Embassy REIT
1Q FY2022 Earnings Call
July 28, 2021

CORPORATE PARTICIPANTS

Michael Holland – Chief Executive Officer (CEO)

Vikaash Khdloya – Deputy CEO & Chief Operations Officer (COO)

Aravind Maiya – Chief Financial Officer (CFO)

Ritwik Bhattacharjee – Head of Capital Markets and Investor Relations

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MANAGEMENT DISCUSSION SECTION

Operator: Good evening everyone. A very warm welcome to all for the Embassy REIT's first quarter FY2022 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 of Capital Markets and Investor Relations for Embassy REIT. Sir, you may begin.

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Ritwik Bhattacharjee

Head of Capital Markets and Investor Relations

Thank you, Steven. Welcome to the first quarter FY2022 Earnings call for Embassy REIT.

Embassy REIT released its financial results for the Quarter ended June 30, 2021 a short while back. As is our standard practice, we have placed our quarterly financial statements, earnings presentation discussing our performance, and a supplemental financial and operating databook on our website at www.embassyofficeparks.com in the 'Investors' section.

As always, we would 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. Specifically, the financial guidance and any proforma information that we will provide on this call are management estimates, based on certain assumptions and have not been subjected to any audit, review, or examination procedures. You are cautioned not to place undue reliance on such guidance and information and there can be no assurance that we will be able to achieve the same. Further, there are significant risks and uncertainties related to the scope, severity and duration of the Covid pandemic and the direct and indirect economic effects of the pandemic and containment measures on Embassy REIT and on our occupiers.

In a significant move, the trading lot size for Embassy REIT units on the Indian stock exchanges will be reduced to 1 unit from the current trading lot size of 200 units upon the notification of the necessary amendment regulations. The announcement follows the Securities and Exchanges Board of India's (SEBI) approval of the amendments to the appropriate regulations to reduce trading lots for both REITs and Infrastructure Trusts (InVITs) which was outlined at its Board Meeting on June 29, 2021. The reduction in lot size brings it in line with the trading lot sizes of listed equity companies on the Indian Stock Exchanges and helps in increasing liquidity, enabling REITs to be included into benchmark domestic indices, and allow greater participation from newer pools of institutional and retail investors.

Joining me today are Michael Holland, the CEO; Vikaash Khdloya, the Deputy CEO and COO; and Aravind Maiya, the CFO. Mike will start off with the 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)

Thank you, Ritwik.

Good evening and thank you for joining us today to review our 1Q FY2022 results.

Despite the full year pandemic, Embassy REIT delivered in FY2021. The second wave and lockdown which started in April 2021 brought similar challenges but we have had the benefit of prior experience and, of course, the ongoing vaccine rollout.

Covid cases and deaths in our four cities have been in a steady decline since early May and are now at a fraction of second wave peak. The last few weeks have seen a steady relaxation of restrictions, re-opening of businesses and uptick in economic activity. While companies are operating with minimal staff levels, our discussions with occupiers indicate plans to return to office in strength starting fourth quarter of this year.

Embassy REIT remains resilient and delivered on its guidance last year. This quarter is no different. As we cautiously enter the recovery phase, we emerge with strength and growing momentum and this is reflected in the encouraging operating results for this quarter.

We signed new leases and renewals totaling 545k sf during the quarter at 13% leasing spreads. We are in-line with the expiry/renewal numbers we reported last quarter, our occupancy stands stable at 89% and our rent collections remain robust at over 99%. Our active development pipeline will deliver 1.1 msf this year which is fully pre-committed to JP Morgan and we have an additional delivery pipeline of 4.6 msf over the next 2-3 years. We are developing our acquisition pipeline supported by our robust balance sheet and we are making good progress with our ESG initiatives. Over 10,000 frontline staff across our office parks have been vaccinated and, in addition, we understand from our occupiers that over 110,000 vaccinations have been completed for their employees and families.

Our perspective on the business outlook and our strategy has not changed, if anything, our previously articulated views have been reinforced. We cater primarily to global technology companies and global captive centers who are in India for the STEM talent that is required by these global businesses. We continue to see strong growth in tech and allied sectors with many of our occupiers reporting record hiring and new business wins. Given our continuing investments in park infrastructure and our new build programme, combined with our ESG and employee wellness initiatives, we are confident that this global tech mega trend will convert to strong demand for our product, the total business ecosystem. Embassy REIT is well positioned for new growth given our concentration to the right markets and we will benefit from consolidation of supply and acceleration of demand.

An update on a few changes within our team. We have reinforced our leasing team through the appointment of Amit Shetty as Co-Head of Leasing for South alongside Rishad Pandole, who remains responsible for our North and West portfolio. Amit Shetty has 15 years of leasing experience in the Bangalore and South India market and has been appointed to focus and accelerate our leasing activity in this 170 msf office market.

Additionally, earlier this year, Sachin Shah, our CIO, had expressed his desire to step down to pursue other interests. We are grateful to Sachin for his contributions and we wish him great success with his future endeavors. Ritwik Bhattacharjee, who has been responsible for our Capital Markets and Investor Relations function over the past two years and is known to many of you, has been appointed as CIO with effect from 1st August. Ritwik has over 12 years of experience in investment banking and capital markets. We have also appointed Rahul Parikh to lead our debt raise initiatives. Rahul has over 15 years of experience in the public debt markets. Our management team now stands at over 120 individuals with expertise across the full property business-cycle and continues to be fully focused on delivering to our Unitholders.

