Azure Power

Q4 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

Nathan Judge – *Investor Relations*

Ranjit Gupta – *Chief Executive Officer*

Murali Subramanian – *Chief Operating Officer*

Pawan Kumar Agrawal – *Chief Financial Officer*

PRESENTATION

Nathan Judge
Thank you, and good morning, everyone, and thank you for joining us. On Friday evening, the company issued a press release announcing its fiscal results for the fourth fiscal quarter of 2020 ended March 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, Chief Financial Officer. Ranjit will start the call by going through recent key highlights. Murali with then follow with comments about how the business has been resilient during the COVID-19 pandemic as well as an industry update. Ranjit will reiterate our longer term guidance and our reduced equity needs. Pawan will then provide an update on the quarter and then we will wrap up the call with Ranjit reiterating FY'21 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. Though it has been only 4 months since our last earnings call, it seems like an eternity. The world has been ravaged by the CoVid 19 pandemic and none of us have been left untouched by the havoc its wreaked on our lives and our economy. I begin with a wish that we all come out of this relatively unscathed and with a prayer for those less fortunate than us. Starting on page 3, we are pleased to report that the Azure 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, despite a 54 day halt in construction of our plants under construction due to an imposed COVID lock down, we expect that all our plants will be completed before the expected revised COD. Due to migration of labor back home from sites & cities across India, return to normal construction speed is slow but we are protected by the SCOD extensions provided by our procurers.

On the Sustainability front, Azure has been very busy due to the CoVid impact on its communities. We enhanced our budget for corporate social responsibility by almost 70% and started relief operations for the needy folks around our projects. So far, we have distributed around 115,000 face masks and pieces of personal protective equipment to frontline health workers and over half a million meals. This exercise continues as we speak. The other big effort at our end was to become water neutral in the coming years. On that front, the current situation has delayed our plans but we are still hopeful of constructing water harvesting facilities in 25 projects before the current monsoon season. Azure remains focused on not only doing good work on Sustainability front but also tracking and reporting it.

As the countrywide lockdown in India dropped power demand and impacted revenue collections of distribution companies, the Govt of India took steps to protect the Renewable Energy industry. In a spate

of orders over March & April, the government rebuffed Force Majeure notices from various procurers, re-confirmed the Must Run status of Renewable Energy, instructed Discoms specifically to pay RE dues and allowed submission of generation invoices through digital means. Recently the govt announced a USD 12 Billion liquidity package to enable the weaker Discoms to pay power dues to Conventional and RE generators.

Another important step by the government has been a push to amend the Electricity Act of 2003 and the Tariff Policy of 2006. Industry has also submitted their suggestions and when passed, the new Act & Tariff Policy will significantly reduce risk in the Indian Power Sector.

Ever since Murali and I joined about a year ago, we have made it a priority to be transparent as possible and to enhance our disclosures to investors. This quarter, we have taken yet another step and will be providing several new data points which we believe will help investors understand and value our business more appropriately.

Beginning this quarter and going forward, we will be reporting cash flow to equity for our operating assets. For this past year, CFe from operating assets was around $43 million, up 15% from 2019. We continue to expect significant growth as we commission more projects.

We continue to expect to need about $600 million of equity to build out the 4 GWs in our pipeline as the 1,307 MWs under construction or development already have equity in place. We remain committed to find the lowest cost sources to fund this and we are pleased to announce that, since February, we have been able to find opportunities which are lower cost than issuing shares that reduces the additional equity need by about $150 million. We will continue to pursue opportunities to find additional equity from the lowest cost sources and we don't expect that we will be issuing any shares before FY'22 unless, of course, issuing stock would be the lowest cost source of equity for our projects. This stock price, however, would need to be substantially above current levels. As an example of our commitment, we have hired advisors to explore selling a second set of assets, in addition to the first set of assets we announced in February.

Despite the disruption to financial markets from COVID, we have been able to access capital at very attractive rates. We recently secured project financing at an interest rate below 9% fully hedged in INR terms for our Rajasthan 8 project. We are in extensive discussions with lenders to complete our near term debt financing needs and believe that we will continue to be able to secure lending at attractive rates given the quality of our assets and projects.

