Embassy REIT

3Q FY2020 Earnings Call

February 14, 2020

CORPORATE PARTICIPANTS

Michael Holland - Chief Executive Officer (CEO), Embassy REIT

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MANAGEMENT DISCUSSION SECTION

Operator: Good evening everyone. A very warm welcome to all for the Embassy REIT's third quarter FY2020 Earnings Conference Call. Currently, all participants are in a listen-only mode. Our speakers will address your questions at the end of the presentation during the question-and-answer session. As a reminder, this conference call is being recorded.
I would now like to introduce your host for today's conference - Mr. Ritwik Bhattacharjee, Head - Investor Relations for Embassy REIT. Sir, you may begin.

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Ritwik Bhattacharjee

Head – Investor Relations, Embassy REIT

Thank you, operator. Welcome to the third quarter FY2020 Earnings call for Embassy REIT.

Embassy REIT released its financial results for the Quarter ended December 31, 2019 a short while back. As is our standard practice, we have placed the reviewed financial statements, an investor presentation discussing our quarterly performance, and a supplemental financial and operating databook on our Website at http://ir.embassyofficeparks.com under the Investor Relations section.

Our management team continues to engage extensively with various stakeholders including unitholders, research analysts, industry associations, media and the regulators for educating investors and strengthening the REIT market further in the country.

As always, we'd like to inform you that management may make certain comments on this call that one could deem forward looking statements. Please be advised that the REIT's actual results may differ from these statements. Embassy REIT does not guarantee these statements or results and is not obliged to update them at any time.

Joining me on the call today are Michael Holland, the CEO, Vikaash Khdloya, the Deputy CEO and COO, and Aravind Maiya, our Deputy CFO. Mike will start off with the third quarter highlights, business overview and strategy followed by Vikaash and Aravind. We will then open the floor to questions.

Over to you, Mike.

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Michael Holland

Chief Executive Officer (CEO), Embassy REIT

Thank you, Ritwik.

Good evening - thank you for joining the call. Today we announced our third quarter results and we have had another great quarter.

The first three quarters of this fiscal saw some uneven macro factors both in India and internationally. In contrast, given that our office business caters primarily to the international corporations based here in India servicing their own home markets through the cost-effective talent available here in India, we continue to see growth from the strong and consistent occupier demand. In fact, we are on pace to have one of our strongest leasing years by square feet leased with YTD re-leasing spreads averaging 56% on new deals.

This buoyant occupier demand for Indian office sector was illustrated by leading property consultants reporting pan India year end gross leasing numbers of around 60 msf, growing more than 25% year on year, a continuation of the consistent positive trend we have seen over the past few years. As we look ahead into 2020, both our portfolio's demand pipeline and the overall market forecasts from leading property consultants remain encouraging, and suggest similar, if not higher, levels of lease up in the coming year.

Technology companies are the fastest growing businesses in the world and accounted for the majority of new leasing in many markets including USA and India in 2019. With over two million students graduating each year in Science, Technology, Engineering and Mathematics, India leads in STEM talent for technology assignments and the cost is also favorable here relative to the rest of the world. It's because of tech talent that, again, in 2019, India absorbed more office premises than any other national market in the world. And Bangalore, which is our key market, continues to be the #1 location in Asia for technology occupiers.

And in the last quarter we've again seen reports of double digit YoY growth in hiring, we've heard our existing occupiers confirm plans for continued growth and there is a strong pipeline of demand across our markets particularly from the technology segment, including demand from artificial intelligence, data analytics, cloud computing and cyber security tech firms and this aligns with the occupier businesses which are growing within our portfolio. And only this week, here in Mumbai, we've heard a similar theme from the Nasscom Annual Strategic Review.

The indicators are consistent. Abundant tech talent at an attractive cost is a powerful combination that has driven leasing, and we believe will continue to drive growth in demand through 2020 for high quality office product in the major metros of India, primarily in the 4 cities in which we operate.

On today's call, you'll hear how the scale of our business give us a significant competitive advantage - how we have maintained our lease up momentum in Q3, how we are growing our portfolio through both organic growth through delivery of 1.4 msf of our on-campus development program as well as inorganic growth through our accretive add-on acquisition of c.0.6 msf at Embassy Manyata, and the analysis of large scale, high quality acquisition opportunities to further expand the portfolio on the strength of our balance sheet and add value for our unitholders.

We remain committed to our business strategy. Delivering total return through regular and predictable quarterly distribution supplemented by growing NOI and underlying value through various accretive growth initiatives including potential acquisitions. The business continues to be in excellent shape, and it's been another quarter of solid earnings growth. Q3 saw year on year Revenue and NOI growth at 14% and 16% respectively and we plan to distribute Rs. 4,707 million to Unitholders this quarter.

Vikaash will now discuss in detail our business and operating performance.

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Vikaash Khdloya

Dy CEO and Chief Operations Officer (COO), Embassy REIT

Thanks, Mike. Good evening, everybody. Business highlights for this quarter include:

- new lease-up of c.527k sf with a strong forward pipeline of c.500k sf;
- successful completion of 2 under-construction office developments totaling 1.4 msf, with both projects delivered ahead of schedule and 44% pre-committed;
- moving ahead with the next phase of on-campus development growth with construction of 2.6 msf now underway; and
- acquisition of c.0.6 msf leasable area in Bangalore within the overall Embassy Manyata campus upon building completion in 4Q FY2023 at a 9.25% yield.

Now let me take you through the details.

Leasing continues to be a core driver of our business growth

We had another strong quarter of leasing performance. We leased c.527k sf in Q3 to 10 tenants driving our occupancy at the end of Q3 to 95.1%, an increase of 40 bps compared to Q2 occupancy. With this, our lease-up for the 9 months of this fiscal year is c.1.7 msf, similar to the levels we achieved for the full 12 months in the previous year.