Let me now handover to Vikaash to provide an update on our business and operating performance for the last quarter.

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Vikaash Khdloya
Dy CEO and Chief Operations Officer (COO)

Thanks, Mike. Good evening, everybody.

Business and operating highlights for Q1 include:

- Total lease-up of 545k sf across 9 deals, achieving 13% leasing spreads;
- We maintained stable occupancy of 89% with successful rent increases of 13% on 2.2 msf leases;
- Our construction on 5.7 msf development projects continue, with 1.1 msf JP Morgan campus targeted for handover by year end; and
- We have progressed our ESG strategy and continued our investments in park infrastructure and amenities.

Let's look at the details.

First, an update on our operations during the second wave

Covid related restrictions by State Governments were in place across our 4 cities through most of Q1. This disrupted back-to-office efforts of our occupiers with less than 5% of workforce operating from our properties during the quarter, a significant decline compared to 4Q FY2021. However, all our properties were fully operational to support business continuity of our occupiers.

On a positive note, recent data suggests a steady increase in recoveries with active cases now significantly below the second wave peak. Vaccine roll-out has also been gaining momentum. Corporates today are focused on vaccinating their employees, providing a safe workplace and planning their office ramp-up. This is demonstrated by a 23% uptick in employees working from our properties in July compared to June and this number is expected to further increase in the coming months – with many occupiers indicating intent to return to office in strength by end of this year. We continue to actively support our occupiers in their efforts.

Next, an update on our leasing

During Q1, we achieved 100% of the scheduled rent increases on 32 leases covering 2.2 msf with aggregate rent escalations of 13%. We are on track for the additional 14% rent escalations due on 5.5 msf across 57 leases in the balance of FY2022.

We achieved 545k sf total lease-up across 9 deals at 13% leasing spreads. This comprised 161k sf new leases at 17% re-leasing spread and 384k sf renewals at 10% renewal spread. All the new leases were expansion by our existing occupiers to cater to their business needs. Our portfolio occupancy remained stable at 89% in Q1, in-line with the previous quarter.

On lease expiries, you may recollect that we guided to 1.9 msf expiries for FY2022 during our previous call. Of this, 0.5 msf were likely renewals and 1.4 msf were likely exits. We remain on track with that guidance. Of the 1.4 msf likely exits in FY2022, we saw 0.2 msf exits in Q1. The balance 1.2 msf remain as likely exits with a mark-to-market potential of over 70%. While there will be an interim void period due to this churn, we view expiry of such legacy leases as an opportunity to bring rents to market, thereby delivering on our embedded growth potential.

The second wave disrupted the office market recovery underway in early 2021. It impacted site visits and timing of deal closures. While hiring and business growth for many of our occupiers is very strong, they continue to defer leasing decisions and are prioritizing employee vaccination. However, several RFPs continue to be active in the market and we are having a number of positive conversations on future leasing. Office demand is likely to rebound in 2022 as vaccinations pick up pace, business sentiments improve and as occupiers ramp up their return to office plans and firm up their space strategies.

Moving to our development programme

We minimized the impact of the second wave lock-down across our 5.7 msf construction by applying our learnings from the first wave of Covid. Post re-opening, activity and labour at site are back to full strength. That said, we anticipate that the disruption associated with the second wave has had a timing impact on our project delivery by one quarter.

The delivery of 1.1 msf built-to-suit to JP Morgan is a near term priority and we are targeting handover by year-end. This campus is a great addition to our Embassy TechVillage asset. The balance 4.6 msf ongoing development is due for delivery over the next 2-3 years. This positions us well to benefit from ongoing consolidation of supply and expected demand rebound.

Our on-campus development programme is a significant growth avenue for us and helps to meet occupier growth needs. Given our ownership of all land for development and that our capex debt costs are amongst the lowest, we believe that the development yields will be attractive and will enhance both NOI and Unitholder value in coming years.

Moving to our 'total business ecosystem' initiatives

- We continue to re-invest in our properties. Whether it is the convention center and sky walks at Embassy Manyata, the central garden and F&B at Embassy TechVillage or the overall asset re-positioning of Embassy Quadron, we continue to enhance our park connectivity, infrastructure and amenities. At our Embassy Manyata property, the flyover construction at the park entrance is on schedule for delivery in Q2. Similar initiatives include metro connectivity for Embassy TechVillage and Quadron and the under-development Hilton hotels at Embassy Manyata and TechVillage – all of these complement our office offerings and create unmatched value proposition for our occupiers.
- We are progressing well with our ESG roadmap comprising 3 pillars of Responsible Business, Resilient Planet and Revitalized Communities. Our 100 MW solar plant in Karnataka and our occupier corporate connect programme in areas of health, education and public infrastructure are two of many initiatives for a sustainable tomorrow. Several other initiatives are underway and we would invite you to review the recently issued Annual Sustainability Report for FY2021 on our website to understand in detail the initiatives and disclosures under the ESG programme.

Our infrastructure projects create long-term value for our Unitholders and fortify our properties for the next phase of growth. Along with our ESG initiatives, we are able to offer a complete business ecosystem to our occupiers, a key differentiator to attract and retain talent.

Finally, looking beyond the pandemic

The tech industry, domestically and globally, continues to report strong earnings, record hiring and business pipeline given the technological transformation of businesses across all sectors. Recent earnings reports underscore these trends with annual hiring increasing by as much as 80-100% from pre-pandemic levels. Concerns around attrition have also been highlighted in recent results. Therefore, attracting and retaining Indian tech talent has assumed increased significance for these global businesses. We believe that our high quality complete business ecosystem product has even more relevance and appeal in this new technology dominated global business environment which will continue to drive demand in the Indian office sector. We are very well positioned for the next phase and beyond.