Also, our largest shareholder, CDPQ, acquired a majority stake in the company earlier this year. This new investment by CDPQ is a recognition of Azure Power's leading solar development platform in India and by having a majority shareholder with a long-term approach and a AAA credit rating, we will have better access to external capital further improving our future growth and return prospects.

Finally, as some are aware, there is a delay in the PPA signing for the 2 GW LOA we received in December 2019, and some delay in issuance of the LOA for the 2 GW Greenshoe option we elected under the same auction. Recently, the other winner in the same auction received a LOA for the capacity they elected under the greenshoe option and we are hopeful that we will receive the LOA for our greenshoe capacity soon, as well. The delay, which is now about 6 months, in receiving the PPA for the first 2 GW and the LOA for the second 2 GWs of greenshoe capacity has opened up a gap in our construction timelines and we are in discussion with our Board for considering bidding for a limited amount of capacity to fill this gap. Rest assured that we will only win projects that, with conservative assumptions, will deliver returns that exceed our cost of capital. If we are successful in securing projects at attractive returns above our cost of capital, our annual equity needs will remain as per our presentation.

We remain firm in our commitment that we will not grow our portfolio for the sake of growth.

With that, I will pass it over to Murali.

Murali Subramanian
Thank you Ranjit.

Looking at page 4, despite the significant impact COVID-19 has had to the economy, financial markets and even electricity demand, we have been one of the few companies that has not seen any material adverse impact. We believe that this really illustrates the quality and predictability of our cash flows. Our plants remain fully operational and we believe we will be able to meet the expected revised scheduled commissioning dates for capacity under construction. With superior access to capital and operations, we should further differentiate ourself to our competition during this challenging time

On page 5, we provide some more granularity around the status of each of our ground mount plants under construction. All of ground mount projects we are working on are expected to be completed by the expected revised COD dates. The COVID-19 pandemic is recognized as a force majeure event and we do not expect to incur any financial penalties for any delays related to the virus. Marginal cost increases associated with slower build out, as the local economy limps back to normal, is expected to be offset by the cost efficiencies we have been able to drive in procurement due to softening material prices resulting from CoVid.

Looking at industry and regulatory developments on page 6, we still see significant demand for new renewable energy in India despite recent events. There were 17 GWs of new tenders released during this past quarter and we are tracking a significant amount of potential new tenders that will likely come up for auction in the next 12 months. The government has committed to maintain a trajectory of Renewable Energy growth as per targets declared by the Indian prime minister of 175 MWs of Renewable Energy and 100 GWs of Solar by 2022.

We are seeing more auctions focused on supply with higher capacity factors, such as wind/solar hybrid, round-the-clock power, as well as dispatchable such as peaking power. DISCOMs want a flatter supply curve of power for grid reliability and capacity that can dampen variability of renewable generation. Longer term, we believe that technologies such as hybrid and storage will be the norm and there is an opportunity for us to participate in the near term and to earn returns above our cost of capital.

The Ministry of New and Renewable Energy or MNRE has also confirmed a blanket extension in CODs for solar projects related to COVID-19 of the duration of the recent lockdown, plus 30 days for normalization. In addition, an extension can be requested for any supply chain disruptions related to the pandemic. Our revised CODs are provided in the appendix of our presentation but generally are about 1 quarter later than originally scheduled.

Our plants remain fully operational during the recent "lockdown" in India as electricity generation is designated as an essential service in the country and we have been receiving payments towards electricity supplied from all our customers in normal course. MNRE has sent a directive to all state DISCOMS to reiterate that all renewable energy facilities in India have been granted "must run status". MNRE has further clarified that any curtailment but for grid safety reasons would amount to deemed generation.

Turning to Safe Guard Duty (SGD) and the proposed replacement Basic Custom Duty (BCD), the Directorate General of Trade Remedies initiated a review investigation to examine whether there is a

need to continue / revise the duty structure, and we expect that they will provide a finding before the SGD expires on July 29 2020. As a reminder, all our projects are protected under change in law provisions and we do not expect any material impact on our returns from BCD or SGD.

