"Mindspace Business Parks REIT's Q2 FY23 Earnings Conference Call"

January 31, 2023

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(This document has been edited for clarity wherever required)

Moderator: Good afternoon, ladies and gentlemen, and welcome to the Mindspace Business Parks REIT's Earnings Conference Call for Financial Results for the Quarter ended December 31, 2022. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this call is being recorded. I now hand the conference over to Mr. Kedar Kulkarni. Thank you and over to you Mr. Kulkarni.

Kedar Kulkarni: Good afternoon, everyone and thank you for joining this third quarter financial year 2023 earnings call of Mindspace Business Parks REIT.

At this point, we would like to highlight that the management may make certain statements that may constitute forward-looking statements. Please be advised that our actual results may differ materially from these statements. Mindspace REIT does not guarantee these statements or results and is not obliged to update them at any time.

I would now like to welcome our CEO Vinod Rohira and our CFO Preeti Chheda. They will first walk you through the business update and the financial performance during the quarter. We will then open the call to "Q&A." I now hand over the call to Vinod. Over to you Vinod.

Vinod Rohira: Good afternoon, everyone. At the outset let me wish each of you a happy and healthy 2023.

We delivered yet another quarter in line with our expectations. Our Parks continue to witness demand for institutionally managed office spaces. We have recorded gross leasing of c.1.3 million square feet in Q3 FY23 taking the cumulative number to c.3.5 million square feet in the first 9 months of this financial year. Our Hyderabad project, Mindspace Madhapur, recorded the highest share of gross leasing in Q3 FY23 followed by Commerzone Porur, Chennai and Commerzone Yerwada, Pune.

We began the financial year with committed occupancy at c.84.3% and achieved c.400 bps increase in the first 9 months of the financial year to reach c.88.3% as at December 31, 2022. The committed occupancy at Mindspace Madhapur, the largest park in the Portfolio, now stands at c.95%. Our parks in Pune, and BKC have near 100% committed occupancy. Our park in Malad also has c.95% committed occupancy. As guided in our earlier calls, we are happy to announce substantial leasing during the year at our Commerzone Porur, Chennai Park which has helped us take the occupancy at this Park to over 93%.

We continue to deliver robust financial performance supported by these tailwinds in the committed occupancy. We recorded NOI of c. INR 4,551 Mn which excluding one-time compensation of INR 186 Mn represents a year-on-year growth of c.16.8% and quarter-on-quarter growth of c.4.6%. Our in-place rents have grown c.9.4% year-on-year to INR 64.5 per square feet per month.

The gradual transition from work-from-home to work-from-office continues. If you refer to the recent commentary of Indian IT companies, more and more organizations are framing definitive guidelines to return to office. As we have been highlighting over the past few quarters, companies have realized the importance of having a dedicated and demarcated work environment. The improvement in productivity from being in a collaborative work environment is quite evident.

During this transition, organizations are careful not to lose out on their talent. They are particular about offering top-quality office spaces that have the best health and wellness measures in place. As a result, we are observing a discernible shift amongst our occupier segments towards institutionally managed grade-A office spaces.

As envisaged, the physical occupancy in our parks is nearing 50% as against c.40% during the previous quarter. While the outbreak of the virus in our neighbouring nation had led to some caution, it has not hampered the transition from work-from-home to work-from-office in India.

Unlike their global peers, Indian office sector has demonstrated robust performance and remarkable recovery in demand in 2022, inspite of the uncertainties with global economic disruptions in the backdrop. Overall, the leasing trends remain encouraging. India continues to be the preferred choice for top tech talent at affordable costs and in the coming months and quarters we may see large GCC/GICs looking at India to expand their support services network to optimize cost and bring in newer and smarter technologies for their customers across the world. However, due to the uncertain economic environment globally, we may see conservative posturing by occupiers in the next few quarters for large ticket size demand.

While Preeti will elaborate on our debt strategy, let me spend a couple of minutes on how growing debt costs are impacting the sector. With low debt levels, AAA credit profile and greater share of fixed-cost debt, we have been able to achieve tighter spreads on our borrowings. This, however, may not be uniformly applicable to the market at large. High cost of debt, difficulty in accessing debt markets and a rush towards residential development is slowing down the potential commercial supply. Also, the under-construction supply is likely to come into the market at higher rents due to the inflationary impact of construction costs and debt costs. This opens up an opportunity for us to bring in strategic supply in the markets we are present in and further consolidate our position.

