Embassy REIT

Q1 FY2023 Earnings Call

July 21, 2022

CORPORATE PARTICIPANTS

Vikaash Khdloya – Chief Executive Officer (CEO)

Abhishek S Agrawal – Interim Chief Financial Officer (CFO)

Ritwik Bhattacharjee – Chief Investment Officer (CIO)

Abhishek Agarwal – Head of 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 FY2023 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 for Embassy REIT. Sir, you may begin.

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Abhishek Agarwal
Head of Investor Relations

Thank you, operator.

Welcome to the first quarter FY2023 Earnings call for Embassy REIT. Embassy REIT released its financial results for the quarter ended June 30, 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 risks and uncertainties related to the Covid pandemic, and its economic effects on Embassy REIT and on our occupiers.

Joining me today are Vikaash Khdloya, the CEO, Abhishek S Agrawal, the Interim CFO and Ritwik Bhattacharjee, the CIO. Vikaash will start off with business and industry overview followed by Ritwik and Abhishek. We will then open the floor to questions.

Over to you, Vikaash.

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Vikaash Khdloya
Chief Executive Officer (CEO)

Good evening and thank you all for joining us on the call today. Let me start by once again thanking Mike Holland, who retired earlier this month. On behalf of the entire team at Embassy REIT, I thank Mike for his contributions over the years and wish him well for the future. I am excited and honored to lead the REIT through the next phase of growth after working with the REIT management team and our sponsors for over a decade.

Diving into our Q1 FY2023 results. We delivered a strong all-round quarter, with our record leasing being the key highlight. We signed a total of 1.8 msf leases with healthy deal traction across new leases, pre-commitments in our under-development projects as well as end-of-tenure lease renewals. We accelerated development of our ongoing 4.6 msf office projects; we successfully launched the 619 key dual-branded Hilton hotels at Embassy Manyata; and we are now proceeding with development of 518 key dual-branded Hilton hotels at Embassy TechVillage ('ETV'). On our financial performance, we delivered a 9% YoY growth in our Net Operating Income and announced healthy distributions of ₹5,052 million or ₹5.33 per unit, marking our 13th consecutive quarter with a 100% payout. Our balance sheet remains conservative with low 27% gearing and given the rising interest rate environment, we are well positioned with 64% of our overall debt locked-in at fixed-rates of 6.7%.

With record Covid vaccinations, normalizing economic activity and steady rise in back-to-office, occupiers have now started planning for their space requirements, both to accommodate head count increase over the last two years as well as their business growth. The physical occupancy in our properties reached 66k during last week, an over 20% increase compared to last quarter. Though the pace of ramp-up varies across our properties and micro-markets, the upward trajectory in the numbers is highly encouraging and is translating to increase in lease enquiries and deal closures.

Let me now update you on our leasing performance

As you may recollect, during last quarter we provided a total leasing guidance of 5 msf for FY2023. We are happy to report that during Q1, we achieved a record total leasing of 1.8 msf across 25 deals, making it the highest total leasing in a single quarter across the last seven years. This 1.8 msf includes new leasing of 415k sf at 31% re-leasing spreads and at above market rents; end-of-tenure renewals of 850k sf, mainly by our IT services occupiers at our Pune and Noida properties and at 9% renewal spreads; and 550k sf pre-commitment to JP Morgan in our under-development Block 8 at ETV. Notably, we added 15 new occupiers during the quarter across multiple high-growth sectors and our occupier base has now expanded to 214 compared to 165 at the time of our IPO in 2019. With this, we ended the quarter with a stable occupancy of 87% and a promising 1 msf new deal pipeline.

Of our 3.1 msf expiries for FY2023, we have successfully renewed 850k sf, and expect a further 1 msf as likely renewals. The balance 1.2 msf are likely exits for FY2023, including 453k sf exits witnessed during Q1. These exits are in-line with our previous guidance and are mainly due to relocation or consolidation of occupiers with certain legacy leases. We view this as positive churn given that in-place rents on these exits are significantly below market with over 50% mark-to-market opportunity. Additionally, we secured 15% rent escalations on 1.9 msf across 22 deals in Q1. As mentioned earlier, our mark-to-market rent potential and our contracted rental escalations are embedded growth drivers for our business.

Our leasing pipeline and conversations with occupiers support our view on three key trends.

First, there has been a clear acceleration in the number of new entrants looking to setup their offices in India. This is driven by India's talent availability at scale and the cost advantage that the Indian office market continues to provide. We signed a number of such deals this quarter with new occupiers, including players from growth sectors like cloud infrastructure, cybersecurity and e-commerce, sunrise sectors like renewables and healthcare tech, and rebound sectors like media and automobile. With an average deal size of 25k sf for our Q1 new leases, our strategy of focusing on high-growth occupiers in early stages of their India operations sets us in a strong position to capture future demand as they expand their India footprint.

Second, given record hiring and increased offshoring, our on-ground interactions indicate that multiple corporates have onboarded more employees than their existing office capacities. Additionally, many corporate leaders have re-iterated that physical offices will remain at the core of their business given the need for collaboration, culture and team-building, thereby driving steady back-to-office. Both these factors together have led occupiers to activate Request for Proposals (‘RFP’s) for their immediate space needs as well as initiate planning for their medium term requirements. This has also resulted in healthy pre-commitment enquiries in under-construction properties as occupiers look to lock-in office space to meet their future business growth.