Our near-term leasing pipeline continues to be encouraging at c.500k sf, including some strong interest for our Embassy Manyata NXT as well as Embassy Oxygen projects wherein we are in advanced discussions with renowned global corporations. With this good progress, we are aiming to surpass the previous highest full year lease-up of 2.1msf achieved in fiscal 2016.

The quality and scale of our portfolio makes us the landlord of choice within our sub-markets resulting in our properties commanding a rental premium. We also achieved c. 56.3% mark-to-market spreads on over 1.1 msf of re-leases YTD demonstrating the continuing appeal of our product and the embedded growth in our portfolio.

Our on-campus development delivers ahead of schedule

In the previous quarter, we indicated that we were ahead of schedule on the 1.4 msf on-campus development projects. We confirm that we have delivered these projects with 44% leasing pre-commitment at rents which are new benchmarks for their respective micro-markets. These occupiers comprise some of the global fortune corporations and they are expected to commence operations in the second half of 2020. We are currently in active discussions with a number of occupiers for the balance area. This impressive traction for our projects even prior to completion and at rents which are at a premium to market validates our strategy in relation to new development.

Given that our portfolio is now 95.1% occupied and our sub-markets are generally running at sub-6% vacancy, we are now moving ahead with an additional 2.6 msf of on-campus development to drive our next phase of growth. This 2.6 msf of new development is spread across 4 blocks and three of our portfolio cities namely Bangalore, Pune and NCR. Our endeavor here is to do more of the same i.e., on time delivery and high levels of leasing prior to completion.

Moving to our add-on acquisition at Embassy Manyata

In late December 2019, we entered into an agreement with Embassy Sponsor to acquire c.0.6 msf leasable area within the overall Embassy Manyata business park campus upon development completion in 4Q FY2023. Considering Embassy Manyata is our largest asset with 11 msf completed area and consistently running at close to 100% occupancy over the past few years, the additional office block will help cater to the growing space requirements of our occupiers in a strong micro-market in Bangalore. This c.0.6 msf acquisition also helps consolidate existing M3 land parcel at Embassy Manyata. At a 9.25% yield, this debt funded acquisition is expected to be DPU accretive upon stabilization. The acquisition cost of Rs. 7.4 bn shall be funded through additional debt and will be paid in tranches linked to milestones.

The other, significantly larger acquisition opportunity which is currently under consideration is the ROFO asset of Embassy TechVillage pursuant to a ROFO notice received from Embassy Sponsor last quarter. With over 6 msf of completed area currently c.97% occupied and c.2 msf of office development as well as proposed 518 keys Hilton hotels, the asset is one of the premium assets located in the Outer Ring Road micro-market in Bangalore with a diverse tenant roster comprising technology, banking, finance, e-commerce and engineering occupiers. The opportunity is currently under detailed evaluation and we will report more at an appropriate juncture. We continue to evaluate other acquisition opportunities which can fit our criteria of high quality, large scale business parks located in the right micro-markets which are accretive, and which offer further upside through active asset management.

Lastly, I will cover our asset management initiatives which are core to our business philosophy

Our hotels exist to complement our business parks and benefit from their captive demand. Hilton at Embassy Golflinks continues to perform well with both YTD GOP margin and RevPAR up 500 bps and 600 bps respectively on a year-on-year basis.

Further, our Four Seasons hotel at Embassy One has had an encouraging quarter after a slow start. Occupancy for Q3 was 26% vis-à-vis 10% in Q2. Our operator Four Seasons has to-date signed over 120 corporate accounts and the hotel has been rated the best new business hotel in India and South Asia by Travel & Leisure. Our on-ground teams remain focused on ramping up occupancy and turn cash positive over next 2-3 quarters.

In relation to our ongoing infrastructure and amenity upgrade initiatives, we have successfully repositioned Embassy 247 including recent launch of a large format lifestyle store by India's leading retailer at the ground floor. Our ongoing efforts at this asset over the last 24 months has seen meaningful increase in both occupancy as well as rents, both metrics significantly higher today.

Our comprehensive infrastructure programme at Embassy Manyata comprising of construction of a new flyover, construction of 619 keys dual branded Hilton hotels and masterplan upgrade initiatives are all on track. The positive occupier interest around the hotels and infrastructure initiatives validates our strategy and will further deepen the moat around this asset and be a key trigger for mark-to-market and pre-commitments during the next phase of development at Embassy Manyata, our largest asset.

To conclude on our business performance for the quarter, our leasing continues to be robust with 1.7 msf YTD, we have made significant progress on our on-campus development adding 1.4 msf to our existing portfolio and are proceeding with an additional 2.6 msf of new development; we continue to be active asset managers across all our properties and we have concluded our first acquisition since listing.

Over to Aravind now for the financial updates.

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Aravind Maiya

Dy CFO, Embassy REIT

Thanks, Vikaash. Good evening, everybody.

I will now present our financial results for the third quarter.

- Our Revenue from Operations increased by 14% YoY to Rs. 5,459 million, mainly driven by continued leasing momentum across the portfolio;
- Net Operating Income (NOI) increased by 16% YoY to Rs. 4,639 million; and
- Our third quarter distribution stood at Rs. 4,707 million which translates to a DPU of Rs. 6.10 per unit for this quarter. With this, our cumulative distribution for the nine month ended December 2019 totals Rs. 13,504 million which is Rs 17.50 per unit.

As you can see from above, we had another strong quarter of financial performance.

Earnings Performance

I will now discuss in detail on our third quarter earnings performance.

- **Revenue from Operations** grew by Rs. 685 million or 14% YOY, mainly on account of our strong leasing momentum with lease up of c.1.8 msf as well as contractual rental escalations across c.6.1 msf of space. In terms of revenue drivers for the quarter, vacancy lease-up and mark-to-market contributed 30% of the revenue growth, rental escalations and other contracted income contributed 30% whereas hotel operations (including our recently launched Four Seasons) contributed 23% of the overall increase in our revenue from operations.
- **Net Operating Income** grew by Rs. 655 million or 16% YOY, mainly due to increase in our Revenue from Operations as well as reduction in operating expenses due to successful implementation of certain cost-saving initiatives at Embassy Manyata. EBITDA for third quarter grew by Rs. 767 million or 21% YOY, due to our NOI increase as well as certain one-off items in the previous year.
- Our **Operating Margins** once again reflect the benefits of our scale as well as our low manager fees - both our NOI and EBITDA margins stood at a healthy 85% and 82% respectively.
- **Net Profit after Tax** stood at Rs. 2,535 million representing an earnings per unit of Rs.3.28 for Q3.