This quarter, we are also pleased to announce the proposed re-development of another strategic cluster at Mindspace Madhapur. This is in addition to our earlier redevelopment that is currently underway. The low-density park has been recently upgraded and the added infrastructure can easily accommodate further developments in the park. The high committed occupancy of 94.5%

of the park is a testament to the strong demand in the micro-market and encourages us to bring in strategic supply within our existing park. Further, the addition of the increased area would also offer an opportunity for tenants to expand and consolidate within our park.

Within this park, we are proposing to re-develop 2 of our legacy buildings constructed around 2005 with a collective leasable area of c.0.36 msf. Post re-development we expect the total leasable area, to grow four-fold to c.1.6 msf subject to design finalization and necessary approvals. This re-development shall be value accretive to the REIT and would also provide a continued supply of new grade A assets within the park.

We have completed the demolition of the existing premises of the redevelopment already underway and is on track to complete by December 2025 and we shall commence demolition of these buildings beginning first quarter of the next financial year and the new development is estimated to be completed by December 2026. Together, the two redevelopment projects shall incrementally add c.2.1 msf to the overall portfolio.

We are still awaiting clarity on the DESH Bill. In the interim, we have made representations to the Government to provide an enabling framework within the existing SEZ Policy for partial denotification. This is the key demand from industry and shall immensely help the revival of demand for SEZ spaces, which are large employment providers.

Most of our non-SEZ supply at Mindspace Airoli West is fully leased. Encouraged by this strong demand, we have applied for the denotification of one of the existing buildings of 0.4 msf in the same park.

To give you an update on the potential acquisitions i.e. Commerzone Raidurg, Hyderabad and The Square Avenue 98, BKC Annex, Mumbai Region, we are nearing completion of our evaluation and intend to soon table the proposal to the Governing Board. Subject to the requisite approvals, as may be applicable, we anticipate closure in the next few months.

I would now like to take you through the specific operational updates for Q3 FY23

- Of the total portfolio area of 32.0 million square feet, 25.6 million square feet is completed and contributed to c.93% of our portfolio value. 1.8 million square feet is currently under-construction, and we have another 4.6 million square feet available in the portfolio for future development.
- We received occupancy certificate for approximately 0.7 msf area across assets
- We have leased c.1.3 million square feet during the December quarter of which c.0.6 million square feet was on account of releasing and c.0.7 million square feet was on account of new and vacant area leasing.

- Collectively, the gross leasing in the first 9 months of the financial year stood at c. 3.5 million square feet. During this period, we have successfully re-leased c.77% of the scheduled expiries for FY23
- We have recorded average re-leasing spreads of c.26.6% on the c.2.3 million square feet area re-let during the 9 months of the financial year
- We leased c. 0.3 msf at our Commerzone, Porur, Chennai Park during the quarter. With this leasing the committed occupancy of the Park now stands at 93.5%.
- The overall committed occupancy of the portfolio stood at 88.3% registering an increase of c.140 bps over the previous quarter.
- Our in-place rents have grown by c.9.4% YoY to INR 64.5 per square feet per month

Coming specifically to the ESG updates, at Mindspace REIT, we stand firmly committed to resource optimization, water management, reduction of GHG emissions, clean energy, hygiene, and safety. In alignment with our ESG targets, we are on the road to addressing a comprehensive set of critical issues that are significant for us as well as our stakeholders.

The quarter saw Mindspace REIT:

- Procure 100% green energy across common areas maintained by us at Mindspace Airoli West, Gera Commerzone Kharadi and Commerzone Yerwada
- Received LEED Platinum O&M certification from USGBC for Paradigm, Mindspace Malad, Mumbai Region and for Building 1 at Commerzone Yerwada, Pune
- Commissioned a Community Need Analysis to understand the requirements of people in the vicinity of our projects of our business parks at Airoli. The outcome is likely to point to specific areas of focus, which will assist us in curating our future CSR projects in our markets

We expect the forthcoming budget to support the growth momentum and further augment the business environment for commercial real estate. We hope to see regulatory amendments that help growth of investments in REITs / InvITs and consequent rise in capital inflows, both foreign and domestic, into these instruments.

With this backdrop, I hand the call over to Preeti to take you over the financial updates.

Preeti Chheda: Thank you, Vinod. I am happy to present our financial performance for the third quarter of financial year 2023.

