

08 April 2024

India | Equity Research | Company Update

Embassy Office Parks REIT

Real Estate

All eyes on proposed Chennai RoFO asset acquisition

The Board of the REIT manager of Embassy Office Parks REIT has announced on 6 Apr'24, that it has agreed to purchase Embassy Splendid TechZone (ESTZ), a Grade-A business park, from Embassy Sponsor, for an enterprise value of INR 12.7bn. ESTZ comprises 1.4msf of completed area, which is 95% occupied; also includes 1.6msf of under-construction area, of which 0.4msf is pre-leased and 2msf earmarked for future development. The REIT manager intends to fund the acquisition via an equity fund raise of INR 25bn; subject to the transaction's success, we estimate accretion of 2.9% to FY24 NOI* and DPU*. Ex-acquisition, we currently see FY24E NOI/DPU of INR 29.2bn/INR 21.7. Retain **ADD**; TP unchanged at INR 405/unit, based on 1x Mar'25E NAV. Key risks: Slower recovery in office leasing; and higher portfolio vacancy levels.

Proposed Chennai RoFO asset transaction contours

The Board of the REIT manager of Embassy Office Parks REIT announced, on 6 Apr'24, that it has agreed to purchase ESTZ, a Grade-A business park, from Embassy Sponsor, for an enterprise value of INR 12.7bn. Embassy REIT intends to raise unit capital of INR 25bn, primarily to finance the acquisition and reduce its current 30% leverage of the portfolio, providing flexibility for future growth. ESTZ comprises 1.4msf of completed area, which is 95% occupied and leased to large global companies such as Wells Fargo and BNY Mellon, among others. It also comprises 1.6msf of under construction area, of which 0.4msf is pre-leased, and 2msf of future development potential. The Board of the Manager to Embassy REIT has approved the ESTZ acquisition and an institutional placement via an enabling resolution of up to INR 30bn, subject to unitholder approval.

Acquisition marginally accretive; estimated 3% DPU accretion

At the proposed acquisition cost of INR 12.7bn for ESTZ, Chennai, the implied NOI yield stands at 8.5% for the completed portion and 10% on development portion. The transaction is at a 6.7% discount to the average of two independent valuation reports and provides estimated accretion of 2.9% to FY24E NOI and DPU on a proforma-basis. Excluding the acquisition, we currently estimate FY24E NOI of INR 29.2bn and DPU of INR 21.7.

*NOI – Net Operating Income; DPU – Distribution per Unit

Financial Summary

Y/E March (INR mn)	FY23A	FY24E	FY25E	FY26E
Net Revenue	34,195	36,797	41,917	49,086
EBITDA	25,444	28,164	31,865	37,146
EBITDA Margin (%)	74.4%	76.5%	76.0%	75.7%
Net Profit	5,060	9,635	10,667	12,938
Distribution/Unit (INR)	21.7	21.7	22.7	26.9
NDCF (INR mn)	20,578	20,593	21,545	25,496
P/E (x)	70.3	36.9	33.3	27.5
Distribution Yield (%)	5.8	5.8	6.1	7.2
RoCE (%)	3.6	4.5	5.4	6.2
RoE (%)	2.0	4.1	4.9	6.6

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Market Data

Market Cap (INR)	355bn
Market Cap (USD)	4,262mn
Bloomberg Code	EMBASSY IN
Reuters Code	EMBA BO
52-week Range (INR)	399 /281
Free Float (%)	69.0
ADTV-3M (mn) (USD)	5.2

Price Performance (%)	3m	6m	12m
Absolute	12.6	23.9	19.6
Relative to Sensex	9.5	10.8	(4.8)