Distribution

I will briefly touch upon our distribution for third quarter. Our Net Distributable Cash Flows (NDCF) at the REIT level for this quarter stood at Rs. 4,710 million. The Board of Directors in their meeting held earlier today declared a quarterly distribution totaling Rs.4,707 million or Rs.6.10 per unit, representing a distribution payout ratio of 99.9% for Q3. Cumulatively we have now declared a YTD distribution of Rs 13,504 million or Rs.17.5 per unit with a YTD distribution payout ratio of 99.65%. The record date for Q3 distribution is February 24, 2020 and the distribution will be paid on or before February 29, 2020.

Turning to our outlook for the remainder of fiscal year FY2020, we continue to expect strong leasing in our key assets, including recent completions at Embassy Manyata NXT and Embassy Oxygen. Partially offsetting these gains, will be two factors we mentioned during the previous quarter's earnings call – namely, the slower than anticipated lease-up of Embassy One office tower and ramp up of Four Seasons hotel. Notwithstanding, we achieved 17% NOI growth YTD and expect similar growth for the remainder of the year. Taking these 2 factors into account, our distribution guidance for the full year

FY2020 is now in the range of Rs.23.9 to Rs.24 per unit i.e. approximately 96.5% to 97% of our initial target. Business fundamentals remain strong and we believe that our proactive asset management approach will continue to drive meaningful results over the medium and long term.

Strong Balance Sheet with Low Leverage

I now want to briefly touch upon our balance sheet strength and how our low leverage of 12% Net Debt to TEV places us in a prime position to drive our growth initiatives. To recap, our capital outlay during Q3 was towards (i) 1.4 msf new deliveries as well as 2.6 msf of under construction projects, (ii) various infrastructure initiatives including the 619 key Hilton hotels at Embassy Manyata, and (iii) add-on acquisition of 0.6 msf. M3 Block B within overall Embassy Manyata campus.

To fund the above growth initiatives, we successfully secured Rs.16,400 million debt during third quarter at an attractive 9.03% interest rate, 86 bps lower than our Q2 in-place debt cost. This includes the Rs.6,500 million Tranche II listed bond at 35 bps lower than our Tranche I bond raised in May 2019 as well as Rs. 9,900 million debt at one of the lowest rates in industry to fund ongoing construction at Embassy Manyata and Embassy Oxygen. Our overall interest cost decreased by 24 bps compared to Q2 and we are currently actively evaluating certain refinancing opportunities to further optimize our debt costs.

Our ability to raise debt at competitive rates demonstrates flight to quality by lenders to fewer, high quality borrowers with disciplined balance sheets. As of end of third quarter, we have a proforma additional debt capacity of Rs.111 billion or $1.6billion (assuming current asset base and constant property values). Our conservative leverage is particularly valuable in the current environment and provides significant flexibility for growth initiatives.

To conclude my remarks, on a YTD basis, Revenue from operations was up 16%, NOI and EBIDTA margins remain robust at 85% and 81% respectively and our YTD distribution totaled Rs.13,504 million i.e.Rs.17.5 per unit. Further, we continue to maintain a strong balance sheet with low leverage and have plenty of firepower to fund our on-campus development as well as pursue acquisitions, should accretive opportunities arise.

I now hand it back to Mike for his concluding remarks.

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Michael Holland

Chief Executive Officer (CEO), Embassy REIT

Thanks Aravind.

So, another solid quarter delivering to all stakeholders and building on the previous two quarters post listing.

Currently, key focus areas include:

- Conversion of the projected leasing pipeline of c.500k sf and lease up of the remaining c.0.8 msf of the 1.4 msf of newly constructed blocks at Embassy Manyata and Embassy Oxygen.
- Continuing our drive for ramp-up of Four Seasons hotel and lease up of 250k sf Embassy One office tower
- Drive progress of 2.6 msf of new on-campus development projects and other infrastructure initiatives; and
- Determine way forward on our ongoing evaluation of the ROFO opportunity relating to Embassy TechVillage asset in Bangalore.

So, to conclude, it's been another strong quarter – our global corporate customer base continue to grow their business in India, and at Q3 YTD we have leased 1.7 msf with an additional c.500k sf near term pipeline, we have delivered 1.4 msf ahead of schedule with ~ 44% leased prior to completion. We have some large scale, high quality acquisition options for our near-term consideration. We have delivered a YOY NOI growth of 16% and a total distribution YTD of Rs 13,504 million i.e. Rs.17.5 per unit and a 41% uptick in unit price as at 31 December 2019.

So that's the business overview for 3QFY2020 – let's move to Q&A please:

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QUESTION & ANSWERS SESSION

Moderator: Sure. Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Murtaza Arsiwala from Kotak Securities. Please go ahead.

Murtaza Arsiwala: Hi, Mike. Hi, everyone. My first question is on the dividend distribution tax. Given the new sort of regulations as they stand right now, a) what is the savings that we could anticipate if we were to take FY'21 as a benchmark in terms of Embassy Golf Links and Embassy Manyata in terms of the exemption of dividend distribution tax, and have there been representations or where does the stance on dividend distribution, taxing of dividends in the hands of the individuals stand as far as the Budget proposals go?

Michael Holland: Thanks, Murtuza. Of course, this has been a hot topic of late. Aravind will explain the detail of how the change proposed, which is as you know yet to be enacted, has minimal impact for Embassy REIT for FY'20 and '21. I'd just like to say that the proposed change to the DDT exemption is far from ideal given such changes do impact investor confidence. You are aware, I think that it has been reported, representations have been made by numerous industry bodies to restore the earlier status and we will watch the outcome of those representations with interest and see the response from the Government before it is ratified in the final Budget in March. But we just underscore that it has limited impact for us over the next couple of years. Aravind, can you go through the detail on that.