We closed the third quarter, with a Revenue from Operations of INR 5.4 billion and Net Operating Income of INR 4.6 billion. The revenue from operations and NOI both included receipt of one-time compensation of Rs. 186 million from a tenant for termination of letter of intent at The Square BKC. Adjusting for this one-time impact, revenue from operations and NOI grew at 18.9% and 16.8% respectively on YoY basis. We continued to maintain NOI margin at 80% plus.

We announced a distribution of approximately INR 2.8 billion i.e., INR 4.80 per unit for the quarter. The distribution grew by 3.4% YoY. The distribution comprises approximately 91% i.e., INR 4.37 per unit of dividend, which is not subject to tax in the hands of unitholders, and approximately 9.0% i.e., INR 0.43 per unit of interest.

At Mindspace REIT, we have followed the strategy to diversify our debt book and optimize our debt cost. In December 2022, post SEBI's clarification allowing REITs to issue commercial papers, we concluded a commercial paper issuance of INR 1 billion thus completing the maiden commercial paper issuance by an Indian REIT. We shall continue to explore ways to optimise our borrowing cost through a mix of short- and long-term funding.

In the backdrop of global as well as domestic inflationary pressures, India has seen significant interest rate hikes this year. For most part of the upcoming fiscal year, we expect interest rates to remain high, before the environment stabilizes. This is expected to cause our borrowing costs to rise in the coming financial year.

Our Portfolio gearing remains low, adding to the strength of our balance sheet.

Our net debt as on December 31, 2022, was approximately INR 48.7 billion. Our LTV as at December 31, 2022 stood at c.17.6%. We have a well spread maturity profile of our debt with only 11%, i.e. INR 5.6 billion expiring in FY24. Approximately 42% of our debt is fixed cost in nature helping us cushion some impact of rise in interest rates. We have undrawn committed lines of approximately INR 4.0 billion from financial institutions. Our low leverage provides us enough headroom for development within the Portfolio as well as inorganic growth opportunities.

REITs continue to witness demand from retail investors. This has contributed to the total number of unitholders of Mindspace REIT nearing 50,000 as our unitholder base expanded by over 13% over the last quarter, largely driven by the addition of retail unitholders. We expect positive policy amendments to help further deepen the market for REITs / InvITs in India.

With this, I request the operator to now open the floor for questions and answers.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Adhidev Chattopadhyay from ICICI Securities. Please go ahead.

Adhidev Chattopadhyay: Sir, few questions. Firstly, you mentioned about the physical occupancy, I just missed the number. Could you also break it up across cities? How have you seen the trends moving across Mumbai and Hyderabad specifically?

Vinod Rohira: So, some parks are outliers, our Kharadi Park is 90%, the rest of it is between 40% and 50% in that range.

Adhidev Chattopadhyay: Sir, my second question was on the expiry profiles. So, I think there have been some fresh expiries of 0.5 million square feet. Could you just help us understand for now the rest of the year, how much do you expect to re-lease out of the expiry? And where do you expect the overall portfolio occupancy to trend at both in terms of the actual occupancy and the committed occupancy? Thank you.

Vinod Rohira: So, whatever expiries were scheduled are already done with and we've predominantly been able to even re-lease the sudden expiries that came through. We're not seeing any expiries for the next quarter.

Adhidev Chattopadhyay: And sir, just final question on the SEZ space. I think last quarter, we alluded that it was I think around 2 million square feet of SEZ space, which was retained. Now you're planning to convert out of that approx 0.4 msf, as you mentioned. So, could you help us understand the timelines for this? And under the existing guidelines, can we expect some more space also to come up under a similar arrangement in the coming few months?

Vinod Rohira: In our Gigaplex Park, cumulatively, we had 1.4 odd million between under construction and ready non-SEZ supplier, which at the beginning of the year, had vacancy of approximately 6 odd lakh square feet. We've completely leased that out. We have no supply in the non-SEZ space at all in that park. So, there is an opportunity of a 400,000 square foot building, which we applied for denotification, we should get it in the next 4 months latest for us to be able to bring that as a pipeline for further supply in the market.

Moderator: We'll take a next question from the line of Jatin from Bank of America. Please go ahead.

Jatin: A couple of questions. First, for Vinod, it would be great to get a color on the 3 things around the expiries and cancellations we saw this quarter. First, on the early termination and the LOI cancellation, if you could help with what categories this client belongs to, global, domestic, technology, captive. And what could be the motivation behind these, believe there could be multiple, either adjustments versus the layoffs the industry has recently seen or re-evaluating their strategy on entering or expanding into India either on their own versus now thinking of outsourcing these to some of the Indian vendors. So, this was part 1. And second, the 0.3 million square feet expiry, which you have seen at the Madhapur redevelopment, was this a planned expiry or initiated by Mindspace to go ahead for the redevelopment in this quarter only?

