Embassy REIT
Q4 FY2022 Earnings Call
April 28, 2022

CORPORATE PARTICIPANTS

Michael Holland – Chief Executive Officer (CEO)

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

Aravind Maiya – Chief Financial Officer (CFO)

Abhishek Agarwal – Head of Investor Relations and Communications

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MANAGEMENT DISCUSSION SECTION

Operator: Good evening everyone. A very warm welcome to all for the Embassy REIT's fourth quarter and full year 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. Abhishek Agarwal, Head of Investor Relations and Communications for Embassy REIT. Sir, you may begin.

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Abhishek Agarwal

Head of Investor Relations and Communications

Thank you, operator.

Welcome to the fourth quarter and full year FY2022 Earnings call for Embassy REIT. Embassy REIT released its financial results for the quarter and financial year ended March 31, 2022 a short while back. As is our standard practice, we have placed our financial statements, earnings presentation discussing our performance, and a supplemental financial and operating databook in the Investors section of our website at www.embassyofficeparks.com.

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 related containment measures on Embassy REIT and on our occupiers.

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 and industry overview 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, Abhishek. Good evening and thank you all for joining us on the call today.

We recently completed the third year since our listing, crossing multiple milestones and we are set on a clear growth path for the future. While we will take you through the details of our full year performance in a while, I am pleased to report that we have delivered in-line with the enhanced guidance set out in January this year, and comfortably exceeded our original expectations outlined in July last year.

Despite Covid disruptions, we have successfully delivered on our leasing, development and financial targets. In the last year, we leased a total of over 2.2 msf, including over 1 msf of new leases, in-line with our enhanced leasing guidance. We delivered the 1.1 msf JP Morgan campus within timelines and budget; we launched the Hilton Garden Inn hotel ahead of target schedule, which is already seeing break-even run rates, and we are ready to open the 266 key Hilton hotel next week at Embassy Manyata. We completed a timely refinance of our Zero Coupon Bonds (‘ZCB’s) and locked 2/3rd of our debt at attractive interest rates, and that too from a widened investor pool. And overall, we delivered on our distributions’ guidance with ₹21 billion or ₹21.76 per unit annual distributions. So, a good year given the external environment.

The year ahead looks encouraging, and we are enthused by the continuation of multiple positive themes for our business.

We have seen a continued improvement in office attendance and a reduction in Covid cases and restrictions since the peak of Omicron in January. The physical occupancy in our parks has ramped up considerably – from ~10% at the end of last month, it has gone up to around 20% as of yesterday; so a 25k increase in just 4 weeks. As per the conversations with our key occupiers, we expect the occupancy numbers to continue on this upward trajectory over the coming weeks and months.

Along with the ‘Back to Office’ movement, the record order books, tech spends and offshoring, as well as rapidly increasing headcounts for our core customer base – technology and Global Captives – is translating into significant demand for office space and Request for Proposals (‘RFP’s). In parallel, the continued focus by companies on higher quality, wellness-oriented properties is likely to result in stronger leasing interest in our portfolio. We are well positioned to benefit from this demand acceleration given our concentration in the right markets and our focus on the ‘total business ecosystem’ offering and sustainability performance of our properties.

Our robust FY2022 performance and promising FY2023 growth prospects places us in a great position. Our business resilience continues to reflect in our stock performance and consistent uptick in our Unitholder register, despite geopolitical conflicts and resulting global market volatility. We are excited for the upcoming year and endeavor to continue to deliver value to our Unitholders, as demonstrated consistently over the last 12 quarters.

Lastly, earlier this year we announced that, Aravind Maiya, our CFO, has expressed his desire to step down to pursue other interests. We are grateful to Aravind for his contributions and wish him success with his future endeavors. The identification of long-term CFO candidates has commenced; and in the meantime, our deputy CFO, Abhishek Agrawal will take over as the interim CFO from 1st June. Our strong finance team of over 40 individuals, with best-in-class systems and processes, continues to be fully focused on delivering to our Unitholders.

I will now handover to Vikaash to present our business and operating highlights for the year.

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Vikaash Khdloya
Dy CEO and Chief Operations Officer (COO)

Thank you Mike and a good evening to everyone.

