Embassy REIT
4Q FY2021 Earnings Call
April 29, 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

MANAGEMENT DISCUSSION SECTION

Operator: Good evening everyone. A very warm welcome to all for the Embassy REIT's fourth quarter FY2021 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, operator. Welcome to the fourth quarter FY2021 Earnings call for Embassy REIT.

Embassy REIT released its financial results for the Quarter and Financial year ended March 31, 2021 a short while back. As is our standard practice, we have placed our quarterly and full year 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. Further, there are significant risks and uncertainties related to the scope, severity and duration of the ongoing second wave of the COVID-19 pandemic, the actions taken to contain and mitigate the pandemic and the direct and indirect economic effects of the pandemic and 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, our CFO. Mike will start off with the FY2021 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)

Thank you, Ritwik.

Good evening everyone and thank you for joining us on the call today to review our Q4 and full year FY2021 results along with our outlook for the coming year. While Aravind will take you through the detail on our full year numbers, we are very pleased to confirm that we have delivered in-line with the guidance set out at mid-year back in October 2020.

You may recollect that, at our last earnings update in mid-February, I had expressed optimism at the decline in COVID cases and the resultant acceleration of return to work by our occupiers. Since then, we have seen the acceleration of the vaccine rollout, but the second wave of cases will delay the return to office and consequent uptick in leasing.

Despite the current short term set back with the second wave, we continue to be encouraged on a number of fronts for the mid to longer term:

First, in addition to delivering on the guidance set out at mid-year back in October 2020, we have now completed two full years since listing, one of which has been fully under the shadow of the pandemic and yet we have delivered 24% in total returns and, taking into account Q4 distributions, we will have distributed over ₹37 billion ($500 million) since listing.

Second, the resilience of our business has been clearly demonstrated – delivering in such a manner despite the global and local challenges. We remain strong on our operating fundamentals. In FY21, we have collected over 99% of our office rents, signed new leases and renewals of 1.2 msf with re-leasing and renewal spread of 18% and 13% respectively. Even in today’s challenging market, our year-end occupancy stands at a healthy 88.9%.

Third, a consensus has emerged, as we had articulated a year ago, that the office of the future will be a place for collaboration, community, and learning and that while we will see more flexibility in the working week, that office, and in particular the type of office product that we provide, the total business ecosystem, will continue to be in demand from the best global companies. The office will continue to be a key tool for attracting and retaining the best STEM talent here in India.

Fourth, the occupiers which we serve, utilizing technology to support their global businesses, continue to prosper and forecast strong growth including significant growth in hiring - a recent NASSCOM and Kotak research report estimates a record annual headcount increase of 350k in the Indian ITES industry for FY2022. In the last two weeks, we have heard public results with India’s leading technology services companies reporting all-time records in business pipeline and hiring in Q4. Similarly, global banking majors, several of whom have their captive centers in our parks, are reporting record Q4 earnings and growth in their home markets. So, numerous strong indicators of growth in our core customer segment.

And finally, we again underline the continuing appeal of the office market in India. Supporting high quality global businesses which continue to grow in a digital and geographically agnostic world, Indian office has a strong future. And within India, with over 70% of our portfolio value, we are focused on the leading market, Bangalore - the market with lowest vacancy, the highest absorption, the largest stock, highest technology export value and most global captive centres in India.

So even in the midst of this second wave, there is a great deal to be positive about around our business – the last year and the coming years. Looking beyond the pandemic, we are using this period to accelerate our growth through the new on-campus developments, to develop our acquisitions pipeline, to sharpen our long term ESG plan, to raise the bar with our occupier engagement activities, to continue to reinforce our already strong balance sheet – to prepare for our next phase of growth as the world returns to work, as it certainly will.

Let me now handover to Vikaash to discuss in detail our business and operating performance.

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Vikaash Khdloya

Dy CEO and Chief Operations Officer (COO)

Thanks, Mike. Good evening, everybody.

