Embassy REIT

1Q FY2021 Earnings Call

August 6, 2020

CORPORATE PARTICIPANTS

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

Vikaash Khdloya - Deputy CEO & Chief Operations Officer (COO), Embassy REIT

Aravind Maiya – Chief Financial Officer (CFO), Embassy REIT

Ritwik Bhattacharjee - Head-Investor Relations, Embassy REIT

MANAGEMENT DISCUSSION SECTION

Operator: Good evening everyone. A very warm welcome to all for the Embassy REIT's first 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 - Investor Relations for Embassy REIT. Sir, you may begin.

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Ritwik Bhattacharjee

Head – Investor Relations, Embassy REIT

Thank you, operator. Welcome to the first quarter FY2021 Earnings call for Embassy REIT.

Embassy REIT released its financial results for the Quarter ended June 30, 2020 a short while back. As is our standard practice, we have placed our quarterly financial statements, earnings presentation discussing our quarterly performance, and a supplemental financial and operating databook on our website at http://ir.embassyofficeparks.com under the Investor Relations section.

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. In particular, there are significant risks and uncertainties related to the scope, severity and duration of the ongoing 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 on the call today are Michael Holland, the CEO, Vikaash Khdloya, the Deputy CEO and COO, and Aravind Maiya, our CFO. Mike will start off with the first quarter highlights, business overview and strategy followed by Vikaash and Aravind. We will then open the floor to questions.

Over to you, Mike.

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Michael Holland

Chief Executive Officer (CEO), Embassy REIT

Thank you, Ritwik.

Good evening everyone and thank you for joining today's call. As the challenging times brought by the pandemic continue across the world and here in India, we sincerely hope that you, your family and colleagues are healthy and keeping safe.

Today we announced our first quarter FY2021 results. You will recollect that the nationwide lockdown in India commenced on 24th March and it has now been recognized as one of the world's most stringent lockdowns. Despite the unprecedented challenges, and thanks to the resilience of our business and efforts of our management team, we have successfully navigated our business through the quarter, maintained a healthy 92.2% occupancy, collected a robust 98.9% of rentals, and the Board have earlier today approved our Q1 distributions of ₹4,499 million. This clearly demonstrates the strong fundamentals of our business and underpins our ongoing commitment to continue to deliver value to our unitholders, including through our regular quarterly distributions.

This quarter began during the early stages of the COVID-19 pandemic for our markets in India. We set clear priorities for our business to navigate successfully through the multiple challenges brought by the pandemic. These priorities included: ensuring the health, safety, and well-being of all our stakeholders, facilitating business continuity for our occupiers, and delivering on our rental collections and quarterly distributions. We are on track on all of these priorities.

Our parks and buildings were open and operational throughout the quarter within the guidelines laid out by the government. This has been delivered through the seamless pan-India execution efforts by our on-ground teams.

Given that India's COVID-19 status is behind the European and US timelines and many of our occupiers are following protocols defined by their global headquarters, employee ramp up is expected to remain slow and cautious. We continue to be actively engaged with our occupiers in each city, every week, supporting their return to workplace and ramp-up plans.

There has been much discussion on emerging trends affecting the dynamics of commercial office industry globally. While the impact of the pandemic still continues to evolve, through our conversations with a number of major occupiers, these inputs over the last quarter have reinforced the initial assessments which we articulated in our previous call.

Firstly, on the Next Generation Workplace

There has been a great deal of conjecture around Work-from-Home, domestically as well as globally. However, it is clear that in India, working from home has significant challenges around physical and digital infrastructure, as well as the softer issues of career, community, learning, and the building and maintenance of corporate culture.

It is indeed likely that there will be more flexibility in terms of workplace with a hybrid of traditional office and home locations. We believe that this will ultimately play out with more flexibility in terms of working hours and location but with the office as the core business hub providing better quality, lower density spaces with high standards of safety and wellness for the best international companies. Offices will continue to be a core amenity for the Indian STEM talent which these companies seek - the young demographic workforce who want to come together for the benefit of their career, for product innovation, for business productivity, company culture and the desire to learn which gets satisfied and enriched through colleagues and mentors in the best corporate workplaces.

This shift will work to the advantage of a portfolio such as Embassy REIT and our total business ecosystem product, with our high-quality large-scale integrated campus environments and a broad range of amenities for our occupiers and their staff.

Demand Outlook

It is clear that one sector which is prospering through this pandemic is the technology sector and nothing illustrates that better than the recent results and press articles on global hi-tech companies expanding their office footprint in key Indian cities. Numerous observers have reported an acceleration of digital transformation globally by a couple of years and bring-forward of technology spends, especially for cloud, digital, data services and cyber security. Also, Indian technology companies continue to shine through the pandemic as reflected by the large deal wins announced recently.