Aravind Maiya: Sure, Mike. I think I will just start off with some background about our distribution which basically takes three forms -- One is interest on SPV level debt; the second one comprises the SPV debt repayment itself; and the third being the dividends distributed by SPVs. The proposed tax change impacts only the last component which is the dividends distributed by SPVs. Assuming that this DDT exemption is not restored back and also given that the dividend for FY'20 is a small proportion, which is about 1% for the distribution YTD, we believe that it will have almost a negligible impact on our pro forma YTD FY2020 yield for our investors. Just to give you some stats, for our foreign institutional investors, it might impact by about one basis point, whereas resident individuals at the highest tax bracket might impact by two basis points. But hypothetically, if we were to assume that the dividend proportion increases to about 10% from the current 1%, then the impact for the current yield for pro forma FY2020 would be for foreign institutional investors approximately 9 basis points, for domestic companies approximately 15 basis points, and for resident individuals at highest tax brackets, approximately 26 basis points. However, what I want to mention is that we will continue to optimize a mix of distribution between these three components and would like to say that we believe the impact to be negligible in the short-term and we are awaiting the outcome of the representations which we have made to several ministries.

Murtaza Arsiwala: Aravind, just as a follow up, the other part of the question was, what is the savings, because Embassy Golf Links is not 100% owned, is there any savings element for Embassy in terms of the dividend distribution tax which you at the REIT level would be paying?

Aravind Maiya: As I mentioned, Murtuza, basis what we have computed, the impact to FY next year should be negligible with the different optimization which we believe we want to factor in including the Golf Links which you mentioned.

Moderator: Thank you. The next question is from the line of Tanuj Mukhija from Bank of America. Please go ahead.

Tanuj Mukhija: My first question is what is the construction cost of the assets completed ahead of schedule? Second question actually a follow up to that is our guidance was that the zero coupon bond was taken basically for under-construction assets. Now that you have completed the assets, would you look to convert the corresponding construction cost to interest paying debt?

Michael Holland: So, I think Vikaash can certainly answer that second question on the zero coupon bond.

Vikaash Khdloya: Tanuj, Hi, this is Vikaash here. So quickly on both of your questions, one, approximately the construction cost for the 1.4 million square feet, which we delivered across two projects would be Rs.5,320 million. Again, just to highlight there, some of the cost was incurred prior to IPO and we incurred the balance as we completed the construction post listing. So that is the first part. On your second part, Tanuj, again, as we mentioned earlier, we are currently 44% pre-committed on these two blocks which we delivered two and three quarters ahead of schedule. If you include the growth options, the pre-commitment levels would be 58% on a blended basis. Now, it would take 6 to 12-months for these assets to stabilize and start generating stabilized NOI due to the time required for tenant fit outs in their entry period. We believe that the full year impact of the NOI would be in FY'22 and it is at that point in time that we will consider converting the zero coupon into a coupon bearing bond to match the interest cost to the yield from the newly built assets.

Tanuj Mukhija: At 44% pre-leasing, could you tell us what are the rents which you have pre-leased so that we get tentative idea regarding what could be the revenue from the asset and how would that impact let us say your dividend growth if at all? Any impact on dividend growth?

Vikaash Khdloya: Again, two, three things; one, of course, we think this demonstrates our philosophy of delivering under construction to grow and de-risk the project by kind of achieving high levels of pre-commitment prior to completion. Now, especially in both these projects, given the high quality, we have been able to achieve market leading rents in the respective micro markets and yields for both these projects were anywhere in the range of 12% to 14%. This is post factoring the land cost which was already valued at the time of the listing.

Tanuj Mukhija: Third question, if I may, was on the 2.6 million square feet additional development. How would you fund the construction cost for this development potential? And could you just remind us, which assets does 2.6 include and what are the assets that you have added currently in this quarter?

Vikaash Khdloya: Sure. Tanuj, in case you have the investor presentation with you, I will quickly refer you to slide #27. If you see FY'20 bar, the two assets which we delivered ahead of schedule are the 0.8 million square feet of Manyata Front Parcel NXT blocks, that is in Bangalore, and the 0.6 million square feet in the dark blue box is the Tower 2 at our Embassy Oxygen Park in Noida. So, that totals to the 1.4 million square feet which we delivered. Now, coming to what we are doing currently is encouraged by this response on the pre-leasing activity we have seen on these two blocks plus given that Bangalore, Pune are sub-6% vacancy level with high pre-commitment interest, we have kick started the next two blocks in Embassy Techzone which is in Pune. Again to highlight earlier the thought was to do one block but now we have launched both Hudson and Ganges block, that we will deliver sometime in December '21 and then we have also kick started the last tower of Oxygen which is the 0.7 million square feet and the 1.6 million square feet which you see in Embassy Manyata Bangalore relates to the M3 land parcel both the earlier 1 million square feet block and recently entered into forward purchase agreement for the 0.6 million square feet Block B. So in summary, what we are trying to do here is all the three assets in the REIT where we have development potential, we have kick started the next phase of growth.

Now quickly to just answer your second part of the question on how are we going to fund it? If I can refer you to page #41, currently, the way we are thinking about it is we have SPV level debt at the respective SPVs, whether it is Embassy Manyata or Oxygen and we have undrawn facilities to the extent of approximately Rs.4,000 million. You can see that in the blue shaded box. Plus, whether it is through the recently raised Tranche II Bond or through additional construction debt at Embassy Tech Zone, Pune, we will fund the construction there. So, we are pretty well covered, we are adequately funded and actually given the distress overall in the market, it actually has worked to our advantage in terms of interest rates where we are able to get even construction financing at really attractive interest rates.

Tanuj Mukhija: One data point request from my end. At what rent did you lease office space in Manyata to WeWork?