Over to Aravind now for the financial updates.

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Aravind Maiya
Chief Financial Officer (CFO)

Thanks, Vikaash. Good evening, everybody.

Let me start with the financial highlights for 1Q FY2022:

- Net Operating Income grew by 36% YoY to ₹6,213 million, with operating margins at 84%;
- Distributions for Q1 stood at ₹5,346 million or ₹5.64 per unit, with 80% of distributions tax-free for Unitholders;
- Raised ₹12 billion debt at an attractive 7.4% interest rate and refinanced ₹5.2 billion with an 80 bps interest savings; and
- Maintained our fortress balance sheet with liquidity of ₹15 billion and low leverage of 23%.

First, let me take you through our Q1 financial performance

- **Revenue from Operations** grew by 43% in Q1 to ₹7,376 million, reflecting rent escalations on 4.6 msf, revenue accretion due to additional 6.1 msf completed area of ETV acquired in December 2020, and revenue from Embassy Manyata and TechZone CAM operations acquisition in October 2020. The impact of these positives was partially offset due to occupier exits.

- **Net Operating Income (NOI)** grew by 36% in Q1 to ₹6,213 million, mainly due to increase in our Revenue from Operations as mentioned above. This increase was partially offset by increase in cost due to acquisition of CAM operations of Embassy Manyata, TechZone and ETV in the previous year. EBITDA for Q1 grew by 33% to ₹6,008 million, in-line with increase in our NOI.

- **Net Distributable Cash Flows (NDCF)** for Q1 grew by 19% to ₹5,350 million. Earlier today, the Board of Directors declared Distribution per Unit (‘DPU’) of ₹5.64, representing a 100% payout ratio. 80% of our Q1 distributions are tax-free to our Unitholders, reflecting the benefits of the 4Q FY2021 restructuring of Embassy Manyata entity.

Moving to our balance sheet and our debt strategy

- Our balance sheet continues to be conservative with ₹15 billion of liquidity, low leverage of 23% and our AAA credit rating as an issuer. Additionally, our proforma debt headroom of ₹121 billion provides us flexibility to capitalize on growth opportunities.

- During Q1, we raised ₹12 billion SPV-level debt at a blended 7.4% interest rate comprising ₹6.5 billion rent amortizing debt at attractive 7.1% and ₹5.5 billion capex debt at 7.7%, one of the lowest in the industry. Of this, ₹5.2 billion was used to refinance existing debt at 80 bps interest cost savings and balance will be utilized to fund our ongoing on-campus development. We continue to focus on reducing our overall debt cost and at the end of Q1, our ₹109 billion outstanding debt stands at 7.7% interest cost compared to 9.6% just a year ago.

- Given our ability to attract debt capital at competitive rates and the continuing flight to quality borrowers, we are evaluating early repayment of our ₹36.5 billion listed bond issued in May 2019 carrying 9.3% interest rate. While this bond is due in June 2022, we have a call option for early redemption in November 2021. On a proforma basis, a 200 bps refinancing spread brings down our consolidated REIT debt cost significantly to around 7% compared to 7.7% currently. Subject to market conditions prevailing at that time, we will explore refinancing the entire outstanding of ₹45 billion through a coupon bearing debt. We believe this is an opportune time given the fact that debt markets continue to be positive for quality borrowers and recent approval to insurers to invest in REIT debt enhances access to deeper pools of capital.

To summarize our overall debt strategy, our plan is to build leverage selectively, finance development through SPV-level capex debt and finance acquisitions through optimal debt-equity mix. Further, based on investor feedback, including our top institutional investors, as well as to enable simpler understanding of the yield and growth components of our total return story by the growing retail investor segment, we are now targeting to consolidate all of REIT's debt to coupon bearing instruments.

Lastly, I will update on the outlook for full year FY2022

During our previous call, given the uncertainty around second wave, we had deferred guidance and instead provided an overall framework and key building blocks of our business projections. Given that we are witnessing a steady decline in cases accompanied by gradual relaxation of restrictions and opening of businesses, we are now providing guidance which is based on the premise that we will not see increased caseloads or lockdowns for the balance of the year. Our estimates are based on the following assumptions:

- Firstly, we will benefit from the transformational acquisition of ETV completed in December 2020. With its stable 98% occupancy, robust collections and 1.1 msf delivery pipeline, we expect full year impact of ETV acquisition to reflect in both NOI and distributions for FY2022. Further, we expect our NOI to reflect the positive impact of Embassy Manyata and TechZone CAM operations acquired in October 2020 and our overall NOI margins to be around 83% reflecting change in segment mix given the acquisition of CAM operations. We had, at the time of acquisition, laid out proforma accretion numbers for both ETV and CAM operations and as of now, we expect to meet or even exceed our underwriting;
- Second, we will benefit from the full year impact of successful lease escalations on 8.4 msf in previous year at an average 13% rent increase. We are also confident that we will achieve and collect rent escalations on additional 7.7 msf due in the current year at an average 14% rent increase;
- Coming to impact of exits, we expect our numbers to reflect 1.5 msf exits which we reported in previous year at an average ₹63 psf in-place rent. Additionally, we have factored 1.4 msf of exits in FY2022 at an average ₹50 psf in-place rent, with a mark-to-market potential of over 70%;
- Next, our guidance assumes a total lease-up of 0.9 msf comprising 0.5 msf of renewals and 0.4 msf of new lease deals. On new lease deals, we remain optimistic of demand recovery starting next year given the technology growth mega trend;
- Our two operating hotels totaling 477 keys are expected to see muted demand recovery for current year given dependency on business travel resuming. We have factored a cash burn of ₹340 million for this year, in-line with previous year; and
- Finally, coming to our refinancing plans and impact on our FY2022 distributions. Earlier during today's call, I have laid out our debt strategy around our ₹36.5 billion listed bond issued in May 2019. Our guidance assumes that we will exercise the call option to repay this bond in November 2021 and we propose to refinance the total outstanding of ₹45 billion through a new, coupon bearing debt.