Despite the external challenges, we concluded another good year for our business and are set on a positive growth trajectory. Key business highlights for the year are:

- We leased 2.2 msf across 47 deals at 18% spreads, and achieved 14% rent escalations on 7.7 msf;
- We delivered 1.1 msf JP Morgan campus within timelines and budget, and ramped-up new growth cycle with 4.6 msf new office development;
- We launched one of India's largest mixed-use complexes offering 619 dual-branded Hilton hotel keys at Embassy Manyata;
- We concluded ₹9.3 billion add-on acquisition at our investment entity Embassy GolfLinks, and initiated evaluation of 5 msf Chennai ROFO opportunity from Embassy Sponsor; and
- We announced our overall ESG strategy, our 2040 net zero carbon operations commitment and a 75/25 Renewable programme.

Let me cover the details under 4 broad areas of leasing, organic growth, acquisitions and sustainability.

First, an update on our leasing for the year and outlook

We are pleased to report that we achieved 2.2 msf of total leases in the previous year across 47 deals, with the deal activity, by number of leases, similar to pre-pandemic levels. We delivered over 1 msf of new leases across 31 deals, in-line with our enhanced leasing guidance last quarter. Notably, around half the space was leased to new occupiers – many of them smaller, newer, tech-focused players with high growth potential for further expansion in our properties. Additionally, we successfully renewed 1.2 msf at 13% spreads and secured 14% rent escalations on 7.7 msf across 89 deals. With this, we ended the year at 87% occupancy, and a promising pipeline of 500k sf along with encouraging pre-commitment discussions for our under-construction projects.

Our leasing pipeline and conversations with occupiers support our view on three clear trends in the Indian office space.

First, the timing of pent-up demand translating to lease closures is directly linked to the back-to-office ramp-up. With record hiring and increased offshoring, multiple corporates have onboarded more employees than their existing office capacities, a trend which was highlighted during our recent interactions with certain occupiers. As office utilization continue to increase, ready availability of quality office stock becomes a key differentiator. Further, long-term office space planning is fast becoming a key focus for occupiers, given the business growth, talent hire as well as limited supply in key micro-markets. As a result, many Global Captives have now issued RFPs for pre-commitments.

Second, there has been an increase in demand from high-growth players looking to setup offices in new locations, including first time occupiers in India, who are focused on accessing talent to support their growth. These corporates are experimenting by leasing smaller or flex spaces but have substantial growth potential in mid-term. As part of our strategy, we have signed over 20 such leases last year at an average deal size of around 50k sf and we are in advanced discussions for more. We believe this sets us in a strong position to capture future demand from these growing corporates.

Finally, the demand rebound is varied across sectors and micro-markets. Of the 31 msf pan-India active RFPs, around 55% relate to Global Captives and around 60% are Bangalore based requirements given the garden city's well-established ecosystem, large office market and talent availability. Expansion and consolidation are the two key themes for Bangalore RFPs. Mumbai is also showing encouraging signs of demand pickup, especially from the financial sector. Given that physical home infrastructure challenges are especially acute in Mumbai, the back to office ramp-up has been significantly faster here which is leading to increased deal activity. Relocation to higher quality and well-connected properties are the key themes for Mumbai RFPs. Our 84% portfolio exposure to these two cities coupled with the favorable location of our properties and several infrastructure initiatives for enhanced connectivity positions us extremely well.

Moving to our leasing guidance for FY2023, we are targeting a total lease-up of 5 msf comprising 1.7 msf new leases on our operating portfolio, 1.2 msf pre-commitments and 2.1 msf renewals. Of our 3.1 msf lease expiries due this year, 1.2 msf are likely exits but with a significant a mark-to-market opportunity of over 55%.

Moving to our organic growth updates

First, an update on our new office development. During the previous year, we successfully delivered a state-of-the-art 1.1 msf campus to JP Morgan at Embassy TechVillage ('ETV') and given the robust demand in this ORR micro-market, we launched an additional 1.9 msf new office development. With this, our ongoing construction projects now total 4.6 msf, we have significantly ramped up activity at site and are on track with our target delivery schedules. However, construction of our 0.6 msf M3 Block B at Embassy Manyata has been impacted given delays in pre-construction approvals, including the acquisition of necessary transferable development rights. On a positive note, we are evaluating additional leasable area opportunities totaling over 1 msf, comprising 600k sf at Embassy Manyata through redevelopment of certain existing blocks and 400k sf new block at ETV, and we will update you as we progress on regulatory approvals for these.