Third, given employee attrition concerns across industries, hiring and retaining talent has become a top business priority. Employee wellness, health and safety have now become a core focus of RFPs and occupiers today are seeking higher product standards for their employees. As a result, institutional-grade, wellness-oriented and green-rated buildings have become the preferred choice, especially for global corporates. With our high-quality portfolio, total business ecosystem offering and ESG focus, we are well placed to benefit from this secular trend.

To sum up, these emerging trends provide significant tailwinds to our business. We are well positioned to benefit from the resurgent office demand given our best-in-class properties and our concentration to Bangalore, India’s best performing office market.

Moving to updates on our ESG program, which is core to our business strategy. In line with our 19 defined ESG programs, our ₹3 billion planned investments over the next 3 years are progressing satisfactorily. Our 75/25 Renewable program, 20 MW solar rooftop project and USGBC LEED and British Safety Council certifications – all of these are aimed to future-proof our properties, as sustainability takes centerstage. For more details on our significant initiatives and progress thereon, we encourage you to read through our latest annual ESG report which is available on our website.

So, overall, a great start to FY2023 with strong leasing performance and promising growth prospects. Despite the external macro environment, our business continues to be resilient, backed by the strength of our growing occupier base, our on-ground teams and our fortress balance sheet. We remain focused to deliver on our guidance and to accelerate our business to the next growth phase. Ritwik will now expand further on our growth initiatives and then Abhishek will provide details on our financial performance.

Over to Ritwik.

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Ritwik Bhattacharjee
Chief Investment Officer (CIO)

Thanks Vikaash. Good evening everyone. An update on our key growth initiatives for the quarter:

- We've accelerated development on 4.6 msf of ongoing office projects. This includes 1.9 msf at ETV, of which we have successfully pre-committed 550k sf to JP Morgan;
- We've successfully launched the 619 key Hilton hotels at Embassy Manyata, and we have commenced development of the 518 key Hilton hotel complex at ETV;
- We've funded ₹9.3 billion to GLSP, our joint venture entity, to finance the Embassy GolfLinks ('EGL') add-on acquisition; and
- We continue to evaluate the 5 msf Chennai ROFO opportunity from Embassy Sponsor.

First, an update on our development portfolio and total business ecosystem investments

We have accelerated development on our 4.6 msf on-campus projects, including the recently launched 1.9 msf office development at ETV. ETV is perhaps the best example of the growing demand for office space that the ORR micro-market in Bangalore is witnessing, as demonstrated by the 550k sf pre-commitment from JP Morgan. With limited upcoming supply in our micro-markets, particularly in Bangalore, we are well positioned to benefit from the resurgent leasing demand and healthy pre-commitment activity.

The 600k sf M3 Block B at Embassy Manyata has been impacted by delays in obtaining pre-construction approvals, including the acquisition of necessary transferable development rights. Other than this, we remain on track with our target delivery schedules across our 4.6 msf development pipeline. We continue to evaluate 1 msf of leasable area enhancements that comprises a 600k sf additional redevelopment opportunity at Embassy Manyata and a 400k sf potential new block at ETV. We are in the process of obtaining regulatory approvals for these projects, and we will update you on the progress. We are continuously upgrading the efficiency, wellness and sustainability performance metrics of our existing properties. In aggregate, we have committed over ₹27 billion investments in our development pipeline and infrastructure upgrades.

On costs, the commercial real estate industry, like several other sectors, is currently experiencing cost inflation. While we are not completely insulated from this, we are largely tracking our previously disclosed budgets with respect to the 4.6 msf ongoing development. This is due to our agile procurement, existing vendor relationships and our record of timely project execution.

Moving to our hospitality business which has seen a remarkable turnaround post pandemic.

- In May, we launched one of India's largest mixed-use hotel complexes at Embassy Manyata. This complex comprises 619 key dual-branded Hilton hotels, a 60k sf convention center and 85k sf of retail and F&B. We are pleased to report that this Hilton complex achieved 47% occupancy and was EBITDA positive in its first operating quarter. We have secured over 150 corporate contracts and we continue to witness healthy demand for the convention center.

- Our other two operating hotels, Hilton EGL and Four Seasons, are also experiencing improvements in operating performance, and increased occupancy. Our overall hotel EBITDA for Q1 was ₹145 million, which tracks ahead of our guidance.

- Given the rebound in business travel, we have accelerated the development of 518 key dual-branded Hilton hotels at ETV. The ORR micro-market is a significantly underserved hospitality market, and we are confident that the hotels will mirror the success of the Embassy Manyata hotels. Excavation is currently underway on-site, and we expect to deliver the hotels by 2025.

Next, an update on our acquisitions

Our acquisition philosophy continues to be one of delivering growth to Unitholders. We look for high-quality large scale business parks that mirror our existing portfolio. We also finance our acquisitions with a prudent mix of debt and equity to manage our cost of capital, and to deliver accretive growth to our Unitholders.