Factoring the above assumptions, for the full year FY2022, we expect NOI to be in the range of ₹22,871 million to ₹24,530 million with midpoint of ₹23,700 million, up 17% YoY and Distributions to be in the range of ₹19,667 million to ₹21,093 million with midpoint of ₹20,380 million, up 11% YoY. Finally, we expect DPU to be in the range of ₹20.75 per unit to ₹22.25 per unit with a midpoint of ₹21.50 per unit, in-line with our FY2021 DPU. Do note that our guidance is subject to the evolving nature of the pandemic, including a possibility of a third wave.

Despite the second lockdown in India for most of 1Q FY2022, Embassy REIT remains in great financial shape, with resilient distributions and ability to pursue growth through organic and inorganic opportunities in the coming years. In the near-term, we continue to remain focused on delivering on our NOI and quarterly distributions, maintaining our balance sheet discipline and continually optimizing our debt cost.

Over to Mike for his concluding remarks.

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Michael Holland
Chief Executive Officer (CEO)

Thank you, Aravind.

In summary, FY2022 is off to an encouraging start. Though pandemic related uncertainties still remain, we remain optimistic of the opportunities ahead and committed to achieve our goals for this year and subsequent years. The economic outlook is certainly looking more encouraging and we are very positive about the global technology trends as these will further provide significant new growth impetus for our business.

Lastly, I would like to thank all our employees, frontline workers, business partners and our stakeholders for navigating this challenging time together, and we are grateful for their continued co-operation and support.

We're happy to drill into any details in Q&A.

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QUESTION AND ANSWERS SESSION

(Note: The Q&A has been edited for clarity)

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Kunal Tayal from Bank of America. Please go ahead.

Kunal Tayal: So, a couple of questions from my side. The first one is, it seems like there have not been out of turn exits that have transpired this quarter. So, is it fair to assume that the thought process of existing occupiers is now more constructive on the balance versus a quarter back? And then the second one is, as you think of return to office by Q4 of this year, is it still largely contingent on what happens around wave three? Or given the vaccination levels, the timelines are more immune to the environment? Thanks.

Michael Holland: Kunal, just your first question, do we see things as being more constructive around the conversations on leasing? And I think that's an unequivocal absolutely we do. It is remarkable how quickly things have turned around from a very positive situation in February, and then 180 degrees turn with the second wave. And now today, we are seeing existing occupiers talking to us about potential expansion. We are seeing occupiers who, perhaps six months ago were talking about surrendering small amounts of space, now coming back and saying that they would retain and perhaps even expand. So, certainly we are seeing more constructive, positive expansionary types of conversations those tend to be with our existing tenants. I think, until people get their employees back at scale, which we think is going to be an end of this year, the final quarter of this year employees back, that is when we believe we will see some real traction on fresh leasing from new occupiers as well as existing.

And your question about, is it contingent on any other eventuality, particularly, essentially third wave, that is a contingency for everybody. But we are getting very encouraging sentiments from occupiers, great take up the vaccination. Our occupiers have rolled out over 110,000 vaccinations, I think, reported by 130 odd companies for us. We have done 10,000 vaccinations of our own frontline staff. I think there's a very positive sentiment about back to work in the final quarter.

Kunal Tayal: Thanks, Mike. Maybe if I can slip in one question for Aravind. Aravind, on refinancing of zero-coupon bonds, I think your earlier philosophy was that it would be a mix of coupon bearing and maybe just further zero-coupon bonds as well. So, just if you could walk us through the shift in thought process as to all of it being coupon bearing now, thanks.

Aravind Maiya: Thanks, Kunal. Yes, at the outset, Kunal, I think our philosophy of having the zero-coupon bonds was to match the value of under construction properties, which come from our principle of matching cash inflows from our properties as and when completed, to cash outflows towards funding such properties. As of today, only about 20% of the under-construction properties at the time of our IPO have been converted into completed and cash generating assets. Having said that, we have taken note of the feedback which has been provided to us by various stakeholders, including large institutional investors around our philosophy. As I also mentioned in my remarks, we just want to enable a simpler understanding of our yield and growth story to the growing retail segment. And considering all of this, we have decided to consolidate our entire debt book into a coupon bearing instrument.

Moderator: Thank you. The next question is from the line of Saurabh Kumar from JPMorgan. Please go ahead.

Saurabh Kumar: Hi, a few questions from my side. So, first is Aravind, on this NOI guidance of Rs. 24 billion and the DPU of this Rs. 21.5 billion. So, I just want to understand, once you refinance this bond, in Q4, because I am presuming you kind of sustain this number for two quarters, so I just want to understand what happens in Q4, you see a big downward shift in DPU because of this coupon bearing debt? So, that's the first one. I will take the other one later. And the NOI also, if you can just highlight, because your first quarter NOI is 6.2 odd, and your guidance midpoint is about 24. So, basically, you are assuming that this Q1 NOI trend doesn't sustain for the full year. So, I just want to understand where do we land up on Q4 basis the guidance you have given.