On the operations front, our assets continue to perform as expected. We have put in place a systematic program for increased digitalization across the assets, and some of the key features of this program, as mentioned in the past, include Drone Based Thermal Imaging, Enhanced analytics in our plant monitoring platform for predictive analysis and root cause failure determination, Robotic Waterless module cleaning systems, Automatic Plant Perimeter Security Management systems, and Spares / Inventory management systems. We expect to see improvement in asset performance and reduction in operations costs on account of these initiatives.

With that, I will turn it back to Ranjit to discuss long term guidance as well as comments on our equity needs.

Ranjit Gupta

On page 7, our view of strong future MW and cash flow growth remains unchanged. Once our 1,307 MWs under construction are completed, we expect that CFe from operating assets will be about double the FY'20 level once these assets have been operational for a full year. Looking out further, as we commission the 4GWs in our pipeline, we expect that CFe from operating assets will be nearly quadruple the levels reports in this past fiscal year.

Page 8 discusses our equity needs for the next 5 years. We are pleased to highlight that we have identified opportunities to reduce the additional equity needed to fund our 4 GW pipeline by $150 million since we provided this number in February. As a reminder, this additional equity need of $450 million is spread out over a five year period.

As I mentioned before and would reiterate again, we will pursue the lowest cost of capital and as we view it today, issuing shares is one of our highest cost options. We believe there are a multitude of lower cost options to satisfy our equity needs including Internal cash flow generation, optimizing cash flow through cost reductions, refinancing, reducing working capital, investment grade Green Bond that lower borrowing cost and reduce equity needs through higher leverage, asset sales, corporate debt at parent level with international lenders and bringing in strategic investors.

As a path to continue reducing our equity needs, we have engaged a banker to explore selling a second group of assets in addition to the first set. COVID-19 could slow the asset sale exploration but currently we see good level of initial interest for these assets.

One other point of corporate housekeeping. We are considering filing a blanket shelf that would be effective for at least three years. We are considering doing this now as there are cost savings and time synergies tied with filing the shelf with our annual report. As a reminder, we do not expect to issue shares before at least FY'22 and we continue to look for opportunities to push this date out even further.

I would now like to turn it over to Pawan to go through the fiscal fourth quarter results.

Pawan Kumar Agrawal
Thank you Ranjit.

On page 9, we show that as of March 31st, 2020, we are operating 1,808 megawatts on a PPA or AC basis or about 25% more than what we had at the end of the last fiscal year and on a DC basis, we added

41% more capacity compared to last year. We are pleased that we have one of the best counter party profiles of any large renewable company in India with about 59% of our operating assets having PPAs with the highest grade offtakers such as SECI, NTPC, GUVNL and BESCOM.

The quality of our offtakers is really illustrated by our days sales outstanding. Currently, the majority of our accounts receivables that are past due are concentrated in only 10% of our operating assets and we are making progress in getting back payments from these customers. If this 10% was excluded, only $6mn, or 4% of our revenue, was past due even during COVID. Even though our customer profile is strong, it should continue to improve even further over time as we complete our committed and under construction capacity of 5,307 MWs, 98% of which is with SECI, one of the highest rated counter parties in India. Just to walk you through the improvement of our counterparty as we finish our portfolio, 59% of our current operational portfolio of 1,808 MWs is with the highest grade off-takers, which will increase to 73% once we complete the 1,307 MWs under construction, and will improve even further to 88% once we complete our entire committed portfolio of 7,115 MW.

Focusing on project cost per megawatt operating for the projects built during fiscal year 2020, excluding the impact of safe guard duties which represented about 40,000 dollars per megawatt, our cost per megawatt on a DC basis decreased by 27% to 430,000 dollars. We are proud of our ability to drive costs lower. Of the 13 cents per watt year on year decline in project costs, only 3 cents of this was related to lower module costs. Most of the reduction in our project cost reflects our innovation, our drive for efficiency gains and pursuit of optimization.