Our business performance was resilient despite the major impact of the pandemic. Business highlights for the full year FY2021 include:

- Our properties were fully operational throughout the pandemic, with over 90% occupiers operating from our parks;
- Our rent collections were robust at over 99% and we achieved 13% rent increases on the entire 8.4 msf scheduled escalations;
- Our total lease-up stood at 1.2 msf across 43 deals, of this half were new leases at 18% re-leasing spread, with the balance being renewals at 13% renewal spread;
- Our 5.7 msf on-campus development programme continues at pace and we are on target for the first phase with the delivery of 1.1 msf JP Morgan campus later this year; and finally
- Our on-ground teams continued our asset management efforts, we successfully integrated ETV asset, undertook several upgrade projects as well as wellness initiatives during the last year.

Now let me take you through the details.

First, the impact of the second wave on our operations

All our parks continued to remain open for business despite localized restrictions on movement. However, the current second wave, with rising daily cases, has interrupted the ramp-up in employee numbers at our parks. Consequently, timelines for back-to-office ramp-up is likely to be deferred by 1-2 quarters. On the positive side, a mass-scale vaccination roll-out is currently underway in India and this will positively influence the rate of return to offices as is the case worldwide.

Our on-ground teams continue to support businesses through this second wave. Through our partnerships with leading hospitals as well as support of local civic authorities, we are facilitating vaccine roll-out at our park premises. This is in addition to our safety initiatives and our investments in touchless technology, advanced air filters etc. Our recent association with WELL Institute is another illustration of our focus on providing world class health and wellness-oriented solutions to our occupiers.

Moving to our leasing performance and outlook

In FY2021, we collected over 99% of rents on our 32.3 msf operating portfolio, secured all our rent escalations due, a 13% escalation on 8.4 msf across 94 leases, and successfully concluded 2.9 msf of rolling renewals. Delivering on above in a pandemic year reflect the strong underlying covenants of our occupiers and the active lease management efforts by our teams.

Further, we leased a total of 1.2 msf across 43 deals in FY2021 at market rents with an average lease tenure of 8 years. Breaking down this 1.2 msf lease-up, half were new leases across 23 deals at 18% re-leasing spread and the remaining were renewals across 20 deals at 13% renewal spread. For Q4, our total lease-up stood at 124k sf across 8 deals comprising 50k sf of new leases and 75k sf of renewals. Also, as reported during the previous calls, we witnessed 1.5 msf of exits during the last year – a mix of 'business-as-usual' churn, portfolio housekeeping and COVID induced exits. Factoring the above new leases and exits, our portfolio occupancy stood at a healthy 88.9% on 32.3 msf operating area.

While site tours, decision making and new deal activity were picking up in January and February 2021, the second wave has once again deferred new leasing decisions for 2-3 quarters and is dependent on lifting of localized restrictions on movement as well as speed of vaccine roll-out. However, based on our conversations with large occupiers, office demand in India is expected to pick up meaningfully in medium-term given the rapid technology and digital acceleration, growth in underlying businesses of our occupiers as demonstrated by recent hiring trends, necessity for physical office as publicly stated by a number of leading global and Indian corporates, as well as positive impact of lower densities given that social distancing norms are likely to be a permanent feature at workplace.

Our portfolio's best-in-class positioning – whether it is our technology sector concentration, or our geographic concentration to Bangalore, which has witnessed 37% of overall absorption in this pandemic year, or our portfolio's resilience in Mumbai city, where occupancy stood at a stable 83%, similar to pre-pandemic levels – all of these demonstrate that our properties are well positioned and likely to be the primary beneficiaries of the significant pent-up occupier demand. Till such time, we continue to maintain our new deal discipline, deepen our occupier connects and listen to their evolving needs and ready our available spaces for occupiers.