Aravind Maiya: Saurabh, so first on the DPU, talking about assumption on refinancing on zero coupon. What we have assumed in our guidance is that we will be refinancing it into a coupon bearing debt sometime mid of October, because this is due to be paid on November 3rd, so it will have an impact on our Q3 as well as Q4. We have factored all of that into the 21.5. If I were to give you the exact number which we have assumed in our guidance, this refinancing will have a Rs. 1.5 per unit impact for our full year guidance. So, that is on the DPU.

Talking about NOI, Saurabh, basically the 17% NOI growth factors, if I were to just kind of give a very broad breakup, it factors in the acquisition accretion of close to around 21%, factors in the escalation positive of around 2%. But it also factors…

Saurabh Kumar: Yes, I understand. I mean, from Q1 if you can just reconcile this, that would be great.

Aravind Maiya: Yeah. So, just to keep it short, the impact of the likely exists will be seen in Q3 and Q4, which is what we have factored a total negative of around 6%. All this plays into the total number of 23,700 million.

Saurabh Kumar: Okay. And just coming back to this DPU, is it fair that the impact will be about 1.2 to 1.3 per unit in Q4, that would be a fair assumption basis whatever you have given?

Aravind Maiya: Saurabh, it will be a simple math, it is Rs. 1.5 for five and a half months, you can compute that proportionately for three months or to five and half months.

Saurabh Kumar: The second one is on this share pledge. So, your annual report has both Embassy and Blackstone pledging 100% of their shares, so could you comment on, I mean, what's happening there?

Michael Holland: I think it's not for us to comment on sponsors' internal financing arrangements. I think if you look at the last couple years, their shareholding demonstrates their commitment to the success of the REIT. They have reiterated that, like us, they understand the strength and resilience of the business, and we understand that they are fully committed as they always have been.

Saurabh Kumar: Okay, fair. Third is, Mike, I mean, what percentage of the workforce is in parks today, I mean, in July basically, what percentage of workforce would be in your park and what number versus in February? And just one last thing is, of these 1.4 million square feet, I am assuming you are not assuming any re-leasing?

Michael Holland: So, let me let me take the numbers in the park, and maybe I will ask Vikaash to take the second part. So, just to put some context, how many people are in the park today? First off, let me start with, there is a very broad range, some occupiers are at 25%, 30%, in different places. And some of the more international tenants tend to be at a sub 5% level. So, a very broad range. I think city by city it also varies. Today, I believe there's approximately 17,000 people working in the parks, that went down to a low point of about 7,000 - 8,000, at the nadir of the pandemic. And to give you a flavor of where that was back in January, February, it was up at 27,000. So, we are seeing big swings. But we have seen a big increase in the number of people just in the last month.

And your second question about re-leasing, I didn't quite get the full question.

Saurabh Kumar: Yes, so the question was of this 1.4 which is expiring, I mean, I am guessing you don't have any visibility on re-leasing of this, so that's why it's been factored into the NOI guidance. Will that be a fair statement?

Vikaash Khdloya: Let me take that. So, Saurabh, again, of the 1.4 million square feet likely exists, we have already seen 0.2 million square feet in Q1, and against that we undertook backfill of about 161,000 square feet this quarter. So, basically, as Aravind mentioned in his assumptions, we have assumed a total lease up for the full year of 400,000. So, what that implies is, for the balance 1.2 million square feet likely exists for the rest of the year, we have factored in lease up or backfill of about 240,000 square feet.

Saurabh Kumar: Understood. One last question, if I can. Off this JPMorgan lease, now it is Q4, and your acquisition had said till September there is rent support, so what happens for that one quarter?

Vikaash Khdloya: So, Saurabh, good question. So, basically the way the rental support and rental guarantee was structured is that we buy this property on a as if it's a fully completed basis. So, for FY 2022, we don't think there will be any impact given that it is supported by rental support. However, any delays, contractually the way it's been agreed, any delays which is on account of construction delays due to pandemic or due to any other force majeure, that would be to our account, as is the case for all of other construction. So, next year, if this gets delayed by, let's say, by one quarter, which is what we are estimating, that in FY 2022-2023 would be to the REIT's account.

Saurabh Kumar: Okay. So, any delay in FY 2022 is not to your account, sponsor continues to pay that?

Vikaash Khdloya: That is correct. But as I mentioned, we were targeting this September, now it has moved to December. So, that one quarter impact we will have in FY 2022, 2023.

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

Puneet Gulati: So, if I got it right, what you are essentially saying is that for new leasing perspective, since you have already renewed 0.4, you are expecting only 0.1 to be renewed for the balance nine months, is this how I should read it? The other one is on the debt side, so you are seeing a date increase of almost Rs. 4.81 billion, while if I look at CAPEX, it was about Rs. 2.94 billion. So, where is the gap and what is resulting in the excess net debt increase?

Vikaash Khdloya: Sure. So, why don't I take the first one, Puneet, and maybe I will hand it over to Aravind for the second question on debt. So, Puneet, just to break it down, we had indicated and guided to 1.9 million square feet expiry split between 1.4 likely exit and 0.5 million square feet renewal, we are on track with that guidance given last quarter. So, on the renewal, of the 0.5 million square feet that we indicated, that we renewed 0.4 million square feet in Q1. Likely renewals for the balance three quarters are 0.1 million square feet, so nothing changes from a previous guidance of a total renewal of 0.5 million square feet. The balance 1.2 million square feet will be likely exit, most of it coming in Q3 and Q4 of this financial year.