Moving to hotels, we are delighted to announce the launch of one of India's largest mixed-use hotel complex at Embassy Manyata comprising 619 keys dual-branded Hilton hotels, 60k sf convention center and an 85k sf retail and F&B hub. Strategically located at our park entrance, this hotel is complementary to our office offering and significantly increases Embassy Manyata's competitive moat. We have already signed over 110 corporate contracts and the 353 key Hilton Garden Inn launched in March of this year is already witnessing encouraging occupancy levels. Similarly, given the recovery in travel, we are seeing occupancy pick-up for our other two operational hotels. With a further boost from the opening of international borders, hospitality demand is set for a strong rebound. We have also kickstarted construction of the 518 key dual-branded Hilton hotels at ETV in Bangalore's ORR, a micro-market with significant long-term opportunity given the demand supply mismatch. We see hotels as immensely complementary to our office offering.

During the year, we completed master plan upgrades for Quadron and TechZone in Pune, launched a public skywalk and flyover near our Bangalore properties and initiated 'Central Garden', an 8-acre amenity zone at ETV. We continue to ramp up our office construction and kickstart new hotel projects to enhance the total ecosystem of our properties, preparing them for the resurgent demand.

Next, an update on our acquisitions

During the last year, we consolidated ownership in Embassy GolfLinks ('EGL') property at Bangalore, one of India's best office parks. Our 50%-owned investment entity GolfLinks Software Park Private Limited ('GLSP') acquired 0.4 msf area within EGL from strata owners, thereby consolidating GLSP's ownership footprint to 3.1 msf and we have witnessed strong leasing for this newly acquired area. GLSP also acquired the property management business for the entire 4.7 msf EGL business park. Property management ownership is a continuing theme for us given the long-term strategic benefits of full alignment and improved service delivery to occupiers. The entire acquisition was completed by GLSP for a total consideration of ₹9.3 billion and was funded through a debt by REIT at 70 bps spread to REIT's recently raised 5-year fixed coupon debt at 7.35%.Since acquisition, the 0.4 msf area has witnessed strong leasing given its consolidation with our EGL property

In addition, we continue to evaluate the Right of First Offer opportunity received from Embassy Sponsor in January in relation to Embassy Splendid TechZone, a 26-acre business park in Chennai totaling around 5 msf when fully developed. We like the impressive scale, global occupier base and micro-market of this property and will update you as we progress further on our evaluation. This is in addition to other third party opportunities which we are currently considering. As demonstrated by our ₹97.8 billion successful acquisition of ETV in December 2020, we remain highly selective and are focused on ensuring acquisitions are complementary to our existing portfolio. Our robust governance framework, strong balance sheet and well-established access to capital markets are our key strengths and help us pursue accretive growth.

Finally, an update on our ESG initiatives

Earlier this year, we announced our ESG strategy based on 3 key pillars of Resilient Planet, Revitalized Communities and Responsible Business. We have committed to achieve net zero carbon emissions by 2040 across our operational portfolio and have set medium-term goals for our 19 ESG programs – key being our '75/25 Renewable Programme', i.e., our commitment to achieve 75% renewable energy usage across our properties by FY2025. To that end, we have initiated a 20 MW solar rooftop project across our pan-India properties, this being one of Asia's largest such initiatives. This project is on track for end 2022 completion and is expected to deliver over 30% IRR given the attractive 5.95% certified green financing.

In recognition of our efforts and leadership position in sustainability, we received multiple prestigious ESG recognitions, such as the Golden Peacock Award for Sustainability, a 4-star GRESB rating, a portfolio-wide WELL score and USGBC LEED Platinum rating for all our Mumbai, Pune and Noida properties. We consider our ESG focus and commitments to be aligned with the broader goals of our global occupiers and investors and our leadership position as a strong differentiator and a long-term advantage.

In summary, we concluded the year with strong execution of our leasing strategy, successful delivery and ramp-up of our office and hotel developments and considerable progress on ESG front. Looking forward, we are well placed for growth considering improving leasing outlook, significant mark-to-market opportunity and our substantial on-campus development. Additionally, as market consolidates to fewer and more institutional landlords, we are well positioned for new growth through accretive acquisitions.

Over to Aravind now for our financial updates.

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Aravind Maiya

Chief Financial Officer (CFO)

Thanks, Vikaash. Good evening. Let me start with our financial highlights for the year.