Now an update on our development programme

We currently have 5.7 msf under development across four of our existing campuses in Bangalore, Pune and Noida which are due for delivery over the next 2-3 years. This development helps us expand our existing campuses and is significantly de-risked. First, only 1.1 msf is due for completion over the next full year and this built-to-suit campus is already fully pre-committed to JP Morgan and on track for delivery in September 2021. Second, over 70% of our current development is in Bangalore, by far India's best office market, and in two of our largest and market dominant properties – Embassy Manyata and Embassy TechVillage. Third, construction permits are in place and financial closure has already been achieved for these projects.

The timing of our new build projects fits well into expected demand bounce back in early CY2022, and increased emphasis by global corporates on the quality of campus infrastructure. Current RFPs in the market, already standing at over 20 msf, are also likely to gain significant momentum given the continued hiring and growth reported by tech occupiers and global captive centers or GCCs. Further, international property consultants have already assessed the two-year forward supply to be down by 25% and actual supply slippages may be significantly higher. This provides an opportunity to undertake new-build at attractive development yields given land is already paid for and given our financing costs are amongst the lowest in the industry. Hence, we continue to invest in new on-campus development as a significant growth driver to enhance our future operating income and DPU.

Next, we are continually enhancing our Total Business Ecosystem

- In Q4, we fully integrated the recently acquired ETV property into our portfolio. We transitioned the on-ground teams, stepped up the execution pace of the 1.1 msf built-to-suit campus and have kick-started an additional 1.9 msf of office development. Given ETV's presence in a key sub-market in Bangalore, this acquisition has enabled significant addition to our market offerings to occupiers and will drive our portfolio's growth.
- We have doubled down on our asset management efforts and are utilizing this downtime to implement planned infrastructure and upgrade projects to continually enhance our value proposition. Notable completions planned in the year ahead include the amphitheater, flyover and skywalks at Embassy Manyata, addition of over 100k sf F&B and amenity spaces across our portfolio and the comprehensive asset re-positioning of Embassy Quadron. At early stages of planning is the integration with proposed metro stations for our ETV, Embassy Manyata and Embassy Quadron properties.
- While our two operating hotels totaling 477 keys witnessed an uptick in occupancy in Q4 with improved visibility of business on books, the second wave and travel restrictions have negatively impacted room demand. Both our hotel operators, Hilton and Four Seasons, are working towards an improved performance contribution in FY2022.
- Our ESG initiatives have always been a significant part of our business philosophy and our 3-year ESG roadmap including GRESB assessment is already underway. Our 100 MW Solar park helps reduce an estimated 200 million kgs of carbon footprint by providing green energy to our occupiers and our 525 kW Roof top Solar project at Embassy 247, Mumbai has been awarded the 'Best Green Building Project of the Year'. We also continue our work within our local communities, particularly through our Corporate Connect and Education programmes.

Moving to our Positive Mid-term Outlook

As we conclude a challenging but successful year for Embassy REIT, delivering to our investors and corporate occupiers, we remain agile and flexible with our leasing efforts and we continue to gear up for our next growth cycle through 5.7 msf new development. We are utilizing this period of pause in decision making by occupiers to fortify our assets through investment in infrastructure and amenities and to be ready for the anticipated resurgence in demand. We will see acquisition opportunities emerge and we will continue to assess such opportunities in the market per our previously stated criteria.

In the mid-term, as we look beyond the pandemic, we are well placed to capitalize on the future opportunities given the continued growth in our occupier businesses, especially technology and global captives, and given that our portfolio comprises some of the highest quality properties in the Indian office market. It is very clear that our differentiated office portfolio will continue to attract quality occupiers, and that owners who have invested in amenities, services and technology will secure increased market share moving forward.

Over to Aravind now for the financial updates.

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Aravind Maiya

Chief Financial Officer (CFO)

Thanks, Vikaash. Good evening, everybody.