During the last financial year, our 50%-owned investment entity, GLSP, acquired 0.4 msf area from strata owners. The acquisition consolidates GLSP's footprint to 3.1 msf at EGL, which is unequivocally one of India's best office parks. GLSP also acquired the property management business for the entire 4.7 msf park. During the quarter, GLSP fully integrated this acquisition, and the asset team did a terrific job in leasing-up this newly acquired area, which is now 87% occupied.

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. Of this, 1.4 msf is fully complete and 85% occupied and an additional 1.6 msf is currently under development. As we have mentioned, we like Chennai as a growth market, and the scale of this property and location of this micro-market continues to witness interest from global occupiers. We will update you as we progress on our evaluation.

Additionally, we continue to evaluate numerous third party opportunities. Our robust governance framework, strong balance sheet and access to capital markets continue to be our key strengths as we pursue accretive growth.

Over to Abhishek now for our financial updates.

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Abhishek S Agrawal
Interim Chief Financial Officer (CFO)

Thanks, Ritwik. Good evening everybody. Key financial highlights for Q1 include:

- We grew Net Operating Income by 9% YoY to ₹6,773 million, with operating margin of 82%;
- We announced distributions of ₹5,052 million or ₹5.33 per unit, with 88% as tax-free to Unitholders;
- We successfully raised ₹10 billion debt at 5-year fixed-rate of 7.35%, taking our total fixed cost debt to 64%; and
- We continued to maintain our strong balance sheet with low leverage of 27% and proforma debt headroom of ₹108 billion.

Let me take you through the details.

First, an update on our Q1 FY2023 income performance

- **Revenue from Operations** grew by 12% YoY to ₹8,294 million, mainly driven by the delivery of our 1.1 msf built-to-suit project at ETV, launch of our 619 key Hilton hotels at Embassy Manyata, as well as business ramp-up in our existing hotel portfolio.
- **Net Operating Income ('NOI')** grew by 9% YoY to ₹6,773 million, mainly driven by increase in Revenue from Operations, partially offset by the increased hotel operating expenses corresponding to the revenue increase. Our NOI margins continue to be best-in-class at an impressive 82%, reflecting both the scale and efficiency of our business, as well as our low fee structure. Our **EBITDA** also grew by 9% to ₹6,544 million, in-line with the NOI increase.
- **Net Distributable Cash Flows ('NDCF')** stood at ₹5,056 million, down 5% YoY but up 1% QoQ. The YoY increase in our NOI and EBITDA contributed positively to our NDCF, which was offset by incremental interest costs on recently delivered buildings as well as the ₹46 billion coupon-bearing debt raised to refinance our earlier Zero-coupon bond. Further, earlier today, the Board of Directors declared a **Distribution per Unit ('DPU')** of ₹5.33 for Q1, representing a 100% payout ratio. Notably, 88% of our Q1 distributions are tax-free to our Unitholders, benefiting from the simplification of two-tier structures at Embassy Manyata and ETV.

Moving to our balance sheet updates and debt strategy

During Q1, we raised ₹10 billion 5-year fixed-rate debt at 7.35% and utilized ₹9.3 billion to provide debt financing to GLSP, REIT's investment entity, for its add-on acquisition at EGL. With this debt raise, 64% of our ₹134 billion debt stack now carries a fixed-rate with an average maturity of 3 years, which insulates us to a large extent from the rising interest rate environment. The remaining 36% floating-rate debt totaling ₹49 billion is exposed to interest rate movements, though impact during Q1 was minimal. However, of this ₹49 billion floating-rate debt, we successfully moved ₹25.5 billion, constituting 19% of our total debt, from a quarterly to a yearly reset schedule, thereby locking in fixed-interest rates for a 1-year period. While the rise in short-term market rates would impact our overall interest costs, this recent renegotiation helps us mitigate a proforma ₹155 million rise in interest cost on an annualized basis.

With this, 83% of our debt book is now locked-in at a fixed cost for FY2023 and we have less than 1% of our debt coming up for maturity during this fiscal. This helps us hedge our balance sheet and substantially mitigates the impact of rising interest rates. We remain focused on actively managing our debt book and we will continue to explore additional refinancing opportunities. With AAA/Stable rated debt, our balance sheet remains robust and well positioned to finance future growth. Furthermore, our entire debt book is now fully coupon-bearing, thereby simplifying the cash flow-through for our distributions and diversifying participation from various debt investors including banks, domestic mutual funds, corporate treasuries, insurers and FPIs.

Lastly, an update on our FY2023 guidance

As a recap, last quarter we provided our detailed FY2023 guidance with a mid-point NOI at ₹27,030 million with a range of +/-5% and a mid-point DPU at ₹21.70 per unit with a similar +/-5% range, thereby implying a 9% YoY increase in NOI and in-line DPU at mid-point guidance. This guidance was based on certain key assumptions including a total lease-up of 5 msf, comprising 1.7 msf new deals, 1.2 msf pre-leases and 2.1 msf lease renewals as well as rent escalations of 14% on 8.2 msf leases and a positive EBITDA of ₹400 million from our four operating hotels. Along with this, we had also factored the impact of incremental interest costs of ₹2.3 billion relating to our recently delivered buildings as well as our ZCB refinance with a fully coupon-bearing debt.