The strong focus on technology occupiers within our portfolio therefore continues to be one of our key strengths as this translates into future demand for our product. India remains the most attractive and cost-efficient destination for global corporates who rely on the talent pool, and is home to the technology skillsets which support so many global companies whether it be through India’s 1,400 captive centers, 17,000 tech sector businesses or the 4.4 million technology specialists, many of whom work from our properties.

In the immediate short-term though, it is clear that many corporate occupiers have paused their capital investment and leasing decisions while they focus on employee safety and re-assess their real estate strategies. We therefore remain confident that once demand returns post this phase of uncertainty, as it certainly will, there will be an even stronger preference for high-quality, institutional grade Indian offices – the core product of Embassy REIT and that this will drive higher demand for our properties.

Supply Outlook

On the supply side, forecast market supply has been in decline since late-2019 and is further shrinking post the COVID-19 outbreak and the consequent labour and liquidity challenges for most developers. The two year forward supply estimate by independent consultants has fallen from 119 msf in January to 80 msf in June of this year, a 32% decline in just two quarters, and this trend is likely to continue. Our assessment is that actual comparable and competing supply for our portfolio is a significantly lower proportion of this reduced supply estimate.

As we emerge from this pandemic, and in India this has not yet peaked, we are very confident that this phase will result in continued consolidation in the Indian office market and, taking all factors into account, we are optimistic of securing greater demand and market share for Embassy REIT over the medium-term.

I will now handover to Vikaash to discuss in detail our business and operating performance for the quarter.

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Vikaash Khdloya

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

Thanks, Mike. Good evening, everybody.

A couple of weeks back, we provided an operational update for Q1 wherein we highlighted business continuity during the COVID-19 lockdown period, our robust rental collections and our 14% rental increases on 1.8 msf office leases. In addition to these, business highlights for this quarter include:

- Our leases signed for the quarter stood at 526k sf, with 201k sf of new lease-up and 325k sf of renewals at 20% MTM spreads;
- Our occupancy remained healthy at 92.2% on 26.2 msf of operating office portfolio, with same-store occupancy at 94.1%;
- Our construction activity resumed on 2.7 msf of on-campus development across three of our existing properties; and
- Our operations team continued to be actively engaged with occupiers to support their 'Return to Workplace' strategies.

Let me take you through the details.

First, an update on our COVID-19 response

Our properties were open throughout the quarter, even during the lockdown periods, to support the business continuity of our occupiers. We continue to monitor the ramp-up in the number of employees returning to our buildings – currently, over 90% of our occupiers are operating their core business functions from our parks, albeit with less than 10% of their employee headcount. Many occupiers are planning only a gradual return to workplace and we continue to prioritize delivering a safe workplace for their employees.

We have implemented international-standard safety procedures including enhanced sanitization and deep cleaning, fumigation, social distancing protocols and daily communication with occupiers. We have also initiated technology driven solutions in our properties such as optical thermal cameras, touchless visitor management, advanced air filtration and UV cleansing systems.

Our teams have ensured that all of our properties are 'COVID-19 Secure' and we have shared comprehensive 'Return to Workplace' playbooks with all occupiers to assist them in managing the phased re-population of their offices. To date, the feedback on the assistance we have been providing to our occupiers has been very positive. Our extensive work with our occupiers to help them navigate through the crisis is also reflected in our robust 98.9% rent collection numbers for Q1.

Moving to our leasing and lease management initiatives

During the first quarter, we maintained a stable occupancy of 92.2% on our 26.2 msf operating office portfolio with our same-store occupancy at 94.1%.

Of our 7.1 msf leases due for escalations during the course of FY2021, we delivered 14% rental increases on 1.8 msf across 22 office leases during Q1, in-line with our target schedule. We are confident to deliver 13% rental increase on the remaining 5.3 msf leases due for revision during remainder of this financial year. Our healthy occupancy, robust collections and successful rental increases form the base of our NOI and distributions.

In addition to above, we signed 20 office leases during Q1 totaling 526k sf, comprising both new leases as well as renewals. New leases comprised 12 deals totaling 201k sf leased mainly to occupiers providing digital, analytics and technology support to their global businesses. Renewals of 325k sf were across 8 office leases at 20% renewal spreads to existing rents demonstrating the embedded growth in our portfolio. In addition to this, we have a forward lease pipeline of 150k sf for the current quarter.