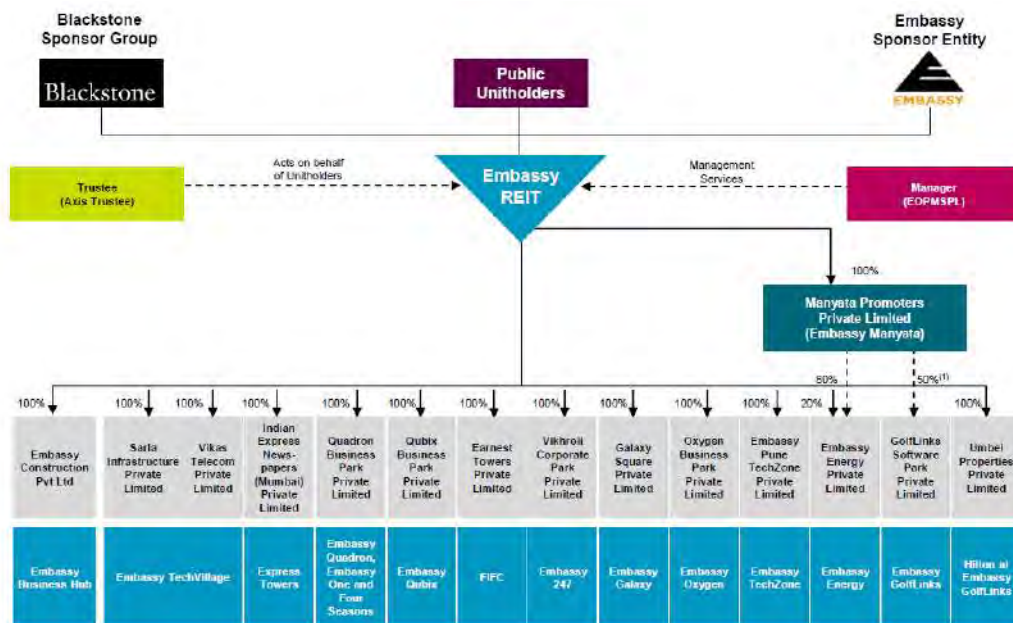
Previous Reports

25-02-2024: [Company Update](#)07-02-2024: [Q3FY24 results review](#)

Company Profile

Embassy Office Parks is India's first listed REIT that owns eight high-quality office parks and four prime city centre office buildings with 35.8msf of completed leasable area and under construction and development pipeline of 9.6msf. In addition to the offices, the REIT owns three operational hotels across 1,096 keys, an under-construction hotel of 518 keys and a solar park with 100MW of output. It was listed on 1 Apr'19. Embassy REIT is sponsored by Embassy Group (Embassy Property Developments Private Limited) and Blackstone Group.

Exhibit 1: Embassy Office Parks REIT Company Structure as of Dec'23



Source: I-Sec research, Company data, (1) Balance 50% owned by JV partner, (2) The 100% owned entities are held jointly with nominee shareholders for the Embassy REIT

Exhibit 2: Embassy Office Parks REIT Asset Portfolio (as of Dec'23)