Vikaash Khdloya: So, Tanuj, again, I would not be able to disclose a specific tenant rent detail, but why don't I say this that overall on the front parcel NXT block in Embassy Manyata, we have really seen triple-digit rents which are new highs for the respective micro market. On the specific lease you mentioned about, one, we see co-working as very complementary to our overall total business ecosystem offering and we have obviously gone through the necessary processes given it is a related party and we have got adequate arm's length benchmarking done by Grant Thornton in this case.

Moderator: Thank you. We take the next question from the line of Saurabh Kumar from JP Morgan. Please go ahead.

Saurabh Kumar: Sir, first is this net debt increase to Rs. 4,500 crores from Rs. 3,900 crores last quarter. So what's driving that? And secondly, Mike, on the supply outlook, so effectively you obviously put out a supply outlook. But if you kind of triangulate versus what some of the listed peers have announced in 3Q, the numbers are pretty high. So I just wanted to get a sense as to how you are thinking about the fact that almost all your competitors in Bangalore and NCR are talking about almost 15 million square feet to 18 million square feet of new developments? And how are you reading the market, maybe not today, but maybe one to two years out? These are the two questions. Thank you.

Mike Holland: Clearly I will deal with that supply question, Aravind, can you take the first question.

Aravind Maiya: Sure, Mike. So Saurabh, in terms of the debt, as Vikaash explained in slide 41 of the investor deck, we have taken about Rs. 16,400 million of debt in Q3, at pretty attractive interest rates. And in terms of end use of this debt, all of these are for the on-campus development which is happening.

Saurabh Kumar: No, I am talking about the net number. So the net number will be the usage. So, I am just wondering where the Rs. 600 crores got used. So I understand the gross part, I just want the net part.

Aravind Maiya: Yes, just give me a second.

Vikaash Khdloya: So, Saurabh, hi, this is Vikaash here. If I understand your question correctly, your question is whether the Rs. 650 crores of the Tranche II Bond, where did that get utilized, is that right?

Saurabh Kumar: No, so last quarter, you declared a net debt of Rs. 3,900 crores, Rs. 39 billion, and this quarter the net debt disclosed was Rs. 45 billion. The entire operating cash flow has pretty much been dividend out.

Aravind Maiya: So to answer that, it has been used for the on-campus development. And to be specific, a large part of it has gone for the M3 Block, the acquisition which we did in Q3.

Saurabh Kumar: Okay. So of the Rs. 740 crores you probably paid about Rs. 600 crores odd, is that fair?

Aravind Maiya: No, we have paid about Rs. 425 crores as at December.

Saurabh Kumar: Okay. And the remaining will be CAPEX?

Aravind Maiya: Yes.

Mike Holland: And the second question, Saurabh, the supply side. I mean, actually, in summary, we see the supply and demand forecast as being nicely balanced. I think if you look at Slide 19 of our latest deck, which is on the website, you can see quite a detailed breakdown of that. We have looked across all the markets, and, our four city markets. We have identified what we believe are all of the projects across those markets which total some 180 million square feet. We have broken those down into projects which, we believe, are credible, that they will be delivered within the next three years. And then we have looked at those projects which we see as being realistic competitors to our type of project. And you can see from that deck that actually within that overall 180 million, because the number of projects simply won't be completed in the three year time frame, in fact, a number of them haven't started, there's about 13% of that overall gap of supply is realistic competition for us, about 24 million square feet.

I mean, clearly, every project which every potential developer announces is not necessarily going to be delivered. And that is accentuated by the well-known liquidity issues that are out there in the market, for funding this development pipeline. So, we looked at it carefully and we have looked at pretty much all of those projects that we believe are there. We feel that it's nicely balanced. And actually, if you look at some of the data points that have been put out by people like a CBRE, they are talking about in 2020 and 2021 the ratio in our markets is approximately 43 million square feet to be absorbed, 40 million square feet of supply, and 39 million square feet and 40 million square feet in 2021. So, yes, people announced schemes, but they are unlikely or many of them are unlikely to be delivered. We are comfortable with the supply demand position.

Saurabh Kumar: Okay, I will take a follow up but probably later. Thank you.

Mike Holland: Yes. And on that, we are happy to go through that detail with you at any time.

Moderator: Thank you. The next question is from the line of Abhishek Bhandari from Macquarie. Please go ahead.

Abhishek Bhandari: Congrats on a very stable performance. If I look on your Slide #31 where you have given detail of the M3 Block what you have acquired from the Embassy Group at a forward rate of 9.25% yield. And comparing that with 8% stabilized cap rate of Embassy Manyata, is it fair to assume these are your guiding lines for the evaluation of the big ROFO asset that is being offered to you?

Vikaash Khdloya: So, a couple of things. One, of course, this M3 add-on acquisition that we referred to, the 0.6 million square feet, is on a forward purchase basis. And this was similar to the construct we did for the M3 Block A which was disclosed at the time of the IPO. Now coming to the

ROFO opportunity, as we mentioned earlier during the remarks, that is something which we are still evaluating. And as of today, we would not be able to comment or provide any more color on that, but we definitely will come back when we have something concrete to disclose. So, as of today, it's early to comment on what the structure, if it all, would be on that. The only one thing I would like to mention is that the structure of M3 was different in the sense that it was a forward purchase with both construction and leasing risk to the sellers account. So, it depends upon the construct in each particular acquisition transaction.

Abhishek Bhandari: Thanks for that, Vikaash. I have two follow-ups here. I know you can't comment on valuation, etc. But if you look at the stabilized cap rate of 8% and our borrowing costs being at best 9%, incrementally, how would you want to make it a DPU accretive one? I am just wondering how does the math work?