Demand impact of COVID-19 played out along the lines we anticipated during the previous call wherein we had projected 2-3 quarters of muted demand. This is mainly due to a pause in decision making while corporate occupiers get past the short-term operational challenges and determine their mid-term strategies. Given that COVID-19 infection spread has not yet peaked in India, this pause in decision making is likely to impact new deals throughout this financial year, and thereafter we anticipate decision making and deal activity to pick up. Demand is likely to be driven by tech occupiers and continuing investments by global captives expanding their presence in India and our properties are well positioned to benefit from this increased demand.

Moving to our lease expiries. Of our FY2021 lease expiries of 1.9 msf, we have already backfilled or renewed 400k sf or 21% of expiries at 17% MTM spreads in Q1. We are in discussions to renew an additional 254k sf which expires only during later part of this year. The remaining 1.3 msf expiries are likely exits during the course of this financial year – of which 0.5 msf relate to occupiers facing COVID-19 headwinds and cost pressures and the balance 0.8 msf is part of normal occupier churn. These include instances of occupiers relocating to a different micro-market, consolidating to self-owned or another property, rebalancing existing portfolios and undertaking portfolio housekeeping.

We view churn as part of 'business as usual' and see it as an opportunity to replace legacy occupiers with higher quality growth occupiers and re-set rents to market. By way of example, over the last four years, we have backfilled 4 msf in total or 1 msf annually at impressive 47% re-leasing spreads. The likely exits for FY2021 form only 5.5% of our annualized rental obligations and current in-place rents on these leases are 13% below market. While there may be a timing gap to backfill these spaces given overall pause in decision making, we remain positive on new deal activity as corporates finalize their plans.

Our on-campus development projects have resumed

Post easing of the lockdown restrictions in June, we resumed construction work on our 2.7 msf ongoing on-campus development projects due for delivery beginning June 2022. We continue to invest in health and safety of our workers through numerous safety precautions at all our construction sites. While the labour ramp-up in Bengaluru and Noida is encouraging with around 50% of peak capacity, Pune ramp-up has been slower given the severity of lockdown restrictions in Maharashtra.

Our on-campus development is an integral part of growth of our existing large-scale business parks. Our strong balance sheet puts us in a robust position to invest and deliver these new projects despite overall supply deferrals and slippages in the market.

Also, our occupiers resumed fit-out works on 0.8 msf relating to the 57% pre-committed spaces in the recently delivered buildings in Embassy Manyata NXT and Embassy Oxygen and they target to go-live by end of this year.

Finally, I will cover our asset management updates

- First, an update on our hotels which represent <1% of our pre-COVID NOI. Both globally and in India, the hospitality sector has witnessed a challenging operating environment due to the pandemic with a virtual halt to travel since early March. We therefore temporarily closed our two 477 key operating hotels in April and reopened them in mid-June 2020 post lockdown relaxations. Both hotels continue to witness skeletal occupancy and we expect hospitality demand to remain muted for the remainder of this year. Our hospitality team has implemented several cost saving measures while adequately servicing occupied rooms. As both Hilton and Four Seasons are reputed global brands, they have instituted safety protocols at par with global standards and this will aid in occupancy ramp-up when travel re-opens.
- Regular investment in our properties by undertaking select infrastructure and upgrade projects is core to our asset management philosophy and helps us increase entry barriers and widen our competitive moat. Our comprehensive infrastructure programme at Embassy Manyata comprising

construction of a new flyover, development of 619 key dual branded Hilton hotels and masterplan upgrade initiatives are on track. Additionally, we have launched a comprehensive re-positioning initiative at Embassy Quadron in Pune. We continue to pursue select projects to add long-term value to our existing properties and make them future-ready for the post-pandemic world.

- In early April, we instituted a cost savings programme for FY2021 targeting savings across our operating, hospitality and corporate overhead costs. We continue to remain judicious on our costs and our NOI margins reflect the positive progress made on this initiative during our first quarter.

As you can see, through the course of this pandemic, we actively managed our leases and our properties and remained focused on operational excellence in a period of heightened external uncertainty. Our strategy has always been to remain fully engaged with occupiers. We have strengthened our occupier relationships through our continuing response and support during this pandemic. We followed an active and nimble approach to lease management and where needed, we have let occupiers with weaker business models exit our portfolio. We continue to invest in growing our portfolio through our on-campus development and continue to selectively reinvest in our properties. All of these factors reinforce our commitment to growth and creating long-term value. As we look forward into 2021 and beyond, we are optimistic of consolidating and growing our market share as occupiers and businesses emerge from this pandemic.