- We surpassed our Net Operating Income ('NOI') and Distributions guidance provided in July of last year by 5% and 1% respectively. This outperformance was largely driven by our leasing recovery as well as improved operating performance by our hotels.
- We refinanced our ₹36.5 billion ZCB with coupon bearing debt at positive spreads of c.300 bps leading to proforma ₹1.3 billion annual interest savings. Post this significant refinance, our balance sheet remains conservative with 24% leverage and 6.7% cost of debt.
- We enhanced post-tax distributions yield for our Unitholders by simplifying the two-tier structures of our Manyata and ETV properties and increasing tax-free component of our distributions from 66% in previous year to 82% in FY2022. Going forward, we expect c.85% of our distributions to be tax-free.
- We achieved a 6% YoY increase in Gross Asset Value for our portfolio, independently assessed by valuers at ₹494 billion as of 31 March 2022. Our NAV also increased by 2% YoY to ₹393.90 per unit, primarily driven by improved market outlook, lease-up, market rent assumptions and new deliveries.

Now, an update on our FY2022 income performance and distributions

- **Revenue from Operations** grew by 26% YoY to ₹29,626 million, mainly driven by revenue accretion due to ETV and other completed acquisitions in the previous financial year, ramp-up in hotel occupancy and rent escalations on 7.7 msf leases. The impact of these positives was partially offset by a decline in occupancy since the start of the Covid pandemic.
- **NOI** and **EBITDA** both grew by 23% YoY, in-line with the increase in our Revenue from Operations and factors the corresponding CAM and hotel operations expenses. Our NOI margins stood at an impressive 84% and continue to be best-in-class, reflecting the scale and efficiency of our business as well as our low fee structure.
- **Net Distributable Cash Flows ('NDCF')** grew by 12% to ₹20,639 million, mainly reflecting the increase in our NOI and EBITDA. The impact of these positives was partially offset by additional interest cost on coupon bearing debt raised for acquisitions and our ZCB refinance. Earlier today, the Board of Directors declared a **Distribution per Unit ('DPU')** of ₹5.26 for Q4, representing a 100% payout ratio. With this, Embassy REIT has declared annual distributions of ₹21.76 per unit for FY2022, about 1% higher than previous year.

Before I move to our FY2023 guidance, an update on our Balance Sheet strength

Our fortress balance sheet is well positioned to drive growth. We have a proforma debt headroom of ₹120 billion with average debt cost at 6.7%, one of the lowest in the industry. We undertook a few notable steps during the year which has further consolidated our strong balance sheet position.

- Through our ₹69 billion debt raises during the year, across listed bonds as well as SPV-level debt, we widened our debt investor pool with participation from numerous domestic mutual funds, corporate treasuries and domestic as well as multinational banks. The regulatory permission to insurers and FPIs to participate in REIT debt issuances further enabled us to access a new and deep capital pool and achieve their first-time participation in our debt book.
- We successfully refinanced our legacy ZCB by raising ₹46 billion coupon-bearing debt at 6.5% debt cost, significantly lower than the 9.4% ZCB raised at IPO. Given the rising interest rate environment, our assessment of prepaying this debt in November last year ahead of the actual maturity schedule has been immensely beneficial. Including additional refinance of ₹7 billion debt across various term loans and construction debt, we refinanced a total of ₹53 billion debt during the year and achieved positive refinancing spreads of around 260 bps, leading to proforma annual savings of ₹1.4 billion to the benefit of our Unitholders. We continue to opportunistically explore additional refinancing opportunities.

- We locked-in majority of our debt at fixed interest rates which positions us well given the trend towards hardening of interest rates. As of March 2022, around 62% of our debt book is at fixed coupon and we do not have significant debt maturities in FY2023. All our debt continues to be rated as AAA/Stable by credit rating agencies. Further, as of 31 March, 2022, our entire ₹121 billion debt book is fully coupon-bearing, thereby simplifying the cash flow-through for our distributions and enabling easier understanding of the yield and growth components of our REIT product by current and potential Unitholders, including our growing retail investor base.
- As part of our broader ESG strategy, we successfully raised ₹22 billion of green loans during the year, much ahead of our FY2024 target of ₹10 billion, and I am pleased to update that 16% of our overall debt book comprises of green loans. As Vikaash mentioned earlier, ESG is a key business focus for us and the 19 programmes across 3 pillars are fully integrated into our execution priorities.