Vinod Rohira: First one had a lot of these in it. But fortunately, or unfortunately, there was an old tenant 2 years ago that walked away from our BKC asset and we got compensation for it. And that is since then long pre-leased and the full building now stands occupied. So, if you ask for that one-time compensation, it was for a client who got hit by COVID at that point in time, didn't have clarity whether to continue or not. But they were committed on that space and they paid us for it. Coming back to the re-leasing of space that got suddenly surrendered in the last quarter, we were fortunate to re-lease that back in the same quarter to a brand-new tenant who took that space for our Hyderabad complex and we saw the vacancy as well as the re-leasing in the same quarter.

Jatin: I have another one for Preeti. Preeti, looking at your NDCF, we've generally seen the CAPEX items and your net debt drawdown generally typically move in line. In this quarter, I think we'll have some bit of divergence and if not for that, maybe the distribution rather a bit more higher. So, do you expect this to reverse in the coming quarters and incrementally aid our distributions?

Preeti Chheda: So, this time in the NDCF, specifically, if you're looking at that CAPEX versus debt number is not really talking to each other. That's because there's a Rs. 100 crore item both which is sitting in the working capital as well as CAPEX, which is I would say mirroring each other. So, therefore, if you remove that, then probably you'll see the debt matching the CAPEX. So, that's where we stand and we should see a similar thing going forward unless you have anything specific.

Moderator: We'll take a next question from the line of Mohit Agrawal from IIFL. Please go ahead.

Mohit Agrawal: So, my first question is for the last few quarters, if we see your NOI growth has been pretty robust, but somehow that has not translated into the NDCF growth. So, NDCF has been flattish. If you look at the NDCF to NOI ratio, that is coming down over the last few quarters. So, how do you see that going forward? And especially in the light that, last 2, 3 quarters, we have had some sort of inflows coming in from the Pocharam land sale, that will not be there next quarter onwards. So, how do you look at the NDCF over the next 2, 3 quarters?

Preeti Chheda: So, just to explain this, we have been able to utilize, the incremental NOI, which has come this year, to reduce our debt support. We had mentioned earlier that because of the shortfall in the rental, we've not been able to get all the rentals that we have envisaged. We were drawing in some bit of debt support to meet our distribution guidance. So, that is reduced with the incremental NOI coming in. And the Pocharam proceeds have also helped us bridge that gap. Going forward, we are hoping that because of the robust leasing that we've seen, which should translate to rentals in the quarters as we move forward. The rental which is going to come from there translating to NOI increase, that should further help us do away with this debt support and then we should be able to independently have the NOI cater to the NDCF.

Also, I must mention this that there is one thing which is also eating up into our NOI which is the interest cost hike because while in FY23, it has not been very substantial, but obviously some of the loan, which we've taken, transmission of those interest cost hikes in the coming year. This year, we enjoyed some loans where we had resets, which were locked in for a period. Now once we are out of those lock-ins, we'll again see those rates getting to market. So, next year, while we will see NOI increase, we will at the same time see the interest cost getting higher than what we see this year.

Mohit Agrawal: And if you look at the NOI growth for 9 months cumulative year-on-year, it's about a 14%, 15% growth. So, do you expect the similar run rate to continue forward?

Preeti Chheda: So, I wouldn't be able to come into a number, but I would say directionally, yes, with the healthy leasing which has happened, and we expect that the NOI growth should be seeing a similar direction.

Mohit Agrawal: Second question is, Vinod, you initially mentioned about the denotification, I think we're talking about the B5 building, 300,000 - 400,000 square feet. With DESH Bill looking like it is getting delayed, what is the plan B? Beyond this 300,000, 400,000, is there any other plan to denotify other buildings? And what is the way forward for Airoli in terms of market lease?

Vinod Rohira: So, the way we see it is while DESH may take slightly longer, you're right, they are in the interim allowing for considering unit wise denotification. And that's come to its final stages, where we can then partially denotify spaces within buildings that are vacant. So, that will be the next step of unlocking. We want to start that process immediately. And that will then allow us for most supply pipeline to come through.

Mohit Agrawal: And will that be just through an executive order or like could that come in the budget or is it just going to be a simple executive order?

Vinod Rohira: It is coming due to the SEZ rules

Mohit Agrawal: Any expectation in terms of how much time can that take with respect to change in the rules?