Over to Aravind now for the financial updates.

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Aravind Maiya

Chief Financial Officer (CFO), Embassy REIT

Thanks, Vikaash. Good evening, everybody.

We delivered a resilient financial performance for the quarter. Financial highlights for Q1 include:

- Our Net Operating Income was ₹4,569 million, up marginally by 1% year-on-year;
- Our NOI and EBITDA margins were 88% and 87%, up by 400 bps and 600 bps respectively year-on-year;
- Our Distributions for the quarter stand at ₹4,499 million or ₹5.83 per unit, representing a 100% payout ratio for the quarter; and
- Our balance sheet remains healthy with ample liquidity of ₹12.6 billion and low leverage of 16% Net Debt to TEV, and only 1.3% of total debt maturities till FY2022.

I will now discuss our Q1 FY2021 earnings performance in detail.

- **Revenue from Operations** for the quarter stood at ₹5,162 million, representing a 4% decrease year-on-year, this decrease was entirely due to the impact of COVID-19 on our hospitality business. In terms of our segment-wise revenue performance, our commercial office revenues of ₹4,739 million for the quarter remained in-line year-on-year, however, our hospitality revenue was impacted due to the temporary closure of hotels as well as ongoing suspension of travel, contributing to a decrease of ₹207 million in the overall Revenue from Operations or approximately 4% year-on-year.

- **Net Operating Income** for the quarter stood at ₹4,569 million, representing a 1% increase year-on-year, mainly given resilience of our commercial office business which contributes over 90% of our pre-COVID gross asset value and NOI. In terms of our segment-wise operating performance, our commercial office NOI was ₹4,306 million for the quarter, an increase of 3% year-on-year, however, our hospitality segment incurred an operational loss of ₹111 million for the quarter. Our NOI margin improved year-on-year by 400 bps to 88%, mainly reflecting the change in segment mix with commercial office segment contributing a higher proportion of the NOI as well as cost savings achieved during the quarter.

- **EBITDA** for the quarter stood at ₹4,507 million, representing a 3% increase year-on-year. Our EBITDA margin improved to 87%, i.e., a 600 bps increase year-on-year. As we have mentioned previously, our operating margins once again reflect the benefits of our scale, efficiency of our business model and our low manager fees.

Next, an update on our distributions

Our Net Distributable Cash Flow for the quarter stood at ₹4,495 million and the Board of Directors of the Manager to the Embassy REIT in their meeting held earlier today declared Q1 FY2021 distributions totaling ₹4,499 million or ₹5.83 per unit, representing a payout ratio of 100% for Q1. This distributions of ₹5.83 per unit comprise of ₹2.14 per unit towards interest receipts from SPV, ₹3.33 per unit towards amortization of SPV level debt and ₹0.36 per unit of dividends. The record date for the distributions is August 14, 2020 and the distributions would be paid on or before August 21, 2020.

Given our robust rent collections and resilient operating performance, we continue to be committed to quarterly distributions and our strong balance sheet and ample access to liquidity gives us the confidence to do so.

Moving to our balance sheet strength

We maintain a strong liquidity position with ₹12.6 billion of liquidity as of June 2020 comprising of ₹9.0 billion of cash and treasury balances and ₹3.6 billion in undrawn committed facilities. With low leverage of 16% of our Total Enterprise Value, additional proforma debt head room of ₹112 billion and only 1.3% of our existing debt maturing till FY2022, we have ample liquidity to manage our business and navigate the current COVID-19 environment.

We, therefore, remain one of the most prudent and well-capitalized companies in the listed real estate sector in India and globally. Our disciplined capital management approach places us in a robust position to navigate through COVID-19 induced global uncertainties and allows us to pursue accretive growth initiatives to the benefit of our unitholders.

Moving to other financial updates

- As Vikaash mentioned previously, our office rental collections have remained strong. We have achieved 98.9% collections for the first quarter. Further, to support our food court, ancillary retail and small business tenants through the pandemic, we have provided rental rebates totaling 1.4% of our annual rents.
- To arrive at our Net Distributable Cash Flows, our EBITDA is adjusted for items such as working capital changes, cash taxes and refunds, interest and principal repayments on borrowings, dividends from our investment entity Embassy GolfLinks and trust level expenses. Our earnings materials include a detailed walkdown of our EBITDA at SPV level to NDCF at the REIT level. Amongst these items, working capital changes include movement in security deposits and other current assets, some of which may not recur given the one-time nature of these cashflows.
- As updated during our previous call, we filed the scheme of arrangement to collapse the legacy two-tier holding structure of Embassy Manyata SPV and we expect to receive regulatory approvals by March 2021. Upon simplifying our holding structure, the proportion of our dividends to our overall distributions is likely to increase to over 60%, comparing favorably to 6% for this quarter. We anticipate that our dividend and SPV level debt amortization components, taken together, will represent over 75% of our distributions post March 2021. This will be a positive given REIT dividend is fully tax free for investors and will further enhance the overall post-tax distributions yield, especially for domestic institutional and retail investors.