Turning to page 10, looking at the P&L, we had numerous adjustments this quarter which resulted in a net loss of US 5.2 million. If you were to take these out, then we would have reported a profit of about US 2.1 million. A couple of modeling items that we would like to point out as it related to 1Q’21 and FY’21. One other point I would like to highlight is that we remain very focused on cost controls and we continue to expect that we will be able to reduce our G&A costs by at least 10% in fiscal 2021. We also expect to incur about $3 million per quarter in tax expenses, most of which is related to the Green Bonds.

One of the major headwinds this quarter and was the volatility of FX. The INR depreciated 9% over the past fiscal year and 5% in the fourth quarter. We recognize that the FX variability results in a longer term higher cost of capital for us so as a management team, we are committed to mitigate forex risk in our business and are taking steps to help insulate our returns and profitability from this. We took out FX hedges for most of our capacity we expect to construct over the next 12 months to provide greater certainty to our cap ex and returns. While so far we have been primarily hedging our foreign currency borrowings, going forward we also intend to hedge the imported components of our capex as well.

On interest rates, the current environment is actually more favourable to us than pre COVID. Much of our project financing is priced off of benchmark base rates, all of which have fallen significantly in recent months. As an example, we finalized a project financing below 9% in INR terms which compares to our average debt cost of over 10%. In addition, our Green Bonds are trading above par and have some of the lowest yields of any Indian renewable energy company which we believe really illustrates the quality and resilience of our assets. Given this more favourable interest rate environment, we will continue to refinance existing loans to save cash flow and capture equity value even if refinancing leads to a one time charge in the P&L. We do expect that we will be incurring a charge for refinancing this quarter and as a result our interest expense in 1Q’21 will be about $35 million. As a reminder, the present value of the equity uplift for every 1% reduction in our effective interest rate is ~$300 million.

We are producing more cash as well. On page 11, we show the primary drivers to the 15% year to year increase in CFe from Operating Assets to $43 million. One item that we would like to point out related to

CFe is on amortization. For reported CFe for FY'20, we include actual amortization in our CFe calculation which was about $8 million as most of our debt is in our Green Bonds which do not amortize. However, for our long term CFe guidance, we assume that our debt will amortize over a 20 year period and our debt amortization assumptions are much higher than what we are actually currently paying under the Green Bonds.

Turning to the balance sheet outlined on page 12, we had ~ $130 million of unrestricted cash and cash equivalents at the end of the fourth quarter and our days sales outstanding was 126. We reiterate what we said in our recent 6K filed on June 12th that our liquidity position remains sufficient to continue normal operations through at least the end of fiscal year 2021, ending March 31, 2021, even if only the highest debt-rated counterparties, such as Government-of-India-owned SECI, continue to make payments for electricity received. It's important to note that while all Banks and FIs in India allowed a moratorium on the servicing of loans due to the CoVid pandemic, your company stood tall and didn't avail any moratorium given our strong liquidity position. In fact we prepaid some of our loans during this period, which clearly reflects how well we are positioned. As of the end of last month, or May 31, 2020, we had about $105 million of cash and cash equivalents as we spent some money on under construction projects and and prepaid a part of our debts. Our DSO as of the same date was around 134 days.

On the green bonds, we expect to report their results by the end of the month. Their performance, as they represent about two thirds of our operating assets, were in line with the operations of the overall company. We would like to highlight that both of our Green Bonds received a one notch upgrade from Moody's in March after CDPQ acquired a majority stake in our company even though the economy was facing the negative impacts related to COVID-19. However, Moody's did revise the outlook for our second restricted group Green Bond to Negative in June, which was in line with Moody's revision of the Government of India's sovereign rating given the portfolio's large exposure to sovereign offtakers and the debt rating on RG2 being only one notch below India's Sovereign Credit Rating.

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

Ranjit Gupta

We are reiterating our FY 2021 guidance at this time as can be seen on page 13. There are only 2 weeks left in the first fiscal quarter of fiscal 2021 and we expect fiscal first quarter 2021 revenue will be between INR 3.8 to 4 bn and our PLF will be between 22 – 23%.

With this, we will be happy to take questions.

QUESTIONS AND ANSWERS