Property	Leasable Area (msf/Keys/MW)			WALE ⁽¹⁾ (yrs)	Occupancy (%)	Rent (₹ psf / mth)		
	Completed	Development	Total			In-place	Market	MTM (%)
Embassy Manyata	12.4	3.2	15.6	7.0	82%	90	94	18%
Embassy TechVillage	7.3	2.3	9.6	6.7	84%	76	94	20%
Embassy GolfLinks ⁽¹⁾	3.1	-	3.1	7.4	97%	147	150	5%
Embassy One	0.3	-	0.3	8.6	78%	149	147	(1%)
Embassy Business Hub	0.4	1.0	1.4	9.9	92%	57	65	14%
Bengaluru Sub-total	22.8	6.5	30.0	7.6	88%	89	103	15%
Express Towers	0.5	-	0.5	3.9	90%	270	275	2%
Embassy 247	1.2	-	1.2	4.0	100%	110	112	2%
FIFC	0.4	-	0.4	2.7	81%	298	280	(6%)
Mumbai Sub-total	2.0	-	2.0	2.6	96%	177	176	(0%)
Embassy TechZone	3.0	2.4	5.5	4.7	77%	54	48	(11%)
Embassy Quadron	1.9	-	1.9	4.8	54%	53	48	(10%)
Embassy Qubix	1.5	-	1.5	3.8	91%	44	48	9%
Pune Sub-total	6.4	2.4	8.8	4.6	74%	51	48	(6%)
Embassy Oxygen	2.5	0.7	3.3	9.3	86%	34	48	(11%)
Embassy Galaxy	1.4	-	1.4	8.2	84%	45	48	7%
India Sub-total	3.9	0.7	4.6	8.8	72%	50	48	(4%)
Subtotal (Office)	35.8	9.6	45.4	6.0	84%	85	94	10%
Four Seasons at Embassy One	230 Keys	-	230 Keys	-	46%	-	-	-
Hilton at Embassy GolfLinks	247 Keys	-	247 Keys	-	58%	-	-	-
Hilton & Hilton Garden Inn at Embassy Manyata (5 & 3 star)	819 Keys	-	819 Keys	-	50%	-	-	-
Hilton & Hilton Garden Inn at Embassy TechVillage (5 & 3 star)	-	518 Keys	518 Keys	-	NA	-	-	-
Embassy Energy	100MW	-	100MW	-	NA	-	-	-
Subtotal (Infrastructure Assets)	1,096 Keys / 100MW	518 Keys	1,614 Keys / 100MW	-	-	-	-	-
Total	35.8 msf / 1,096 Keys / 100MW	9.6 msf / 518 Keys	45.4 msf / 1,614 Keys / 100MW	-	-	-	-	-

Source: I-Sec research, Company data, WALE = Weighted Average Lease Expiry

Proposed Chennai RoFO asset acquisition transaction contours

The Board of the REIT manager of Embassy Office Parks REIT announced, on 6 Apr'24, that it has agreed to purchase ESTZ, a Grade-A business park, from Embassy Sponsor, for an enterprise value of INR 12.7bn. Embassy REIT intends to raise unit capital of INR 25bn, primarily to finance the acquisition and reduce the current 30% leverage of the portfolio, providing flexibility for future growth.

ESTZ comprises 1.4msf of completed area, which is 95% occupied and leased to large global companies such as Wells Fargo and BNY Mellon, among others. It also comprises 1.6msf of under-construction area, of which 0.4msf is pre-leased, and 2.0msf of future development potential. The Board of the Manager to Embassy REIT has approved the ESTZ acquisition and an institutional placement via an enabling resolution of up to INR 30bn, subject to unitholder approval.

At the proposed acquisition cost of INR 12.7bn for ESTZ, Chennai, the implied NOI yield stands at 8.5% for the completed portion and 10% for the development portion. The transaction is at a 6.7% discount to the average of two independent valuation reports and provides estimated accretion of 2.9% to FY24E NOI and DPU on a pro forma basis.

Exhibit 1: ESTZ, Chennai – asset profile

Location	Pallavaram-Thoraipakkam Road, Chennai	 <p>Actual Picture</p>
Total Leasable Area	5.0 msf	
Completed Area / Occupancy	1.4 msf / 95%	
Under Construction Area / Pre-Leased %	1.6 msf / 26%	
Future Development Area	2.0 msf	
In-Place Rent (psf p.m.)	₹89	
Gross Rentals from GCCs	81%	
WALE	14 years	
		<p>100% Multinational Occupier Base</p> <div>    </div>