As at Q1, we are on track with our leasing guidance and are tracking ahead of our estimates for performance of our operating hotels. However, we expect our interest costs to be higher due to the impact of rising interest rates on our floating-rate debt. Overall, we maintain our earlier FY2023 guidance range. We continue to remain focused on delivering to our Unitholders, as demonstrated consistently since our listing.

Over to Vikaash for his concluding remarks.

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Vikaash Khdloya
Chief Executive Officer (CEO)

Thank you, Abhishek.

In summary, FY2023 is off to a solid start with 1.8 msf leasing in the first quarter, and the demand outlook for Indian office market looks very encouraging. India's favorable demographics and abundant STEM talent continue to act as catalysts to offshoring demand by global corporates. This increased offshoring supports expansion of tech and global captive customer base in India, thereby providing growth impetus to our business.

Embassy REIT remains an ideal combination of yield, growth and stability. Our stock continues to be resilient even in a volatile global market. With 13 consecutive quarters of 100% distributions, we have now delivered total annualized returns of 13% to the benefit of our 47k+ and growing Unitholder base.

Looking forward, our strategy remains unchanged. Backed by our high-quality portfolio, favorable concentration in right markets and strong balance sheet, we continue to remain resilient, as demonstrated during the Covid pandemic. We are now accelerating our growth investments and initiatives. Our quality occupier base, on-campus development and acquisitions pipeline – all drive our growth and help us consolidate our market position. And significantly, the recent rebound in leasing activity, supported by continuing occupier expansion plans, positions us well as we move forward.

With this, let's now move to Q&A.

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QUESTION & ANSWERS SESSION

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

Moderator: Ladies and gentlemen we will now begin the question and answer session. We have our first question from the line of Kunal Tayal from Bank of America. Please go ahead.

Kunal Tayal: Hi Vikaash. Given that you have had a good start of the year in terms of new leases, how are you thinking about the target of 1.7 msf that you had set out last quarter? And, just a clarification, if that target of 1.7 msf would also include 550k sf of pre-commitment that you signed this quarter?

Vikaash Khdloya: Thank you Kunal. So the 1.7 msf target is for new leases on our existing operating portfolio. So, the breakup of the guidance – apart from this, we have also assumed 2.1 msf renewal and an additional 1.2 msf pre-commitments – the total of all of these put together sums up to 5 msf. So, 1.7 msf is only on the operating portfolio on a like-to-like basis that translates to the 415k sf what we did this quarter.

Kunal Tayal: Essentially, we should take 0.4 msf of 1.7 msf as basically done in Q1?

Vikaash Khdloya: That is correct and just to add to your earlier question, as of now, we are maintaining a 5 msf guidance but we do see markets, especially Bengaluru, rebounding quite well. So, we will revisit this next quarter to see if that guidance need to be updated.

Kunal Tayal: Got that and then a follow-up question. A couple of days back there was an update on the work-from-home policy for the SEZ. If you had a chance to think through, what could be the implications for your assets?

Vikaash Khdloya: As we mentioned earlier, the back to office trend has been gradual and encouraging. Within the numbers that we have laid out, of about 25% physical park population, the back to office actually differs considerably between cities and assets. For example, Mumbai is already at 55% to 60%. Interestingly, at Embassy TechVillage, with a large proportion of global captives, the park population has risen to 45% or higher.

To answer your question, we have seen that the SEZs with primarily IT services companies have been slower on back to office compared to the global captives and tech product companies. We believe that as the current attrition concerns balance out, there will be more positive ramp-up on back to work by the IT services companies and we will see more demand. Combined with that is the SEZ work from home benefit. Given cities like Pune and Noida had earlier extended that benefit up to December, we have seen very slow ramp up of about 15% or less in Pune and Noida. However, with the new notification mandating at least 50% back to office and additional compliances for those companies who continue work from home, we should see a positive trend for occupiers in SEZ premises which are primarily IT services companies. We will have to wait and watch but we think this will help the back to office ramp up, especially in properties in cities like Pune and Noida.

Kunal Tayal: Alright. Thank you so much.

Moderator: Thank you. We have the next question from the line of Puneet from HSBC. Please go ahead.

Puneet Gulati: Thank you so much and congratulations on your good performance again. My first question is if you can give more colour on what is happening in Manyata. We have not seen material leases getting signed there, only 32k sf was signed this quarter.

How should one think about the ramp-up in Manyata, at what point do you think it will pickup materially?

Also, on the financial front - if you look at NDCF for ETV, that seems to have fallen while the NOI has gone up - anything to read there? And another question on the distributions part for EGL. There are now two distributions - one is dividend and second is distribution number which I have presumed is a composition of both interest and return of loan. If you can give the breakup between interest and return of loan and explain the policy behind that?

Vikaash Khdloya: Sure Puneet, I will take your first question and then I will hand over to Abhishek from our finance team to take the other questions.