Puneet Gulati: Thank you. And just since you are on leasing, if I look at the trend on re-leasing, it's certainly more on second generation basis. Is there something to read on that or should one consider first generation, second generation leasing as pretty much similar?

Michael Holland: When you say second generation leasing, so we are assuming that it's end of lease, and then a new lease which has been a significant part of that 545,000 square feet that we have linked in the last quarter?

Puneet Gulati: Yes. So, basically the older ones are getting leased out or renewed, is there something more to read into that from occupiers' perspective?

Michael Holland: Well, I mean, the point to observe from that is that on those older leases, we often have a very strong potential mark-to-market, so we see good escalations from those types of renewals.

Vikaash Khdloya: And maybe I want to add here, Puneet, is that, obviously, it's also a natural progression, simply because some of these legacy leases, we replace them with new-age occupiers doing more sophisticated and high-end kind of value creation works, who have higher propensity to pay rent. So, I think, we would call it business as usual and normal course to kind of churn some of those long tenure 10, 15-year-old leases to backfill it with more new-age occupiers.

Aravind Maiya: Puneet, on the question on increase in net debt of Rs. 480 crores, if I were to just give a simple walk of that, about Rs. 100 crores of the increase is because of the accrual of interest on Series 1 debt, about Rs. 140 crores is because of the loans we have taken from bank for CAPEX purposes, and about Rs. 240 crores is the opening surplus cash which is used for CAPEX as well as other payments.

Puneet Gulati: But loans from CAPEX is anyways cashed in also, right, so net debt change of Rs. 480 crores should all be CAPEX only, right? And maybe Rs. 100 crores accrual of interest, which are laid out here?

Aravind Maiya: Yeah, that's correct. It's all towards CAPEX, towards the Rs. 100 crores of the Series 1 accrual. And just to give you an example, we will play certain amount of fixed deposits for some of the BGs and LCs which we use for CAPEX, so it's a combination of these.

Puneet Gulati: But that also gets counted as cash only, right, so that shouldn't impact net debt again?

Aravind Maiya: We don't consider those fixed deposits which are lien marked as cash.

Puneet Gulati: Got it, thank you.

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

Adhidev Chattopadhyay:

Just a question for Aravind, again, this working capital adjustment is almost Rs. 70 crores for this quarter, so just a housekeeping question, what is the nature of this adjustment?

Aravind Maiya: So, broad breakup of the Rs. 69 crores, some of this we have spoken in the previous calls, including the acquisition as well. Approximately Rs. 29 crores are coming from the rental support payments towards the JPMorgan building, approximately Rs. 15 crores are because of this fit-out rental cash flows which are treated as finance lease and not operating lease. And the balance is towards normal working capital movements, including movement in other current assets and current liabilities. So, that's the broad split of the Rs. 69 crores, Adhidev.

Adhidev Chattopadhyay:

So, just to follow-up, so this trend should continue, this working capital, this accretion of cash in the remainder of the year? Or will it smoothen out over the rest of the year?

Aravind Maiya: Yes, Adhidev, I think, broadly, this is the trend which is going to continue for the rest of the three quarters. And the guidance also assumes similar numbers.

Adhidev Chattopadhyay:

Second question is, for all our under-construction assets, can you give the cumulative number of what is the pending CAPEX? And in the next couple of years or next two, three years, the annual budgeted spends, a broad number?

Vikaash Khdloya: I will guide you to Page #19 of our Supplemental Data Book, why don't I take you through that. Basically, we have laid down here for all our under-construction projects, including infrastructure and upgrade projects the CAPEX outlay, the pending cash to be spent, split by all the projects. So, basically, on the numbers we are looking at spending about Rs. 2,663 crores over the next three years across the base build projects and infrastructure projects. And there's a detailed breakup of that. Roughly, it was Rs. 3,000 crores last quarter, and we roughly, let's say, spent Rs. 300 crores during the quarter on construction.

Adhidev Chattopadhyay:

Okay, fine. And just one last question, we have heard a lot of talk about the dedensification of office spaces because of the pandemic. So, now in your discussions with your existing office occupiers as they bring people back to office, do we expect the leased area to go up on account of that? Just throw some light on that. Thank you.

Michael Holland: I think the dedensification topic has kind of got bundled into the overall back to office, higher quality product. I think what's clear is that the type of occupier that we have in our portfolio is going to be looking for a higher quality product that may include less density, but it will also include specific requirements around energy efficiency and ESG requirements, safety and security, wellness for the staff. But broadly, some of those companies that are in our portfolio have had a very low density in the past in any event, it's really the ITes type of companies that had moved to the high-density spaces. We would anticipate that there will be a move to a less dense, more collaborative environment. And again, that's going to be good for us because our type of product, not just within the building, within the four walls, but also the overall amenities of our business parks is what the best occupiers are going to be looking for over the coming years.

Adhidev Chattopadhyay:

Okay. And just last question if I could just squeeze it in. Are you again seeing fresh RFPs to float in the market again from July? Or is it just the ones which in January or February which are again not being revised?

Michael Holland: We are seeing fresh RFPs across the country, I think, we have got a list of 26 million square feet of RFPs. We have actually scaled that back to something which is A) applicable to our markets; and (B), we have written out a couple of the really large numbers that skew the overall numbers and still, in our markets, we have visibility to about 9 million square feet of RFPs. And yes, some of those are new.