I will be covering three key areas with you today i.e., our FY2021 performance, a brief update on our balance sheet and outlook for FY2022. Let me start with our financial highlights for FY2021 which include:

- Net Operating Income grew by 12% YoY to ₹20,323 million, with operating margins at 86%;
- Total Distributions stood at ₹18,364 million or ₹21.48 per unit, representing a 100% payout ratio, with Q4 distributions of ₹5,308 million or ₹5.60 per unit for the quarter;
- Simplified the holding structure of Embassy Manyata, thereby increasing tax free component of distributions to 78% for Q4;
- Raised ₹52 billion debt at attractive 6.9% coupon and refinanced ₹32.8 billion existing debt leading to 336 bps interest savings; and
- Maintained our fortress balance sheet with liquidity of ₹15.5 billion and low leverage of 22%.

Now let me take you through the details.

First, our NOI and DPU were on target with our annual guidance

- Our **Revenue from Operations** for FY2021 grew by 10% YoY to ₹23,603 million mainly due to ETV acquisition, contracted rent escalations and income from new deliveries in Q4 FY2020 which were partially offset by reduction in hotel revenues and decrease in commercial office revenues due to occupier exits.
- Our **Net Operating Income (NOI)** for FY2021 grew by 12% YoY to ₹20,323 million, in-line with increase in our Revenue from Operations and reflects savings due to our cost saving initiatives. Our delivered NOI is on target with our full year NOI guidance. Further, on a same-store basis, NOI grew by 2% YoY, reflecting the underlying covenant of our 190+ creditworthy occupiers and the contractual growth inbuilt in our lease contracts.
- Our **EBITDA** for FY2021 grew by 12% YoY to ₹19,693 million, in-line with increase in our NOI. We have included further details on each of the above components for Q4 in our earnings materials.
- Our **Net Distributable Cash Flow ('NDCF')** for the quarter stood at ₹5,324 million and the Board of Directors have declared a Q4 FY2021 **Distribution per Unit** ('**DPU**') of ₹5.60 with the tax-free portion of distributions increasing to 78% for the quarter given successful completion of Embassy Manyata's restructuring. For the full year FY2021, we have delivered distributions totaling ₹18,364 million or ₹21.48 per unit, on target with our full year DPU guidance. We are also pleased to confirm that the acquisition of ETV assets is accretive to our NOI and DPU, as reflected in our Q4 numbers.

As you can see, our robust cash collection ratios, leading operating margins, low manager fee and prudent leverage to fund select capex and growth initiatives results in our healthy NOI to unlevered distributions conversion.

Next, an update on our strong Balance Sheet

- In Q4, we raised ₹26 billion of listed debt at an impressive 6.4% coupon, our lowest cost debt till date, which were primarily utilized to refinance ETV's in-place debt. Further, we have also secured ₹11 billion of SPV-level construction debt at 7.9% cost, one of the lowest in the industry. To round up our full year activity in the debt markets, we successfully raised ₹52 billion debt at an impressive 6.9% coupon through a combination of REIT level listed debt and SPV level debt and we refinanced ₹32.8 billion debt at 6.9%, leading to 336 bps interest cost savings.
- We continue to maintain a strong liquidity position of ₹15.5 billion and a low leverage of 22% Net Debt to Gross Asset Value (GAV). Considering our AAA credit rating, additional proforma head room of ₹126 billion and our ability to raise debt at competitive rates, we are in a strong position to pursue growth through on-campus development and accretive acquisitions, thereby enhancing overall return to our Unitholders.

Moving to other financial updates

- Our independent valuer undertook a detailed property valuation exercise at year end and assessed the GAV of the portfolio at ₹466 billion with 95% of REIT's value from our core commercial office segment and with over 72% of value from Bangalore. We recognized an impairment loss of ₹989 million in our hospitality business as well as Embassy One due to slower occupancy ramp-up and current economic conditions due to the second wave. Factoring the above, our Net Asset Value (NAV) as of March 2021 stood at ₹387.54 per unit, a 3.3% increase to NAV as at September 2020.
- We are pleased to deliver on the simplification of Embassy Manyata holding structure within the timelines committed. Collapsing of the legacy two-tier structure has enabled Embassy REIT to significantly increase tax-free component of its overall distributions and our Q4 numbers reflect the enhanced post-tax returns to Unitholders. Further, we have initiated the simplification of holding structure of our newly acquired Embassy TechVillage assets and expect this to be completed by September 2021.