So just to lay out where we are today at Manyata. The last quarter occupancy was 88% and the occupancy of Manyata this quarter is 87%; this compares to around mid 90s pre-pandemic. While there is a lot that is currently going on at Manyata, the one key reason for the drop in occupancy is because of one large exit of about 1 million square feet of a legacy lease which has mark-to-market potential of over 150%. Having said that we have seen around 700-800k square feet of those exits already factored in as of now. We also have an additional vacancy relating to the same lease coming up in the next quarter – about 400k square feet of additional exit which has a mark-to-market of over 150% At the same time, we have a pipeline of around the same quantum.

Just to give you a flavor of the kind of occupiers we are talking to today. Manyata has actually seen good incremental demand from a lot of existing and new occupiers – smaller in quantum to start with to factor for their immediate growth, but we are now seeing it quickly translate into larger RFPs and pipeline as they think of future growth. So the guys we are talking to now for the 400k square feet pipeline, which we are targeting for Q2, include an American listed healthcare InfoTech firm setting up a new office. Then there is a Fortune 10 healthcare and insurance company, an existing client, who is looking to take up a larger space at Manyata. We are also looking at AI cloud data analytics player which facilitates medical research and also a digital transformation firm which does AI and automation. So, if you see the profile of occupiers that we have at Manyata, over the last two years we have moved from 36% of global captives to 50% today and our efforts are ongoing to take this higher, similar to ETV where the global captive share is significantly higher. We remain quite positive as Manyata is seeing good traction from global captives who are really expanding. Manyata has already seen in-place rentals increase from ₹61 in FY2020, from the time of the pandemic, to ₹66 today. So we are realizing the mark-to-market and the market rent today is anywhere between ₹95 to ₹100, so there is a huge potential.

The other trend is on EGL and ETV, both have seen strong momentum on leasing and are now almost 100% occupied. So, we believe that Manyata will now continue to see even more share of the traction, given that the other two, in the micro markets of CBD and ORR, are on full occupancy. We will see how this translates into numbers or into leasing, but we are currently in advanced discussions with a global bank for 600k square feet pre-commitment on one of the under construction blocks and apart from that we are seeing a lot of activity from existing and newer occupiers. We remain pretty encouraged on Manyata and we estimate that by the end of this year Manyata should move into early 90s in terms of occupancy.

The reason behind our enthusiasm on Manyata is also because of the Hilton Hotels that have really helped attract a lot of tenant attention and interest in Manyata. Of course you are aware about the flyover. Also, what will happen is, as some of the older spaces come up, we are considering redevelopment of the existing 450k square feet to 1.2 million square feet total leasable area, so an increment of 600k to 700k square feet. So at Manyata we are focused on how we can enhance overall value and NOI and of course distributions and not necessarily just the occupancy numbers. On the mark-to-market, we have already seen the way Manyata mark-to-market have been delivered over the last two years. So I hope that gives you a little bit flavor of how Manyata is moving. We are putting in efforts to move it to more global captive kind of occupier base.

Puneet Gulati: Two questions related to this. You talked about early 90s occupancy by end of this year. Does that mean you capture in your leasing guidance some bit of occupancy happening in Manyata? Also, a deduction of 0.4 msf from the total leasable area, is that also counted in the 90%?

Vikaash Khdloya: That is correct.

Puneet Gulati: So the denominator also goes down. Got it.

Vikaash Khdloya: 400k square feet odd, that is correct. Abhishek would you want to take the second question.

Abhishek S A: Puneet there were two questions for me. First was relating to ETV NOI increasing and NDCF falling.

There are three reasons for that. One is because the SIPL JP Morgan Block 9 got completed this year in March, so the interest is now not getting capitalized and impacting the NDCF while it is not hitting the NOI. Second major reason is that, if you remember, till last financial year we were getting rental support which was directly going and increasing the NDCF but did not have any impact on NOI; but from this year it is getting routed through the Revenue from operations because rental support is over, and rentals have started. So this is increasing the NOI, without having any impact on the NDCF. The third reason is that as this is the first quarter, we have paid all the property tax for the year so that is taking the NDCF down while having no major impact on the NOI. So these largely are the three reasons; other than that, there is normal movement in working capital, which also reduced the NDCF.

The second part of your question was on GLSP regarding the loan that we had provided to GLSP, our investment entity, for acquisition of 0.4 msf and CAM business of the entire EGL park. During this quarter, we have received three components – first one is dividends of around ₹40 crores, second one is interest on the loan that we provided - around ₹18.5 crores and the third one is amortization of the debt that we provided as there was some excess cash in the entity – which is a small number of ₹15 crores.

Puneet Gulati: On this amortization, is there a policy that you will continue to amortize ₹15 crores or you think this was a one-off thing?

Abhishek S A: Puneet, while interest will come every quarter, this amortization of debt and dividend will depend on the cash flows and the profit that they have at their disposal, so it will be dependent on whatever cash they have.

Puneet: Understood. That is all from my side. Thank you so much.

Moderator: Thank you. We have the next question from the line of Karan Khanna from Ambit

Capital. Please go ahead.

Karan Khanna: Thanks for the opportunity. So Vikaash, my first question is when you look at the leasing pipeline across Quadron Pune, Oxygen Noida and Embassy One, can you give us some sense as to how you are looking at these assets given the occupancy is still below the portfolio occupancy as far as these assets are concerned?