Source: I-Sec research, Company data, (1) All data as of March 31, 2024

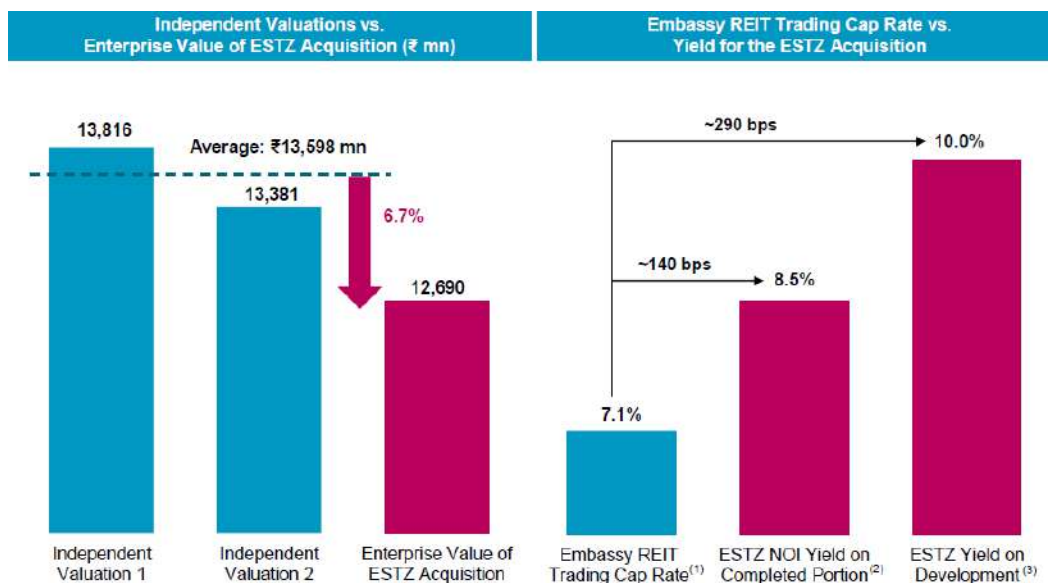
Exhibit 2: ESTZ, Chennai – asset layout

5.0 msf campus-style office park spread over ~26 acres, with 1.4 msf of completed area, 1.6 msf under construction and 2.0 msf future development potential



Source: I-Sec research, Company data, (1) All data as of March 31, 2024

Exhibit 3: Estimated value accretion at proposed transaction value



Source: I-Sec research, Company data, (1) Embassy REIT Trading Cap Rate calculated as FY2024E adjusted NOI (REIT NOI + 50% NOI of Embassy GolfLinks) based on mid-point of management guidance divided by TEV of completed portion. TEV of completed portion = (Market Capitalization + Net Debt and other adjustments as of September 30, 2023) x % of Completed portion of Embassy REIT as on September 30, 2023 as per independent valuation undertaken by Ms. L Anuradha, in conjunction with independent property consultant review services undertaken by C&W. Market Capitalization computed as units outstanding as of March 31, 2024 multiplied by INR375.43 per unit (assumed issue price for the institutional placement); (2) ESTZ NOI Yield on Completed Portion for ESTZ Acquisition calculated as the Contracted NOI of the completed portion divided by the Enterprise Value of the completed portion; (3) ESTZ Yield on Development for ESTZ Acquisition calculated as the expected stabilized NOI of the development portion divided by the Enterprise Value of the development portion plus pending cost of construction, including interest during construction

Exhibit 4: Sources and uses of funds for proposed acquisition

Key Acquisition Terms

▶

ESTZ Acquisition for an Enterprise Value of ₹12,690 mn^(1,2) which comprises of:

– 61% share of the lease revenue from ESTZ

– 100% share of CAM income and all expenses on an ongoing basis to manage ESTZ

– Rental support of ₹429 mn⁽²⁾ from Embassy Sponsor for pre-leased under-construction area of 0.4 msf

Indicative Sources and Uses⁽²⁾

Sources	₹ mn	Uses	₹ mn
Proposed Institutional Placement	25,000	Consideration to Embassy Sponsor	429
External Debt Raise	4,000	Debt Refinancing for ESTZ	4,000
		External Debt Repayment and General Corporate Purposes, incl. Transaction Costs	24,571
Total Sources	29,000	Total Uses	29,000