Moderator: Thank you. The next question is from the line of Karan Khanna from Ambit Capital. Please go ahead.

Karan Khanna: So, my first question is on the upcoming supply, so your thoughts on the upcoming supply over the next two years. Your last quarter's presentation suggests nearly 37 million square feet of the upcoming supply as unrealistic which has now reduced to 32 million square feet. With encouraging signs on the demand side, do you see further risk to the unrealistic supply estimates? And resultantly, how should one think about the impact on your lease expires, especially any mark-to-market potential because of this?

Michael Holland: Yes. So, I mean, our view on upcoming supply actually just gets reinforced every quarter where we have been saying the same thing for a year now. And it's turning out, like many of the things we have been saying, to be the case. We believe that supply over the coming two years is down 25%. We have had that reconfirmed from a number of different sources. That combined with what is clearly going to be a very significant uptick in demand, given the hiring figures being up so significantly, we think we are going to be in a very strong position in 2022. I think there was some detail that I missed; I couldn't quite understand.

Vikaash Khdloya: Karan, why don't I add to what Mike said. Karan, our view is very clear, and this is based on not only conversations, but what we are seeing on the ground. And pretty much we track line by line all the projects which are announced, or which are under construction. If any project is already not under construction today, it is not likely to come up in the next three years. And on the basis of that, and the dislocation which we see in the availability of financing for some of the Grade A minus and Grade B projects, we really think supply is going to consolidate to very few institutionally owned landlords or developers with strong balance sheets. So, we think this will start playing out. While there's a lot of talk about supply, we think, actually, the situation on the ground is to the converse, and a lot of the supply will simply get deferred. And there are some interesting anecdotes which are coming from the ground where, in some cases, the developers are contemplating or have already converted a potential announced supply, which is coming in this figure that you mentioned, to let's say, a residential project also. So, I think, we will have to wait till it pans out, but we think supply has already declined versus what was announced. And it is going to continue to consolidate to very few landlords simply because office business is a longer gestation business, and the capital requirements come into play.

Karan Khanna: And talking about the demand side, Vikaash, we have seen data center emerging as an asset class, where one or the other REITs has also recently closed a long-dated agreement with one of the leading data centers. So, in that context, this being a fairly mature asset class globally, and given your experience, can you help us with your thoughts with respect to the opportunity with respect to this segment? And if you are seeing any RFPs from this asset class in your micro market?

Ritwik Bhattacharjee:

Let me take that. I think to just directly answer your question, do we get asked a lot about data centers? We do. But I think we have got to be a little pragmatic in the way we approach it. And first and foremost, our bread and butter is being an office REIT, catering to the tenant base that we have for all the reasons that we have repeatedly outline about why they are in India, right. I mean, the Indian talent pool effectively has been the biggest REITable story of our times. And that's the reason over the last three years you have seen three office REITs come to market. Now clearly, I think, I mean, given the global sort of technology mega trends that are taking place and sort of the pull towards with data analysis, data storage and performance of crowds of data centers worldwide, there has clearly been a focus on seeing how that can sort of be replicated in India. But I think it's an opportunistic view, but really depends on the scale. Data centers tend to be incredibly capital intensive, they are definitely cost a lot more to put together than an office. And I think it's really a question of the markets that are most conducive to actually having data centers. For example, I think Bombay, given that it's a coastal market or a market like Chennai, again, markets that either have coastal markets or good power are more conducive to setting up data centers. I think if you are looking at cities like whether it's Pune or Bangalore, I think it's really sort of more of an opportunistic sort of data center proposition that would make sense. As of this point in time, given sort of the expenses involved, given the sort of high capital-intensive nature of it, and given how we are actually deploying capital and thinking about growth in the office market, we think that at this point in time it's too complex, too many technicalities that involve our full and undivided attention. So, we will continue to analyze the market. I think we do, on top of sort of a lot of the intelligence that's there, we can clearly see some of the trends. And if we have something to report, we will.

Karan Khanna: Sure. Thanks, Ritwik. And just one last question, if I may. With ETV in your portfolio now. what kind of quarterly rental run rate can one expect which will be possible once the business normalizes this year 95% portfolio level occupancy? And further, assuming there is no threat of a third wave etc., by when do you expect this will be possible? And what kind of distribution would be relevant at that point?

Aravind Maiya: Karan, so probably in terms of future, as Mike and Vikaash mentioned, we are pretty positive on the demand returning later half of 2022, considering all the technology and the GCC demand which is likely to come. But having said that, in terms of projecting or forecasting when we are going to reach 95% or whatever is the stable occupancy, we would want to stay away from that. And as time passes, we will keep giving you guidance on the more near-term numbers. But on overall basis, I think we are pretty optimistic and bullish on the levers of growth what we have.

Moderator: Thank you. We take the last question from the line of Kunal Lakhan from CLSA. Please go ahead.

Kunal Lakhan: Just on an earlier question on the distributions, so Aravind, even if we take the higher end of the distribution estimate of 22.25 DPU, and even if we adjust the Rs. 1.5 impact on account of the refinancing, we are looking at like almost Rs. 22.5 billion of total distributions. And if I adjust the TechVillage impact in this and try to do a like-to-like comparison versus last year, is it fair to assume that there could be a decline in the distribution excluding TechVillage, is that understanding correct?