Lastly, I will update on the outlook for the remainder of FY2021

Given COVID-19 pandemic is still evolving, we are not providing formal guidance due to the continued uncertain environment. However, I would like to provide some high-level perspectives for the remainder of the year:

- Our rent yielding commercial office business continues to be resilient with 92.2% occupancy levels given strong underlying covenants of our 160+ creditworthy corporate occupiers. Despite the lockdown, we collected 98.9% of our office rents in the first quarter;
- Our rental increases of 14% on 1.8 msf during the first quarter is in-line with our target schedule. An additional 5.3 msf of contracted escalations come up in the remainder of this financial year with an estimated 13% rental increase. Given these leases are already 49% below market, we remain confident to achieve these rental increases;
- Our existing occupancy of 92.2% on 26.2 msf operating portfolio translates to a 2.0 msf vacancy across the 4 cities in which we operate. Also, 1.3 msf or 5.5% of our annual rents may be likely exits during the remainder of this financial year. While backfill may take time given overall pause in decision making by occupiers, we remain positive on return of demand in 2021 given in-place rents on these leases are 13% below market;

- Our 0.8 msf pre-committed spaces in recently delivered buildings are likely to be operational by end of this year given occupiers have resumed fit-out works post the lockdown induced pause. Further, construction activity on our 2.7 msf under development buildings has resumed and the buildings are expected to be delivered starting June 2022 onwards; and
- Our 477 key operating hotels re-opened in mid-June 2020, however occupancy ramp-up is expected to be muted given the pandemic induced travel restrictions. The hotel business is expected to marginally impact NOI but on the positive side, our cost savings programme for FY2021 is progressing well.

With the above information, we have provided you the building blocks which will assist you to come up with estimates for the remainder of the financial year.

Over to Mike for his concluding remarks.

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Michael Holland

Chief Executive Officer (CEO), Embassy REIT

Thanks, Aravind.

So, despite the challenges in the first quarter, we have delivered strong distributions of ₹4,499 million.

For the coming quarters, we are focused on continuing to deliver on organic growth for our business through active asset and lease management and building healthy leasing pipeline as occupiers formulate their mid-term real estate strategies. We also continue to actively pursue acquisition targets and opportunities which are value accretive and complementary to our existing portfolio in terms of scale, quality and location. With our strong occupier connect, robust balance sheet and prudent capital management, we are well-positioned to deliver on these focus areas.

Before I conclude, two other events since we last reported – one, the dilution by one of our Sponsors and secondly the reported forthcoming listing of India's second REIT. We welcome both events. On the trade, the resultant increase in our free float to 38% and increase in liquidity addresses the feedback from a number of our unitholders. The potential inclusion in global and regional benchmark indices would be another positive outcome. As India's first REIT, we welcome the new REIT listing as a natural part of the evolution of India's office market moving away from fragmented, low scale, variable quality market to a more institutionalized, consolidated, higher quality, compliant market providing better products to occupiers, end-users and investors.

Finally, we remain committed to our business strategy to deliver total return through regular quarterly distributions supplemented by our organic and inorganic growth initiatives. In the short-term, the pandemic has certainly slowed the growth velocity of our business and the industry as a whole, but we are extremely well-positioned to navigate this period of uncertainty and emerge even stronger. We are confident of the importance of the physical workplace for international companies in India and there is a clear opportunity to benefit from continuing consolidation and flight to quality as businesses emerge from the pandemic.

So that was the business overview for Q1 FY2021 – let's move to Q&A please:

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Q&A

Closing comments

Thank you all very much indeed, for your time and for your excellent questions.

I would like to highlight that we do have a supplemental deck for this quarter on our website. So, you can find further details there on our leasing, occupancy, development, distributions, and other key data.

I'm sure it's clear to you that we have had a resilient quarter even when the world is gripped with high degree of uncertainty and volatility. While it may take some time to get through this challenging period, we're confident in the strength of our underlying business and our post pandemic future. And, of course, we are once again pleased to announce the ₹4,499 million distributions for the first quarter of FY2021.

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

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