Second, on the expansion of 1 msf M3 block at Embassy Manyata, we know that this is now expected to be delivered in December 2022 versus originally agreed to obtain the OC in December 2019 by Embassy Property Development. Consequently, can you give us any sense on specific reasons for the delay, while acknowledging that EPDPL is paying rental compensation of around ₹57 million per month which is lower than what can actually be generated?

Vikaash Khdloya: Sure Karan. I will take the first question and then hand over to Ritwik for the second question.

On these three properties. A couple of things on Pune as a region and this would be true for both Pune and Oxygen. We have seen slower than average ramp-up of back to work, especially given all the three Pune properties as well as Oxygen cater predominantly to IT services players. While we see deal pipeline now being generated, we have not seen it progressing to a stage where there are closures. Just on Pune itself, we think Hinjewadi is one of the most competitive office markets. It has now got good infrastructure in place and at ₹50 per sf rents, it is pretty compelling, given the quality that we have built, both on existing and the new product in TechZone, we think it is a good market to have a ready product available. As and when the back to office ramp-up speeds up, IT services companies will start activating the leasing requirements, especially given our ongoing conversations suggest that many of them have hired more people than they have office space for. I can give you example of six specific conversations we have had with our existing occupiers in Pune, where they said that factoring for all the people that they have already hired, they need additional 400k square feet. So it is just that we do not see a trigger or an urgency for the occupiers, but with the back to office as well as the recent work from home policy of 50%, we will wait and see if that helps to kick start or speed up the pipeline and the lease conversions. So that is on Pune - we admit and agree that it has been slow.

On Oxygen, again, the back to office has been slow in SEZs in Noida. We are seeing around 15% levels of back to office. While we have renewed with existing occupiers, we are seeing very slow momentum on lease pipeline converting into deals. Interestingly, both in Pune and in Noida, we have recently seen 350k square feet each of renewals with existing IT services players at about 15% premium to market rents. So that is an interesting trend where pipeline has been slow to convert into deals but existing IT services companies despite the 15% low physical occupancy have renewed end-of-tenure leases with 5 year commitment and at a premium to market. We are hopeful that the pipeline will pick-up and we are having lot of conversations on-ground in favor of how occupiers are conducting the site visits and thinking about space, but it is waiting for a trigger.

Lastly, on Embassy One. We are hopeful to move the occupancy higher next quarter as we are in advanced discussions for about 40k square feet with three firms – one is a legal firm, one is electronic and automotive firm's front office and another one is a biotech firm. All of these lease discussions are in advanced stages and with 40k square feet additional leasing, Embassy One occupancy will move to 70%, that is our target for the coming quarter. Interestingly, a lot of the demand right now in the north is moving to Manyata, so we are seeing that interesting play of occupiers trying to take up space in larger business parks with their expansion optionality. I hope that answered your question, before we move to M3.

Karan Khanna: Just a follow-up to that. So, you have seen 367k square feet renewal at Embassy Quadron in Pune and 345k square feet renewal at Embassy Galaxy in Noida. Despite your in-place rentals being higher than the market rentals, you have still managed to close 9% higher renewal spreads on 850k square feet of area in the first quarter. Just wanted to understand, what is driving this higher spread because your in-place rentals are already higher than the market rentals, for both Pune and Noida?

Vikaash Khdloya: For couple of Mumbai renewals, in-place rents were higher than the market and we brought them back to market. So, to answer your question in another way. On the renewals of 850k square feet, we renewed them at 10% higher that market rents and around 9% higher than in-place rents. The in-place rents for some of the Mumbai properties, especially in Express Towers which earlier had a fit-out component, as we renewed those earlier leases to new occupiers, the rents were brought back to what the market is today at. So that answers your questions – overall 850k square feet renewals were still done at 10% higher spread to the market rents.

Ritwik B: On M3 Block A, we still obviously think that the deal makes complete sense given it's Manyata and we are always looking to consolidate the area within the park. On the 1 million square feet of Block A, it was originally scheduled to be completed by December 2019 but then there were obviously delays due to the pandemic. Right now, we are expecting to receive the occupancy certificate by December 2022 and construction is effectively completed at this point. We have put out a note on page 22 of our supplementary deck, which talks about what the net receivable is in Block A and in Block B. Looking roughly at around ₹170 million receivable on Block A that we think is recoverable and we are really progressing as planned, now that the pandemic has abated. We feel fairly good about the way the projects are going.

Karan Khanna: Sure great. Thank you and all the best.

Moderator: Thank you. We have the next question from the line of Mohit Agrawal from IIFL. Please go ahead.

Mohit Agrawal: Thanks and congratulations on a great set of leasing numbers. My first question is on your under-construction or your development pipeline. This year, we are completing about 2.7 msf of assets and you have given a pre-leasing target of about 1.2 msf, half of which is done, which is great but that pertains to FY2025 ETV like assets. So just trying to get your thoughts on how do we see this 2.7 msf coming and where do we see the leasing of this 2.7 msf by the end of this year?

