploying bi-facial modules in our current Rajasthan 6 project and about half of the modules in our Rajasthan 8 project are expected to be bi-facial.

Over the last quarter, we have transitioned our operating projects to a new and powerful analytics platform. We continue to get all our data into a centralized monitoring station at head office but the driver behind this new platform is the ability to monitor and analyze plant performance at site which is a very powerful efficiency improvement tool. Now the site teams have greater visibility of even minor plant failures and various pre-set alarms allow them to spot not only failures but even parts of the plant where performance is lower than expected. Installation of string inverters in 50% of Rajasthan 6 and 100% in Rajasthan 8 & 9 will further help this new Analytics platform provide string level data to spot localized failures. String inverters will not only prevent mismatch losses but will also aid in faster failure rectification. This will help in improving generation from each & every operating asset and we hope to see the benefit accrue to us over the next fiscal year.

We are also planning to test battery storage and its integration in our ground mount projects, to be future ready, to satisfy DISCOM concerns on reliability and intermittency, and to reduce deviation penalties. In anticipation of upcoming wind-solar-storage tenders, we also are working on development opportunities for hybrid projects such as solar plus wind.

We would like to provide some highlights of our ESG accomplishments on page 7. As Ranjit mentioned earlier, we did get a strong double AA rating from MSCI for ESG and we obtained the ISO 45001 certification which verifies that Azure Power provides a safe and healthy workplace. Our carbon free generation has avoided about 2.4 million tons of CO_2 equivalent, bringing the total to 8.9 million tons equivalent since inception. We remain net carbon neutral. We have reduced our water consumption per unit of electricity generated by about 20% this fiscal year versus calendar 2019 and about two thirds from calendar 2018 levels. Another environmental focus this year is safe disposal, even recycling where possible, of damaged solar modules and we have made very good progress this fiscal year. On the

Social side, in addition to the ISO 45001 certification, we have provided over 175,000 people with assistance by delivering masks, food, facilities to purify water, powering a school, and job training. We also remain actively engaged with the communities in which we operate. On the governance side, we have adopted many policies including an enhanced health and safety policy and have increased gender diversity on our Board. We are not stopping here and will continue to implement best practices to enhance our sustainability.

Looking at industry and regulatory developments on page 8, there is a logjam of about 19 GWs of allocated solar projects with LOAs but no PPAs at the moment. In the last couple of quarters, DISCOMs have not been signing PSAs which SECI needs in order to enter into PPAs with developers, such as ourselves. Clearly, the uncertainty around COVID has taken a toll on DISCOMs. Their reticence has been exacerbated further by the recent drop in tariffs discovered during the last couple of solar capacity auctions. To explain further, during much of 2020, many solar auctions cleared in a range of 3.3 to 3.7 US cents per kWh. However, in this past November and December, the discovered tariffs for a couple of auctions fell to record lows of around 2.75 US cents per kWh, a 20%+ drop. On the positive side, India set new records for power demand twice in the last month which indicates a strong recovery after months of subdued industrial & commercial activity.

We have gotten numerous questions from investors about our view of future tariff pricing. Whilst we do not have a crystal ball, what we do know is that, over the next several years, there are more projects than there is development capacity and capital to finance it in India, at the moment. History has shown that there are periods where competition increases but eventually, competition moderates. We have a leading platform with some of the lowest costs in the industry that has some of the best and lowest cost access to capital. There will be many opportunities to add projects that create significant value in the future. In addition, Azure is in a tremendously strong position with LOAs in place for our 4 GW pipeline. We have a strong pipeline and do not have to chase growth. We will be patient and disciplined, and we will not do projects that do not have returns above our cost of capital.

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

Pawan Kumar Agrawal
Thank you Murali.

Turning to page 10, as of December 31, 2020, we were operating 1,987 megawatts on a PPA or AC basis, which is 8% higher than what we were operating as of September 30, 2020. Our portfolio of 7,115 MWs remained stable from the previous quarter. Our construction costs continue to fall and were about 10% lower year on year.