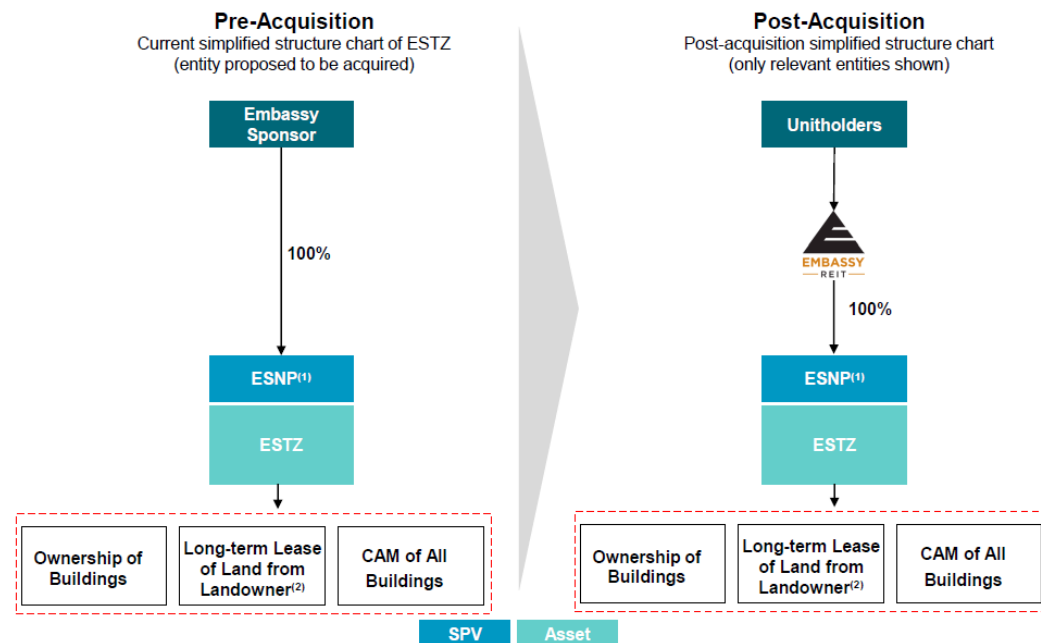
Source: I-Sec research, Company data, (1) Subject to closing adjustments; (2) Rental support of INR429 mn will be based on all-inclusive rental of INR81psf /p.m. and CAM income of INR12psf /p.m. from the acquisition closing date until expected rent commencement date. In the event that a binding agreement to lease in relation to certain identified leasable area at ESTZ is not executed prior to the closing of the ESTZ Acquisition, Embassy REIT, at its discretion, may still proceed with the completion of the acquisition, at a reduced Enterprise Value of INR11,853mn without rental support of INR42 mn; (3) Representative of the base case financing plan and assuming Enterprise Value of INR12,690 mn for the ESTZ Acquisition. The structure and timing of the Institutional Placement has not been determined yet. In a scenario, if the condition precedents related to the acquisitions are not satisfied on or prior to July 31, 2024 (the long stop date) and the acquisition is terminated, then proceeds from institutional placement or any other permissible mode of capital raise are proposed to be utilized for external debt repayment at the REIT or HoldCo/SPV/investment entity level. The information presented in this table are management estimates and the actual amounts may vary.

Exhibit 5: NOI to NDCF walk for proposed transaction

Particulars	₹ mn	Remarks
ESTZ Acquisition Impact		
Contracted NOI ⁽¹⁾	891	– For Blocks 2, 3, 9, 10 (rental support) and food court
Interest Cost on External Debt	(85)	– Interest of ₹85 mn is on ₹1,000 mn target debt assuming 8.50% cost of debt (Interest on remaining ₹3,000 mn target debt capitalized against under construction blocks)
Other Expenses	(104)	– Overhead and R&M expenses, property management fees, cash taxes
REIT Management Fees	(8)	– Assumed as 1% of incremental NDCF ⁽²⁾
Incremental NDCF (A)	694	
De-Leveraging Impact		
Interest Cost Savings on External Debt	1,356	– Interest cost on external debt proposed to be repaid at REIT and other SPVs (at ~8.3% p.a.)
REIT Management Fees	(16)	– Assumed as 1% of incremental NDCF ⁽²⁾
Incremental NDCF (B)	1,340	
Total Incremental NDCF (A+B)	2,033	

Source: I-Sec research, Company data, (1) Contracted NOI for ESTZ Acquisition calculated as annualized NOI of leases with lease commencement date prior to March 31, 2024, and including rental support on 0.4msf pre-leased under construction area, (2) Plus applicable taxes