Ritwik Bhattacharjee: I think that's a pretty good point. We as a REIT in India do face sort of the situation of having our cap rate inside the borrowing rate. So I think, theoretically, when you think about REITs being able to sort of finance a lot of acquisitions and I'm talking very theoretically here, and in global markets they are able to use debt. For us I think we got to be a little more prudent about how we finance any sort of acquisition that we can make in an accretive format. I think there is clearly, we are trading well with our equity at this point, we are trading at a premium to equity, so that's always also a consideration that we would use. But I think then I am talking about this, just from a very theoretical construct. But you are right, we are trading inside our cost of borrowings.

Abhishek Bhandari: Is there any firm timeline being asked to you by the sponsor for this asset consideration?

Vikaash Khdloya: So as we mentioned, we are currently doing our homework on the ROFO evaluation. But just to take a step back, the ROFO agreement which we have with the sponsor, it provides a broad framework for the process which needs to be followed in case any asset meets the defined criteria and is offered to the REIT. There is a time frame that is defined by the ROFO agreement, but that can be extended by mutual consent. We are currently focused on evaluating the opportunity in detail, and it will be difficult for us to give any particular timeline on next steps. We will definitely keep you posted as and when there are concrete next steps.

Abhishek Bhandari: Thanks for that. What is the process of the e-voting? Is it a majority of minority excluding related party?

Vikaash Khdloya: That is correct. So it's a majority of minority, excluding the related parties, which in this case, would be the Embassy sponsor as well as the Blackstone sponsor.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Just to understand this new acquisition, 0.6 million square foot. What does this Rs. 740 crores consideration include? Does it include the construction cost?

Vikaash Khdloya: Yes, it's an all-in cost. It includes the construction cost, the implied value on the land itself. So basically, it's a fully built out basis, that also includes whatever transaction fees that we incurred in terms of diligence, etc.

Sameer Baisiwala: Okay. And I presume the capital cost over the next three-year period, say roughly at 9%, that would be borne by the buyer?

Aravind Maiya: Sameer, so as I mentioned, of the cost which we have agreed, we paid about Rs. 425 crores as of date. So, the balance will be paid over the remaining 39 months, which we have agreed as the end date by when they need to deliver.

Sameer Baisiwala: Okay, got it. So, they spend money on construction and then we reimburse, something like that?

Vikaash Khdloya: That is correct. And just to add to this, Sameer, as we have disclosed in the same slide, during construction as we keep funding based on milestones that they achieve, we would make a 100 basis points spread on our cost of debt so that it is then net debt positive from a NDCF perspective.

Sameer Baisiwala: Okay. Sorry to belabor on this, so my guess here is Rs. 740 crore may move up, including the cost of financing to about Rs. 900 crores. I am just trying to get to your 9.25% rental yield on this. So, what's the sort of rental assumption that you have, rental rate?

Vikaash Khdloya: Two things, Sameer. One is that, the way the transaction is structured, as of now, we have assumed a certain rent and hence an NOI number, and did the math on the 9.25% yield, and then determined the tranches based on progress made on construction. But at the end of the project completion and delivery, there would be a true up based on actual rents received. So right now we have assumed the rents that we are seeing in the market are based on our experience at Manyata.

More importantly, in your second point on the interest, so Rs. 7.4 billion is the all-in cost, because the interest cost which you mentioned, which is the cost that we will incur as we keep paying in tranches, up to the point of completion, the Embassy sponsor is going to actually bear that cost with a 100 basis points spread. So, interest cost will not be additional.

Sameer Baisiwala: Okay, great. Now that that explains it well, thanks for this. And second question, if I heard you correct, did you say that you are going to miss the distribution target for the year and what you are going to get to be 96%, 97% of the target?

Aravind Maiya: That's right, Sameer. So if I can just give you a bit of background on that. So just starting off, as we mentioned, we have delivered about 16%, 17% growth in revenue and NOI for the year and we have delivered about Rs. 1,350 crores of NDCF. But having said that, a couple of our assets which are less than 5% of the value have had a slower than expected ramp up, which is mainly the Embassy One commercial space of 250,000 square feet, which has a leasing of approximately 5% as of date. And the Four Seasons Hotel has had a slow start as we mentioned, and the YTD occupancy of that is around 14%, but the Q3 occupancy has picked up to 26%. So basis of these factors we have taken stock of where our estimated full year numbers will be, and hence we now project that we will hit 96.5% and 97% of our initial targets.

Having said this, I think our core leasing business is still doing well with 1.7 million square feet of leasing done over the first three quarters, MTM of 56.3% achieved over 1 million square feet. And we have also delivered two office towers ahead of schedule. So, while there are these two areas where we are driving for improved performance, I think overall the fundamentals still look very strong.

Sameer Baisiwala: Thanks. There's always a good reason for missing things. But given that it's a first year of projection, and with such strong sponsorship, it's a little disheartening to see that you are going to miss your distribution target. And this is the most important target, I would imagine, from the investor perspective. Just one final question, with your permission. So, if I have understood correctly, you have to do pre-leasing of 0.5 million square feet, that's the re-leasing part in this quarter, but that's what is going to come up. And another 0.8 million square feet for the completed assets, so total we need to do about 1.3 million square feet in next couple of quarters. Is that the right number?

Mike Holland: Yes, let me take that, Sameer. So as we talked about 0.5 million square foot pipeline that we have in hand, and here we are pretty much midway through the quarter. So we are feeling good about that. You will see from our deck that every quarter we update on Slide 24 the leasing that we have done. Year to date we have done 1.7 million; we have got a strong 0.5 million foot pipeline. We have averaged 1.8 million over the last four to five years. I think in the current market conditions, leasing 2 million square feet is something that we feel comfortable with.

Sameer Baisiwala: Yes, that’s fine. But this is something that you need to do very quickly because either the asset is completed, which is 1.4 million square feet. Or leases are expiring, which is current quarter. So we don't have one year to do all this, we need to do this in a short order of time, I would imagine.

Mike Holland: Yes. So just on the 1.4 million square feet, that's 44% leased at present. We have 0.5 million square feet pipeline in our hand. And as you know, we have a very strong tenant retention rate at expiry, and we will report out on those significant leases that we have renewed at the end of this quarter. I think again, also, if you look at the market conditions in terms of demand and vacancy, we are in a comfortable position on that.