Vikaash Khdloya: We actually feel pretty good about this much quantum of under-construction and are in fact looking to see if we can bring forward some more proposed developments and place them in the under construction bucket. To answer your question, the pre-commitment activity levels have just picked up since last quarter. Through the pandemic, of course the occupiers were not looking to make active leasing decisions, especially from a medium-term perspective. They were not looking to firm up and commit to capital costs. As we have seen the demand or enquiries or RFPs pick-up for under construction, we are seeing increased momentum and of course the best micro-markets and properties are seeing the highest traction. ETV remains one of the best micro-markets in the country today, not just in Bengaluru and we have done a pre-lease there and of course that under construction is scheduled for delivery after two or three years. Let me give you a flavor of how the demand is panning out on all of our under construction projects.

For ETV, apart from what we have already done, we have multiple RFPs chasing the balance 1.5 msf. Given that the delivery is three years later, we are actually holding-on to rents and seeing if we can get a really larger occupier at the rents we would like them to be at. We are currently in discussion for two large 1 msf RFPs each at ETV.

Manyata has now started seeing pick-up in demand for the 1 msf that gets delivered this year and 0.6 msf that gets delivered after two or three years. Here, we are in advanced discussions with a large Asian bank for the 0.6 msf which comes up in 2023-2024. For the 1 msf, as Ritwik just mentioned, it comes up this year. We are still in early stages of discussions, but we feel very good about having a ready or almost ready product in a market like Bengaluru and an office campus like Manyata. So hopefully, we will be able to translate some of the early stage discussions into leases.

In Pune, as I mentioned earlier, 900k sf at Hudson and Ganges comes up later this year. While we are on track for delivery, pipeline here is slow. While we will be the only developer or landlord having both SEZ and non-SEZ offering in Hinjewadi and we are a dominant player in the micro-market, but I think we will have to wait till the back to office and the leasing enquiries in Pune pick-up. Pune is expected to take two to three quarters at least.

Lastly, in Noida, that comes up only mid next year, we are in initial discussions with one of the largest tech companies for the entire 700k square feet. Again, the speed of progress on some of these lease discussions depends upon back to office.

So, in summary, this year we have 1 msf at Manyata which is in early stage discussions, and we are hopeful that we convert it to leases by the end of this financial year. And on TechZone in Pune, it is expected to take some time although delivery is on schedule.

Mohit Agrawal: Going back to that SEZ question asked earlier, you did answer from a physical occupancy perspective regarding the 50% work from home but does anything change from a direct leasing perspective? What I mean is that where you are facing hurdles in Pune and Noida parks due to SEZ restrictions, do you think the new draft addresses those and probably that could help in leasing those assets faster?

Vikaash Khdloya: Yes, that is actually a pretty good point. Currently about 60% of our completed area is in SEZ. As you know, the SEZ regulations are being phased out and we are consistently seeing more occupiers belonging to the high-end of value chain, mostly global captives or tech product companies, looking to take up spaces in large office parks, of the quality that we offer with the large scale business ecosystem. So, the demand has moved from 50:50 SEZ vs non-SEZ five years back to predominantly non-SEZ today. It is actually not a function of SEZ or non-SEZ, it is the function of the kind of occupiers looking to take up space with us. Given that these have moved high-up in the value chain, their sensitivity to rents is continuously reducing and the real estate decisions are now more influenced by flexibility and ease of operations. With the sunset clause, most of them are preferring non-SEZ space.

We have done a couple of things. One, all of our new development, whether it is the 9 lakh square feet at Embassy TechZone which was originally in SEZ as well as the 0.7 msf in Oxygen that was in SEZ, we have initiated the conversion into non-SEZ and we are offering that as a non-SEZ product. The ETV 2 msf proposed development and the new development at Manyata as well as the redevelopment, all of them are proposed to be non-SEZ, so for all new products, we are moving to non-SEZ. The first draft of the current policy directives has been encouraging with permitted coexistence of SEZ and non-SEZ. So the contiguity requirement is no longer required, once it gets notified. However, there are couple of additional asks that the industry has, and this impacts the entire industry and not just us. One of the requests is to allot floor-by-floor denotification because there are existing occupiers with remaining lease tenures on current SEZ buildings who would like to continue to be SEZ. We are hopeful that the regulations are notified factoring this aspect on floor-by-floor denotification not just building-by-building and with that it becomes fairly easy. The request is also to make it on a self-declaration basis so it is not cumbersome and that is where I think the industry and we will move to, but this obviously is expected to take a quarter or two.

Mohit Agrawal: The last one is on your debt number. So, at 27% net debt to GAV, we are pretty comfortable. The headroom is till 49%, but obviously one would not want to go up to that level. So, at what level would you be comfortable and at what level will you be worried? At around 30 to 35% net debt to GAV, will you will be comfortable to go to that level?

Abhishek S A: As of today, we are only levered at 27%, though we have already got approval to go up to 35%, and as per regulation we could go up to 49%. To answer your question, maximum 35% is where we are comfortable to go up to.