Exhibit 6: ESTZ acquisition structure



Source: I-Sec research, Company data, (1) Leasehold rights over the Embassy Splendid TechZone Land for a period of 30 years from November 9, 2016, with option to renew for 3 further terms of 30 years each

Valuations

REITs derive their cash flows in the form of interest, debt repayment and dividend payments from owned assets which have differing cash flow profiles. Unlike assets in Infrastructure Trusts like toll/annuity roads or power transmission assets, which have a fixed tenure of operations, the underlying assets in REITs which consist of offices, malls and hotels, are perpetual in nature and carry an element of capital appreciation as well through escalation in rentals, addition of new assets and ramp-up in occupancies. Hence, the total return offered by a REIT should be measured as a mix of annual distributions and capital appreciation of the units of the REIT.

Hence, we prefer a DCF-based approach, which captures the upside from an uptick in rental income along with the annual distribution of at least 90% of the Net Distributable Cash Flow (NDCF) to REIT unitholders.

Our key assumptions include:

- 5% annual increase in rentals from FY24E.
- Cap rate of 8% on Net Operation Income (NOI) of each asset.
- WACC of 12.0% assuming 0.3x debt/equity with cost of equity of 14% and cost of debt of 8.5%.
- Our estimates and target price are excluding the proposed acquisition of ESTZ, Chennai and proposed equity fund raise of INR 25bn by the REIT manager.

We retain our **ADD** rating with an unchanged target price of INR405/unit based on 1x Mar'25E NAV. Key risks to our call are a slower recovery in office leasing and higher portfolio vacancy levels.

Exhibit 7: Return profile of Embassy REIT (ex-proposed Chennai RoFO asset)

Embassy REIT Cash Flows (INR mn)	FY21	FY22	FY23	FY24E	FY25E	FY65E
Revenue from Operations*	23,603	29,626	34,195	36,797	41,917	49,086
Net Operating Income (NOI)*	20,324	24,913	27,661	29,234	33,435	39,448
EBITDA*	18,508	22,981	25,444	28,164	31,865	37,146
NDCF at SPV level^	18,740	24,785	25,058	27,530	29,620	34,184
NDCF at REIT level^	18,356	20,638	20,608	20,593	21,545	25,496
NDCF Distribution Payout (%)	100%	100%	100%	100%	100%	100%
NDCF Distribution by REIT^	18,364	20,626	20,578	20,593	21,545	25,496
Distribution per Unit	21.5#	21.8	21.7	21.7	22.7	26.9
Distribution Yield (%)	6.0#	5.8	5.8	5.8	6.1	7.2

Source: I-Sec research, Company data, *excludes Golflinks and includes Tech Village from Q4FY21 onwards, ^ includes Golflinks, #assuming proforma diluted shares post ETV acquisition which was done in Dec'20

Exhibit 8: Valuation of Embassy REIT (in INR mn ex-proposed Chennai RoFO asset)

Enterprise Value	564,664
Less: Mar'25 REIT level net debt*	170,309
Less: Security deposits	10,315
Equity Value	384,039
Equity Value per Unit	405

Source: I-Sec research estimates, *adjusted for NDCF distribution in Q2FY24

Exhibit 9: Sensitivity of target price to cap rate and cost of equity

		Cost of Equity (%)					
		10%	11%	12%	13%	14%	15%
Cap Rate (%)	Target Price = 405						
	6%	651	611	573	538	505	473
	7%	561	526	493	462	432	405
	8%	494	462	432	404	378	353
	9%	441	413	386	360	336	313
	10%	400	373	348	324	302	281
	11%	365	340	317	295	274	255