Lastly, our outlook for FY2023

We expect our NOI to be in the range of ₹25,679 million to ₹28,382 million with midpoint of ₹27,030 million, which is 9% higher than previous year FY2022. We expect our NDCF to be in the range of ₹19,541 million to ₹21,598 million with midpoint of ₹20,569 million. Correspondingly, our DPU is expected to be in the range of ₹20.62 per unit to ₹22.79 per unit with a midpoint of ₹21.70 per unit, in-line with the previous year. I would like to highlight that this distribution guidance includes the impact of the ZCB which we refinanced in November last year with a coupon-bearing debt. To that end, our new guidance should be viewed as core recurring distributions, and on a like-to-like basis, post factoring the impact of ZCB refinancing, our guidance is 9% higher compared to the previous year.

Our outlook is based on following key assumptions:

- Considering the improved demand outlook and our leasing pipeline, we expect a total lease-up of 5 msf, comprising 1.7 msf new deals on operating portfolio, 1.2 msf pre-leases on under-construction projects and 2.1 msf lease renewals. We have also factored income from our recently delivered 1.1 msf JP Morgan Campus at ETV.
- We will benefit from the full year impact of the successful 14% rent escalations on 7.7 msf across 89 leases in the previous year. We also expect to achieve 14% rent escalations on an additional 8.2 msf across 68 leases during FY2023.
- In relation to our hotels, considering the revival of business travel and hospitality demand, we expect continued improvement in business on books across our 1,096 keys operating hotels, including the soon-to-be inaugurated Hilton hotel at Manyata. We have factored a positive EBITDA of ₹400 million from hotels compared to an average cash drag of ₹244 million in the previous two years.
- Finally, we have factored incremental ₹650 million interest costs relating to the recent 1.1 msf office and 619 key hotel deliveries as well as 0.9 msf expected completions during FY2023. We have also factored ₹1.7 billion or ₹1.8 per unit full-year impact due to interest expense outflows given our recent ZCB refinance.

While business outlook and sentiments have certainly improved, please note that our guidance remains subject to the evolving nature of the pandemic. We are focused to deliver accretive growth through mark-to-market leasing, new development completions and prudent acquisitions. We remain well-positioned to finance our growth given our strong balance sheet.

Over to Mike for his concluding remarks.

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Michael Holland

Chief Executive Officer (CEO)

Thank you, Aravind.

So, another very solid and encouraging year; marking our 3-year anniversary since listing in April 2019.

Over the last 3 years, we signed total of 6.4 msf leases across 135 deals, delivered 2.5 msf of new space, launched three 849 keys premium hotels, expanded our occupier base from 165 to over 200 corporates, acquired a 9.2 msf world-class business park, raised over ₹36 billion equity through India's first QIP by a REIT, raised over ₹174 billion debt, refinanced around ₹89 billion debt reducing our debt cost by around 265 bps, launched our ESG framework and 2040 net zero commitment, and finally, distributed over ₹58 billion to our Unitholders, which along with our stock performance equals over 15% annualized total return. Our team has accomplished a great deal in these three years, despite having two years in the shadow of the extraordinary circumstances of the global pandemic.

Finally, I am pleased to confirm that the Board has today approved the appointment of Vikaash Khdloya as CEO for EOPMSPL, the Manager to the REIT, and that I will retire from the business effective 30th June 2022. Vikaash is known to many of you as he has been part of our leadership team since before our IPO in April 2019. Our Nomination & Remuneration Sub-Committee ('NRC') has followed a rigorous process by engaging two globally recognised leadership consulting practices to assess potential external candidates as well as undertake an independent skills assessment; and the NRC has unanimously concluded that Vikaash Khdloya is the best fit for the role of CEO to Embassy REIT. It has been a privilege for me to serve in this position for the three years post IPO, and I am confident that our strong leadership team led by Vikaash will take the business through its next phase of growth for the benefit of all our Unitholders.

Looking forward, we have a clear strategy to further solidify our resilient business and undertake accretive growth by building and acquiring assets complementary to our industry-leading portfolio. We have an excellent team of over 160 very talented individuals who are committed to execute this strategy and are driven by our ultimate goal of delivering growth and maximizing value to our Unitholders.

Let's move to Q&A.

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Q&A

Closing comments

Thank you so much for joining us on today's call and for your great questions. Most of the data points covered today can be found on our website and in the published materials, and we are always happy to engage further if any additional clarifications are required.

Good evening.

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