Ritwik B: Let me break this down in another way. In this rising interest rate environment, we are actually more focused on making sure our balance sheet is absolutely pristine and at 27%, we are more than comfortable at this point. From next week, people are thinking that there might be a 75 basis point hike in the fed rate. Clearly, the rates are looking to rise at a pretty dramatic pace over the new few quarters. The last thing we want is to get caught offside with a debt that we have a tough time refinancing or paying down. Whether it is construction finance or even future growth, there is lot of sort of focus on what we buy, when we buy. Fundamentally, interest cost is a big component sort of the entire drop down into distributions and we want to be very cognizant of that in this environment. You must have seen that across the broad as many of you work for banks or asset managers and you can see that effectively debt refinancing, equity underwriting, and everything has fallen off quite dramatically. So, we feel comfortable with the debt levels that we currently are at. To Vikaash's point of all the development that is out there, we want to make sure that we deliver it on time. So that is priority number one and number two, if the markets do open up effectively to fund the growth and we will make sure to keep a clean balance sheet. We will look at it but we want to be very careful at this stage, given that this is a volatile environment.

Mohit Agrawal: So, theoretically it could go up to 35%, correct?

Abhishek S A: What we are saying Mohit is that we will be comfortable up to 35%, but we are very much comfortable at 27%.

Mohit Agrawal: Okay great. Thank you. That is all from my side.

Moderator: Thank you. We have the next question from the line of Poonam Joshi from Nirmal Bang. Please go ahead.

Poonam Joshi: Congratulations to the management for the good set of numbers. I want an idea on the lease expiry which the company is going to witness this year. So, it will have an impact of approximately 8% on revenue front. How is the company leasing that in this year and some color on the leasing spreads also?

Vikaash Khdloya: If I could guide you to slide 27 of our deck. So as laid down last quarter, our total expiry for FY2023 is roughly about 3.1 msf. Refer the colored pie on the right hand side. What we have been able to do last quarter is of that 3.1 msf that we indicated, about 1.8 msf will be renewed and of that we have already completed 0.8 msf renewals at 9% higher than market rents. The balance 1 million square feet we have indicated are likely renewals. Some of these leases do not come up for renewal in this quarter. Many of the leases come up over the course of the full year; in fact a large component comes up in the end week of March. As these come up, we have indicated that we 1 msf will be likely renewed and there is a 26% mark-to-market opportunity on that. At the same time, we indicated in our guidance in last quarter, that the balance 1.3 msf, i.e. 3.1 minus 1.8 of renewals, the balance 1.3 msf are likely exits. We have visibility on these and we have already seen about 0.5 msf exits this quarter and there is a potential of 50% mark-to-market on that. We expect the balance 0.8 msf as likely exits over the course of this financial year. Again, of the 0.8 msf, roughly 0.4 msf is in Manyata at with 150% mark-to-market lease opportunity and as I indicated, we are in advanced discussions for around 400k square feet of leases in Manyata, which we are targeting to convert in Q2. So, to sum up all the numbers that I mentioned, we are on target on our lease expiry renewals and exits. Exits obviously provide us an opportunity to mark-to-market and all our exits have more than 50% mark-to-market on a combined basis, and we believe we will be able to backfill a significant chunk of it. 1.3 msf are the total likely exits for this year and we have laid out a new fresh leasing guidance of 1.7 msf, so we believe that we will be able to backfill all the exits on an overall basis and achieve a net positive leasing number.

Poonam Joshi: Yes this is helpful. There is a followup question on this. We had the pre-commitment lease of approximately 550k sf at Embassy TechVillage. So, wanted to understand what is the in-place rental that we got there?

Vikaash Khdloya: While we have refrained from disclosing exact terms on leases, for obvious reasons, what I can confirm is that this deal was done on underwritten rents at the time of the ETV deal in December 2020. This was part of the growth option, so we had underwritten the rent considering that.

Poonam Joshi: Okay understood. Thank you.

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

Saurabh Kumar: Just two questions. One is if you net out the JP Morgan adjustment to the NOI, the NOI would be flat quarter-on-quarter – would that understanding be correct?

Abhishek S A: Yes. However, there is an increase in the hotel ramp up and the new hotel that we launched at Manyata which is also doing very good. So there is a positive NOI from all three hotels, as compared to a drag in the last quarter.

Saurabh Kumar: Second thing. I missed out the rationale for this ₹1,200 crores quarter-on-quarter debt increase.

Abhishek S A: The debt has increased by ₹1,200 Crores last quarter where we have taken ₹940 crores to fund GLSP which is our investment entity, and the balance is for our capex purpose.

Vikaash Khdloya: Just to clarify that a bit. The ₹1,200 crores of debt increase that you see is mainly towards the add-on acquisition at GLSP, our investment entity, where we gave a loan to GLSP and raised a 5-year fixed bond for that and the balance is just to fund the ongoing capex.

Saurabh Kumar: So, if I look at your P&L statement and look at the profit plus depreciation number, there seems to be an adjustment of about ₹55 crores between your profit plus depreciation and your dividend and I think your interest capital allocation is not there, so what would be the other adjustment?

Abhishek S A: Saurabh, I did not quite get your question.

Saurabh Kumar: No worries, I will take it offline.

Moderator: Ladies and gentlemen, that was the last question. I would now like to hand the conference over to Mr. Abhishek Agarwal for any closing comments.

Abhishek A: 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.

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