Lastly, our outlook for FY2022

As Mike and Vikaash mentioned, the current second wave is likely to delay return-to-work and consequently defer leasing plans by occupiers in the short-term. Considering this, we believe it is prudent to defer annual guidance for FY2022 till such time we have more clarity on trajectory of the second wave. However, I will provide a few key building blocks of our business components which may have a bearing on our FY2022 NOI and distributions:

- To start with, we will benefit from the full year impact of the successful 8.4 msf lease escalations in FY2021. Further, we have an additional 7.7 msf of upcoming contracted escalations across 89 leases during the course of FY2022 with an average 14% rent increase. Similar to FY2021, we believe we will be able to achieve most of these rent escalations as well as achieve continued current trend of collecting close to 100% of office rents;
- We are currently 88.9% occupied as of Mar'21 with 3.6 msf existing vacancy. Of our 1.9 msf expiries in FY2022, basis our conversations with occupiers, 0.5 msf are likely renewals and balance 1.4 msf are likely exits at this stage. The in-place rents on these exits are significantly below market and provide over 50% mark-to-market opportunity. We expect new lease deals to see traction/ conclusion towards end of CY2021 with an expected rebound in CY2022;
- We expect the full year impact of ETV acquisition to reflect in both NOI and NDCF for FY2022. As you are aware, we acquired ETV assets in the last week of Dec'20 and these assets contributed to the NOI and NDCF accretion in Q4 FY2021; and
- We will determine the timing, coupon structure and contours of a potential refinance of our initial ₹36.5 billion listed debt based on then prevailing market conditions. This NCD is due for redemption in June 2022 with call options in November 2021 and January 2022 for early prepayment.

Recent budget amendment enabling Foreign Portfolio Investment ('FPI') participation in REIT debt as well as the recent IRDA announcement in mid-April permitting insurance companies to invest in REIT debt, both give us access to longer tenor and larger pools of debt capital and are expected to be positive for our debt refinancing plans. These developments are very positive for us as a falling interest cost scenario contributes incrementally to our distributable cashflows to the benefit of our Unitholders.

We remain focused on delivering our NOI and quarterly distributions, maintaining our balance sheet discipline and continuing to reduce our cost of debt. Even after one of the most challenging years for businesses worldwide, we are pleased to report that Embassy REIT, remains in great financial shape, with a robust balance sheet which provides a strong platform for organic and inorganic growth in the coming years.

Over to Mike for his concluding remarks.

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Michael Holland

Chief Executive Officer (CEO)

Thank you, Aravind.

So, the key takeaways:

We have delivered on guidance for the past year FY2021 with ₹5,308 million distributions for Q4 and full year distributions of ₹18,364 million – underscoring the resilience of our business model through a full twelve month pandemic environment.

Notwithstanding the uncertainties created by the 2^{nd} wave and the subsequent delay that will result in the re-opening of office and consequent leasing, our business remains resilient and ready for the future growth opportunities.

Our occupiers are largely international, technology driven and growing. On all parameters, we believe this will feed through to a leasing recovery in due course, though timing has been delayed.

We are absolutely confident in our various theses around the business. The total business ecosystem in this Digital Talent Nation, our geographic concentration, our on-campus development and our ESG focus. The management team remains focused, doing all that can be done in the current external environment, to deliver in the best interest of our unitholders. And we remain excited on the growth opportunities that lie ahead for our business.

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

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Q&A

Closing comments

Thank you very much for joining today's call and for these great questions.

We hope that we have communicated that the last year represents a great result in a challenging year, that the business is resilient and is well positioned for further growth backed by our robust balance sheet, our strong occupier relationships and our committed on-ground teams.

We appreciate your interest in Embassy REIT and for your time today. Good evening.

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