Vinod Rohira: In the next couple of months, we will have clarity on that for sure.

Mohit Agrawal: And last one from me. What is happening on the data center demand? So, I guess, we have been quite positive on both Mumbai and Hyderabad. So, any movement, any progress there beyond the 2 data center building that we are doing?

Vinod Rohira: So, a lot of the data center operators wanted to buy land and we were not too keen doing that unless it was value accretive for us cumulatively. The leasing demand, I think for data centers will come back where you want the landowner developer to build and lease it to you. And we are focusing our attention on those clients because a lot of the data center and hyperscalers want to buy land. The demand continues to be very strong in the New Bombay region.

Moderator: Our next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Preeti, can you quantify what could be the interest cost impact for next year? Is it 100 basis point, 150 on the overall debt?

Preeti Chheda: So, 2 impacts, Sameer. One is obviously the debt will also rise because of the CAPEX that we'll incur. We do expect to incur anywhere around Rs. 1,000 crore of additional cost on the developments which are undergoing at the moment. So, obviously, the interest cost on that also will add. On the existing in this quarter, we expect about 15 bps to 20 bps versus where we are today. And in the coming year, depending on how much the RBI would increase the policy rate, of course, it depends on that, but we do expect 50 to 75 basis hike. Also, Sameer, just to explain what I've said sometime back that currently we have about 70% of our variable cost rate, which has interest rates logged in for a couple of months. So, once those lock-ins end and even those will move to market. So, what I'm seeing will have an impact on that as well.

Sameer Baisiwala: So, 50 to 75 basis point increase, does it include the second part, the lock-in which gets opened up?

Preeti Chheda: Yes, it does.

Sameer Baisiwala: So, that's the overall impact. And we need to add Rs. 1,000 crore to Rs. 4,800 crore on debt outstanding right now?

Preeti Chheda: Yes, you should.

Sameer Baisiwala: And the second question is for the 2.1 million square feet, B9, B5 and data center, which is getting completed in Q4, what's the sort of rental accretion that you expect next year?

Vinod Rohira: So, these are all, most of them are actually pre-leased as we speak. The data centers fully built to suit. The Commerzone Kharadi building has probably 50,000 odd square foot left, and the Airoli building 9 is about 130,000 odd square foot left, which we are hopeful before the end of the next quarter, we'll be done with that.

Sameer Baisiwala: So, what I'm trying to get is so that average rental would be like, 70-75?

Vinod Rohira: So, each of these assets are different. Pune will be in the region of 80, the Mumbai region one will be between the 58 to the 60 number, and the data centers already pre-leased at between 74 and 75.

Sameer Baisiwala: So, maybe roughly Rs. 150 crores all of them put together on a 12-month basis?

Vinod Rohira: Rents will at different dates. But yes, you're right, annualized you're right.

Sameer Baisiwala: And 1 final question from my side and that is for the 2 acquisition assets, the interest rates have moved up as you know over the last 6, 8 months. So, how are you thinking about funding the same? Has the valuation expectation changed? Are you getting these at a higher cap rate, so a better value for you as a buyer? And just your thoughts would be very helpful.

Preeti Chheda: So, Sameer, Vinod can come in, let me just attempt to answer that? We will be cognizant of the interest rate hike when we are acquiring these assets. Obviously, when we are acquiring these assets, we'll not just look at the short term, but we are looking at adding these assets for long term asset augmentation in the REIT. So, we will look at the fundamentals of the asset besides of course, your value accretion and all, we will be mindful of.

Vinod Rohira: Just to add to that, primarily to us, the profile of tenants quality of building, location, and the cumulative value and quality of that asset really matters in the long term. And both these are really strategic and of the quality we want to infuse in the REIT. So, we'd be very happy to take them in.

Sameer Baisiwala: I get that and that's why they qualify, Vinod. But Preeti, I mean what you said, does it imply that maybe there could be short-term pain and long-term gain? Is that what you're trying to say?

Preeti Chheda: So, Sameer, it's not about short-term pain. But I'm saying that today when we are evaluating an acquisition in the REIT, we are just not going to look at what the short-term interest rate increase would do to the overall acquisition decision. We are going to look at the long term and when we are buying this asset, we will look at accretion for the REIT.

Moderator: Thank you. as there are no further questions from the participants, on behalf of Mindspace Business Parks REIT, that concludes this conference. Thank you for joining us and you may now disconnect your lines.