Aravind Maiya: If I can simply explain this in terms of same store, as we have reported in Q1, the same store NOI is down 3% and the same store number for the full year in terms of NOI is expected to be down 5%. And in terms of distributions, when you factor in the impact of the Series 1 refinancing and the Rs. 1.5 which I spoke about, on the same store basis the distributions are around 12% to 13% lower as compared to last year. And this is got offset by the accretion which we are estimating or projecting from the ETV as well as the CAM acquisition.

Kunal Lakhan: Okay. But that should be accretive, I thought, right, in terms of absolute distribution?

Aravind Maiya: Yeah, so ETV is accretive, both in terms of absolute as well as percentage wise, taken together our DPU number is flat. So, there is a decline in the same store distribution, offset by accretion in ETV.

Kunal Lakhan: And that decline is 12% in the same store distribution, right?

Aravind Maiya: Yes. So, NOI is around 5% when I factor in the impact of Series 1, the Rs. 1.5 I spoke about, together with that it's 12%. But just from a business perspective, the same store is 5% down.

Kunal Lakhan: Fair enough. That's quite clear now. Secondly, on the renewal side, the 1.4 million square feet expiries that we are looking at, a large part of that, almost 1 million square feet is actually in Manyata, where the MTM increase that we are targeting is almost like higher than 120% odd. So, actually just wanted to understand, have we renewed any leases at these kind of MTM increases in Manyata, especially like last year we had seen some early leasing in Manyata, have we done that at these rates?

Vikaash Khdloya: Kunal, why don't I take that. So, the answer to that is definitely a yes. Let me give you an example. Some of the leases that come up in Manyata which kind of reflects in the MTM opportunity we spoke about over, in fact, over 80% on the 1.2 million square feet, I am referring to Slide #28 of earnings presentation, those are realistic. The in-place rents today, to give you a flavor, are about Rs. 30 to Rs. 33. Whereas, in the lowest cost market in India today, let's say a Noida or a Pune, the passing rent or the market rents would be Rs. 50-55. So, yes, these are achievable. And Manyata, in fact, pre-pandemic, we have done deals crossing Rs. 105, Rs. 107, and we did report that in Q3 and Q4 of the first year, the rents that have been assumed here for the mark-to-market of 83% are the CBRE estimate of rents. And for Manyata, if my memory is correct, they have assumed a Rs. 93 rents. In fact, the latest lease that we have presented in Slide #26, which is the new lease that we have done in Manyata, the two new leases, actually in the middle of the second wave, those have also been in excess of the CBRE guided market rent. We think those are achievable. There may be a timing gap of a quarter, two quarters or so, depending upon the rebound. But we think those are definitely achievable.

Kunal Lakhan: That's helpful, Vikaash. Lastly, just wanted to understand how is the landscape for acquisitions. We talk about new supply being delayed, stalled, but what is the situation on existing rental yielding assets? Are you seeing any attractive opportunities for acquisitions in the assets? Or have capital values come off from the pre-COVID levels?

Ritwik Bhattacharjee:

I think on acquisitions, we do see opportunity. We continue to be very selective on how we view them and we are very, very stringent on the way we evaluate acquisition. And let me kind of put it into this perspective. In a perfect world, we want to buy assets that resemble the assets we own in our portfolio, we cater to the world's best companies, they are in the best micro markets in sort of the top four to six cities in India, just from a strategic perspective, and they obviously have to be accretive to unit holders net of financing. I think those kinds of assets effectively, given sort of where the market is, are quite hard to find. And we will continue to be extremely selective in the way we incorporate and evaluate these assets in the portfolio and how we actually finance them. Now, there are a lot of assets out there in the market that are one-off standalone assets. Quite frankly, we think it's a difficult proposition to sit here and say that you buy maybe 500,000 to 1 million square feet and saying that that's going to be able to provide a significant boost to a 42 million square foot portfolio. Because our focus is really to widen the moat against our competition with scale and with the kind of sort of assets that we could have in the portfolio, as well as some of the opportunities we get from our partner and sponsor network. Clearly, we have executed on growth on ROFO opportunity, we do have the opportunity to look at more of that, we have opportunity to look at over 20 million square feet from our partner network as well.

So, clearly, there is supply out there. I think the expectations around value from one-off owners, from certain parties certainly hasn't abated. I think the REIT is viewed as being strong credit, strong currency, and clearly it stands the test of time, both from a resilience perspective and the potential of future growth. But that being said, we are obviously in no rush, we will continue to evaluate the market and execute as we go along. You have to remember, we bought growth in a very volatile market, and executed and continue to execute on that to the best in a very meaningful manner and in a very good manner. So, I think, fundamentally, we will be on the lookout, and we will make sure that we update you as and when we see opportunities and execute on them.

Moderator: Thank you. I would now like to turn the conference over to Mr. Mike Holland, CEO at Embassy Office Parks REIT, for closing comments. Over to you, sir.

Michael Holland: Thank you very much. And to each one of you, thank you very much for joining today's call. I hope that we have been able to communicate to you two things, one, the strength and resilience of the business, so looking back. But also, secondly, our positivity about the midterm, given the very conducive supply and demand prognosis that we have set out. We genuinely appreciate all your interest in the REIT and for the time today. Many of the data points that we spoke to are covered on our website, but we are always happy to engage further if there's any additional clarification required. So, with that, we say thank you and good evening.

Moderator: Thank you. Ladies and gentlemen, on behalf of Embassy Office Parks REIT, that concludes this conference. Thank you all for joining us. And you may now disconnect your lines.

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