Sameer Baisiwala: Excellent, and good luck to you for this. Just one final, on Slide 23. And this is a new lease signed 527,000 square feet. How much of this has been the existing tenant continuing? Is it 128,000 square feet or is it the higher number?

Mike Holland: So, I think we have got that number.

Vikaash Khdloya: Sameer, so the existing tenants, and just to clarify, when I mentioned existing tenant, it can be in the same asset or it can be in any other asset in our portfolio. The existing tenants contributed 78% of the 527,000 square feet lease in the quarter, while our historical average is of approximately 62%. And 128,000 square feet that you mentioned, Sameer, that relates to the renewals with the tenant which are already in place in our respective assets.

Moderator: Thank you very much. The next question is from the line of Chandrasekhar Sridhar from Fidelity. Please go ahead.

C. Sridhar: I just had a bookkeeping question, on Slide #25. In the previous quarter, you had indicated there's about 0.8 million square feet of area expiring in FY'20. And for this quarter's presentation is 1.2 million square feet expiring. So could you just sort of help me understand how has this number gone up?

Vikaash Khdloya: So, while we will get back to you with the specifics, so what we do on this slide is we continuously update this every quarter so expiries of two kinds - One, when we do present out this slide, let's say, for FY21, FY22, FY23 numbers, those are based on current contractual expiries. But there may always be cases where tenants due to the other considerations may want to move out or we may encourage tenants who are more legacy businesses to kind of move out as we kind of try to incorporate more value-add and sophisticated tenants. So that's why you would see a change. So while I don't have a specific reference of which asset it is for, here it would also be a similar case where they have an expiry of an existing tenant which was not scheduled, which is what we re-lease. And we kind of either achieve the mark-to-market already or we are targeting to do that over the next one or two quarters.

C. Sridhar: And the second question is on Tech Village, sort of broadly to understand that is the hotel also now included in Tech Village? So you have 6.2 million square feet plus 1.9 million square feet, plus the hotel also included?

Vikaash Khdloya: That's right, Chandra. So, it was always envisaged to be a part of this entire Tech Village project. So, what we have been offered is that out of 100-odd approximate acres, we have been offered 6.2 million square feet of completed area, 1.9 million square feet of under construction office buildings. And there's also a proposed 518 key Hilton Hotel as part of this ROFO offer that we have received. So, Chandra, I think what you were referring to is, the notice was for 2.4 million square feet under construction, so that's split between the office of 1.9 million square feet and the balance hotel, which is 518 keys.

Moderator: Thank you. The next question is from the line of the Adhidev Chattopadhyay from ICICI Securities. Please go ahead.

A. Chattopadhyay: Just wanted to ask on Manyata, now are we still looking to collapse the structure? And where are we on that? And with this DDT going away, so is it neutral to what we were planning on earlier?

Vikaash Khdloya: Again, we have done all the preliminary steps to collapse the two tier structure. Given the recent proposed announcement in the Budget, we right now just waiting and watching till the Bill is enacted. And then we will take a final call. Assuming that there was no specific announcement in the Budget, we are ready to roll the process forward. But we will still wait to see how the final enactment of the law is and we will take a call.

A. Chattopadhyay: Okay. So to understand it correctly, so if let's say the proposal in the Budget is retained, then what the SPV pays out to Manyata hold-co that would no longer attract a DDT?

Aravind Maiya: That's correct.

A. Chattopadhyay: And that would get kind of recouped in the NDCF distribution also, will it get appended to the REIT, is it the right way to look at it?

Aravind Maiya: I didn't get the second part.

A. Chattopadhyay: No, I am saying, would the tax ticket still be there under this new, whatever, DDT regime at the Manyata level, and even in the three tier structure?

Aravind Maiya: When you take away DDT, effectively when dividends come up, and the same dividends are moved up all the way to unit holders, both these entities don't pay any DDT. And the current proposed structure envisages tax directly in the hands of the unit holders.

A. Chattopadhyay: Sure. The second question is, the buildings which you have completed, both at Manyata and at Oxygen. Now, you said the OC has come post December and we have done pre-leasing, I think, close to 50%. So when do the tenants move in and start doing fit-outs? And from when they do the first rents accrue to us?

Vikaash Khdloya: So in general, for the large occupiers taking space of, let's say, 200,000 square feet and above, rent-free periods would be anywhere in the range of four to six, seven months, again, basically reflecting the amount of time it would take for them to do their TIs or fit-outs. Given that we received OC post December sometime in January, for Manyata NXT, we would expect the first rents to kick in six months post that. And obviously, some tenants do have space take up and we are still pursuing other opportunities where we will lease up and the rents will keep commencing based on when we do actually complete the lease up.

A. Chattopadhyay: Sure. And have we purposely kept the leasing or preleasing lower to get higher rentals on completion, is it a strategy thing or it's more of a demand thing?

Vikaash Khdloya: So, that's a good question. The way we look at our development, Adhidev, while obviously we would want to maximize both occupancy and NOI, at the same time, we don't manage for the quarter. So, we are comfortable with less than 100% being pre-leased prior to completion. What we generally would look to do is pre-lease anywhere between 40% and 60% of the project prior to completion, that kind of de-risks the project, and it also helps us secure anchor tenants. And for the balance space, we try and lease it to tenant who are looking for smaller spaces that helps us increase the rentals, because the smaller tenants look for space on an immediate basis. Even in this case if you see, while 44% has been pre-committed, it you include all the growth options which these same tenants have to whom we have pre-leased, then the pre-leasing percentage is approximately 58%, assuming they will exercise those growth options. We are pretty comfortable with this approach.

Moderator: Thank you. The next question is from the line of Puneet Gulati from HSBC. Please go ahead.

Puneet Gulati: Just to understand this payout of Rs. 425 crores, would you be earning interest on this? Is that how much one should think about it?