Source: I-Sec research, Company data

Exhibit 10: Price chart

Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 11: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Revenue from Operations	34,195	36,797	41,917	49,086
Operating expenses	6,534	7,563	8,482	9,639
Net Operating Income (NOI)	27,661	29,234	33,435	39,448
Operating Expenses	80.9%	79.4%	79.8%	80.4%
Other expenses/REIT expenses	2,217	1,070	1,569	2,302
EBITDA	25,444	28,164	31,865	37,146
EBITDA Margin (%)	74.4%	76.5%	76.0%	75.7%
Depreciation & Amortization	11,284	10,613	10,724	12,622
Interest expenditure	9,761	9,614	10,565	11,194
Other Non-operating Income	1,441	2,162	2,270	2,383
Exceptional items	-	-	-	-
Recurring PBT	5,840	10,099	12,847	15,714
Less: Taxes	1,558	1,515	3,212	3,928
PAT	4,282	8,584	9,635	11,785
Less: Minority Interest	777	1,050	1,031	1,153
Net Income (Adjusted)	5,060	9,635	10,667	12,938

Source Company data, I-Sec research

Exhibit 12: Balance sheet

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Total Current Assets	35,550	36,609	37,246	38,667
of which cash & cash eqv.	8,754	8,181	5,746	4,939
Total Current Liabilities & Provisions	12,396	13,095	14,041	15,195
Net Current Assets	23,154	23,514	23,204	23,472
Investments	23,081	22,581	22,081	21,581
Net Fixed Assets	3,20,615	3,14,009	3,06,681	2,96,982
Capital Work-in-Progress	12,668	13,519	18,704	26,389
Total Intangible Assets	63,946	63,946	63,946	63,946
Deferred Tax Assets	-	-	-	-
Total Assets	4,43,564	4,37,669	4,34,715	4,32,469
Liabilities				
Borrowings	1,48,055	1,60,055	1,76,055	1,95,055
Deferred Tax Liability	51,826	51,826	51,826	51,826
provisions	-	-	-	-
other Liabilities	-	-	-	-
Total Net Worth	2,43,683	2,25,788	2,06,834	1,85,588
Minority Interest	-	-	-	-
Total Liabilities	4,43,564	4,37,669	4,34,715	4,32,469

Source Company data, I-Sec research

Exhibit 13: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Operating Cashflow	24,353	27,101	28,576	33,142
Working Capital Changes	1,302	(932)	(2,126)	(1,074)
Capital Commitments	(10,921)	(11,670)	(16,088)	(18,115)
Free Cashflow	14,735	14,499	10,362	13,952
Other investing cashflow	5,776	3,715	3,312	2,931
Cashflow from Investing Activities	(16,697)	(7,955)	(12,776)	(15,184)
Issue of Share Capital	(20)	-	-	-
Interest Cost	(9,862)	(9,614)	(10,565)	(11,194)
Inc (Dec) in Borrowings	21,439	12,000	16,000	19,000
Others	(20,267)	(20,593)	(21,545)	(25,496)
Cash flow from Financing Activities	(8,710)	(18,207)	(16,110)	(17,690)
Chg. in Cash & Bank balance	249	8	(2,436)	(806)
Closing cash & balance	8,754	8,181	5,746	4,939

Source Company data, I-Sec research

Exhibit 14: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
Per Share Data (INR)				
Earnings per Unit	5.3	10.2	11.3	13.6
Distribution per unit (DPU)	21.7	21.7	22.7	26.9
Book Value per Unit (BV)	257.1	238.2	218.2	195.8
Growth (%)				
Net Sales	15.4	7.6	13.9	17.1
EBITDA	10.7	10.7	13.1	16.6
EPS (INR)	(43.0)	90.4	10.7	21.3
Valuation Ratios (x)				
P/E	70.3	36.9	33.3	27.5
P/BV	1.5	1.6	1.7	1.9
Distribution Yield	5.8	5.8	6.1	7.2
Operating Ratios				
Debt/EBITDA (x)	5.8	5.7	5.5	5.3
Net D/E	0.6	0.7	0.8	1.0
Profitability Ratios				
RoE	2.0	4.1	4.9	6.6
RoCE	3.6	4.5	5.4	6.2
EBITDA Margins	74.4	76.5	76.0	75.7
Net Income Margins	14.8	26.2	25.4	26.4

Source Company data, I-Sec research

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