On page 11, when looking at the quarter, we faced reduced insolation by ~4.6% compared to our expectations of normal weather. Had insolation been as per the long term average, our revenues would have been about $50mn, or a 20% YoY increase. I will discuss G&A in more detail in a few moments but excluding stock compensation expenses which rose significantly due to the rising stock price, our G&A would have been about 15% lower than G&A in the same quarter last year after adjustments. After adjusting for stock compensation expense, our EBITDA would have been $39.4 mn, or a 21% increase from the same quarter in the prior year and we would have reported a net loss of about $2.7 mn vs about a $7.9 mn loss after adjustments last year.

Turning back to G&A, on page 12, cash costs were below our internal expectations, save for stock appreciation rights, or SARs, which added about $18 million to G&A. We remain very focused on reducing our costs as we had outlined earlier this year. We are pleased to report that we are on track to deliver on our original target of a 10% reduction in G&A, excluding stock compensation, during FY'21 when compared to FY'20. One example of cost savings is the relocation of our head office which is expected to save about $1 million annually. When looking out into FY'22, we expect that cash G&A will rise about 10% from FY'21 levels reflecting inflation and an increase in MWs operating.

We also have embarked on a refinancing initiative and so far, we have been able to refinance about $73 million of debt saving about 150 to 200 basis points on our interest costs. We are working on refinancing about $185 million and would highlight that our first Green Bond for $500 million dollars that we issued in 2017 with a 5.5% coupon is now callable. Based on indicative rates in the market, we would expect to be able to realise savings once this is refinanced.

Turning to stock compensation expenses, as the share price rises, our Stock compensation expenses will rise inflating G&A. To help with modeling, the impact of SAR expenses on our G&A is directly linked to the share price. For 4Q'21, we would incur about $2.5mn of additional SAR expenses if the share price remained at yesterday's close. Every $1 change in the stock price above and below last nights close of $37.76 will have about an $800,000 impact in that period, both positive and negative.

Given the uncertainty around collections when the pandemic first began, we are particularly proud of our ability to improve our DSO despite the challenges this year. Our 3Q'21 DSO was 113 days, which is better than the 119 days when the pandemic first began about a year ago. We continue to make progress in getting back payments and believe there will be further improvement in the future.

On page 13, you can see that EBITDA from operating assets increased about 26% YoY and that Cash Flow to equity from operating assets rose about 142%. Net debt for operating assets was about $1,030 million and EBITDA for the last 12 months was about $172 million resulting in a Net Debt/EBITDA ratio for operating assets of 6.0x. 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 balance sheet on page 14. We had about $122mn of cash and cash equivalents and our Net Debt stood at approximately $1.15bn. As a reminder, for those that are calculating our debt ratios, the hedging assets included in Other Assets on our balance sheet should be netted against our total debt as this is directly linked to the foreign exchange hedges we put in place related to our Green Bonds.

Before I pass it over to Ranjit to discuss guidance, I would like to mention that Azure continues to gain traction, stock trading liquidity and visibility as a leader in the India Solar Industry. At December 31, AZRE was a part of at least 25 stock indices compared to none at the middle of the year. Now, over to Ranjit to provide some commentary on FY'21 and long-term guidance.

Ranjit Gupta

In February 2020, when we had issued our guidance for FY21, I had mentioned the caveats of timely commissioning, normal weather and no curtailment. I am happy to report that despite the pandemic, we have hardly seen any curtailment across our projects. Pandemic did impact timely commissioning and continues to impact construction. On page 15, as Murali noted, because of supply constraints and delays related to COVID, we now expect to be at the lower end of our previously provided range of 2,300 – 2,500 MWs operational by March 31, 2021. Performance of our operating projects has improved significantly but lower insolation in this quarter and in fact the entire year to date, to the tune of about 5% compared to the 20 yr average, has weighed on our performance and we are now expecting to be at the lower end of our previously provided revenue guidance. For 4Q 21, we expect revenue to be between INR 4.335 and 4.435 billion and the PLF to be between 22 and 23%. We also provide initial guidance on our operating capacity and expected revenue generation for the next fiscal on page 15.

Turning to page 16 which is our long-term outlook, at the moment, due to uncertainty around the tariff that will be realized for our 4 GW pipeline, we are pulling our long term outlook which included our 4 GWs.

With this, we will be happy to take questions.

QUESTIONS AND ANSWERS