Aravind Maiya: Yes, Puneet. As Vikaash mentioned previously, we would get about 100 basis points spread over the interest what we are paying from the sponsors on the advance we have paid.

Puneet Gulati: Okay. And the responsibility of leasing also rests with them or does that move to you now?

Vikaash Khdloya: That's correct, the responsibility is with them. At the same time, we have overall control and oversight of the kind of covenants that we would want to secure on the leasing that is proposed to be done.

Puneet Gulati: Okay, that's great. Thank you so much. Secondly, on the Embassy Energy side, the NDCF has come back from that, has there been any restructuring which is done at Energy level?

Aravind Maiya: Puneet, just a couple of reasons for that. There's been no restructuring, but effectively the units generated this quarter have gone up, that's more seasonal in nature. And the second reason being, a couple of working capital changes which are positive this quarter as compared to negative in the previous quarter. Just these two reasons which have made it positive.

Puneet Gulati: So, it was a minus 31 which has become a positive number by a pretty decent amount?

Aravind Maiya: Yes, these are the two reasons, Puneet, for that.

Vikaash Khdloya: And Puneet, generally in general, not specific to Embassy Energy, we would guide you towards year-to-date cumulative numbers, because quarter-on-quarter there may always be a timing issue. And year-to-date numbers may be more reflective about how the numbers are moving.

Moderator: Thank you so much. The next question is from the line of Amandeep Singh from Ambit Capital. Please go ahead.

Amandeep Singh: My first question is in continuation to the DDT question asked earlier. So currently Embassy REIT is not distributing cash flows in the form of dividends. However, if these distributions were to be in the form of dividends, can you guide us on how would this have impacted a unit holder based in, say, Hong Kong, Singapore or US, overseas currently?

Aravind Maiya: So just reiterating the answer which I gave some time back. So, what I will do is, if you just take the FY'20 distribution, as in 1% dividend out of a total distribution, as I mentioned, the impact is negligible. But just for the sake of illustration, if you were to increase the dividend to 10% out of the overall distribution, then the impact basis YTD yield what we have given so far would be, for FIIs, it is about 9 basis points, domestic companies is about 15 basis points, and resident individuals at the highest tax bracket about 26 basis points. So, this is the potential yield dilution at a 10% dividend distribution.

Vikaash Khdloya: And Amandeep, I just would want to add here, is that this is just for the sake of illustration. We obviously will continue to, one, engage with authorities and make representations; and two, more importantly, we continue to evaluate the mix of the three components of distribution to see how best we can optimize it for the investors.

Amandeep Singh: Sure. So where I was coming from is that, as per REIT and income tax regulations, the dividend received from a REIT in India is exempt. However, say, for a unit holder in Singapore, Hong Kong, is he liable to pay income tax on dividends received from REITs in India currently? So, if yes, then post this development our impact on yields would be negligible. So I was coming on from that.

Aravind Maiya: Just to understand the question, are you talking about the yields earned by investors in Singapore who have invested into Embassy REIT?

Amandeep Singh: Right.

Aravind Maiya: Yes. So that the impact as I mentioned, foreign institutional investors, if you take the example of a Singapore basis the current treaty agreements, the impact which I mentioned of 9 basis points, assuming a hypothetical number of 10%, that stands good.

Amandeep Singh: And secondly, a bookkeeping question. So your net tax for 9M FY20 has been like around 3%, given your MAT credit entitlement and deferred tax. So can you help us understand how would this net tax rate move, say, in next one or two years?

Aravind Maiya: So, what I would do in terms of tax is, while there are non-cash items like deferred tax, probably what makes sense to look at is the cash tax or the current tax. If you look at that number, currently it's about 5.5% of revenue. And we believe that, that will remain around the same number for the next couple of years.

Moderator: Thank you. The next question is from the line of Pulkit Patni from Goldman Sachs. Please go ahead.

Pulkit Patni: Most of my questions are answered, one bookkeeping question. First up, if I look at Slide 45, if I compare the numbers year-on-year, your direct operating expenses have actually come down on an absolute basis also. Are there any one-offs there or what is it that is driving overall operating expenses down on a year-on-year basis? That's question number one.

Vikaash Khdloya: So two things. One, obviously, previous year may not be strictly comparable, because while it's been done on the same portfolio, but couple of assets were under repositioning, for example, the Embassy 247 which we highlighted, right. But more importantly, the reason that the current year-to-date and the quarter numbers are slightly below is, as we mentioned earlier, we have initiated a couple of cost saving measures, especially at Embassy Manyata where we have had a substation to provide continuous power to our tenants. So that has helped us save energy costs, because earlier we built faster than the energy could keep pace. So we were providing them with a costlier form of power and fuel.

Pulkit Patni: So that's the major reason for this?

Vikaash Khdloya: Yes, that is one of the key reasons for the drop in operating expenses.

Pulkit Patni: Sure. My second question is regarding the ROFO asset Tech Village. My understanding was that typically you have 45 days to respond to the offer, otherwise, the offer expires. Is that understanding correct? Or is the timeline much longer?

Mike Holland: So, there's a period named in the ROFO agreement. And there's the ability to extend that by mutual consent. So we are still looking at it, we are still doing our due diligence. It's an exciting opportunity. But we have got some more work to do.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference over to Mr. Mike Holland, CEO of Embassy REIT for closing comments.

Mike Holland: Thank you all very much indeed, for your time and for your excellent questions. And one point, we do have the supplemental deck which is on the website. So, a number of the questions that are related to CAPEX, leasing, distribution, other key data, you can find that there. We are also very happy at any time to provide more information to drill down into some of the data. I hope you can see we have had a great quarter, a great year-to-date, we are very happy with where we are at in terms of leasing that 1.7 million square feet. We have got a great pipeline in hand at 0.5 million square feet. And we are very happy to be announcing that Rs. 471 crore distribution again this month. And of course, the exciting acquisition opportunities in hand. So thank you for your interest in Embassy REIT. And thank you for your time this evening.

Moderator: Thank you very much. On behalf of Embassy Office Parks REIT, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.