



Hudson Pacific Properties, Inc. (HPP) Q2 2024 Earnings Call

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Corporate Participants:

Laura Campbell *Executive Vice President-Investor Relations & Marketing*

Victor Coleman *Chairman & Chief Executive Officer*

Harout Diramerian *Chief Financial Officer*

Mark Lammas *President*

Arthur Suazo *Executive Vice President-Leasing*

Other Participants:

Blaine Heck *Analyst Wells Fargo Securities LLC*

Ronald Kamdem *Analyst Morgan Stanley & Co. LLC*

Nicholas Yulico *Analyst Scotiabank*

Caitlin Burrows *Analyst Goldman Sachs & Co. LLC*

John P. Kim *Analyst BMO Capital Markets Corp.*

Alexander Goldfarb *Analyst Piper Sandler & Co.*

Thomas Catherwood *Analyst BTIG LLC*

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Operator: Hello, everyone. Thank you for attending today's Hudson Pacific Properties Second Quarter 2024 Earnings Call. My name is Sierra, and I'll be your moderator for today. All lines will be muted during the presentation portion of the call with an opportunity for questions and answers at the end. [Operator Instructions] I'd now like to turn the conference over to our host, Laura Campbell, Executive Vice President of Investor Relations and Marketing. Please proceed

Laura Campbell: Good afternoon, everyone. Thanks for joining us. With me on the call today are Victor Coleman, CEO and Chairman; Mark Lammas, President; Harout Diramerian, CFO; and Art Suazo, EVP of



Leasing. This afternoon we filed our earnings release and supplemental on an 8-K with the SEC and both are now available on our website. An audio webcast of this call will be available for replay on our website. Some of the information we'll share on the call today is forward-looking in nature. Please reference our earnings release and supplemental for statements regarding forward-looking information as well as the reconciliation of non-GAAP financial measures used on this call. Today, Victor will discuss industry and market trends as well as other highlights from the quarter. Mark will provide an update on our office and studio operations and development. And Harout will review our financial results and 2024 outlook. Thereafter, we'll be happy to take your questions. Victor?

Victor Coleman: Thank you, Laura. Good afternoon, everyone, and welcome to our second quarter call. The results we reported this quarter were in line with our FFO outlook, with our office portfolio performing better than our expectations. This quarter, our team's strong execution resulted in leasing over 0.5 million square feet. This is our highest leasing activity since the second quarter of 2022, and our year-to-date leasing was up 40% compared to last year. Two-thirds of those leases were new, the most since first quarter 2019. Even after another strong quarter of leasing, our pipeline of deals in leases, LOIs or proposals is healthy at 2 million square feet, with an average requirement of above 15,000 square feet, up from about 9,000 square feet two years ago. All of this is a testament to our team's ability to attract and capture demand and successfully move leases through the pipeline to execution. And while still challenging, there's a gradual strengthening across our West Coast office markets almost uniformly relative to the trailing four quarter average available sublease space is declining, development pipelines are diminished, tenant requirements are growing, crime is falling, and transit ridership is improving. Nowhere is this more evident than in San Francisco.

The city had its second best leasing quarter in two years at 2 million square feet, with several submarkets experiencing positive or near positive net absorption. There were 13 deals signed over 40,000 square feet, the highest number since the third quarter of 2021. And kudos to our team for signing 2 of the 10 largest deals.

Tenant requirements continued to increase, reaching 6.8 million square feet this quarter, up 50% year-over-year to levels not seen since late 2019. Continued strong investment in AI is reigniting the San Francisco office market and spilling over into our other markets, especially Silicon Valley, and to some extent, Seattle. With over 600,000 square feet of AI leases signed in San Francisco year-to-date and 740,000 square feet of AI tenants already in the market, 2024 is on pace to be another significant AI leasing year.

Second quarter US VC investment of \$56 billion was the highest quarter in two years, driven by AI mega deals. Reportedly, investors are gaining confidence in the US markets' relative performance and getting more pressure from LPs to allocate nearly \$300 billion of dry powder. The Bay Area, where we have obviously a significant presence, continues to receive the largest allocation of VC funds, along with about 75% of all AI funding in the first half of the year.

We're energized by this positive leasing momentum and by significant funding for businesses that are choosing to locate in our core markets. While we cannot control the timing on leases closing, we expect our office fundamentals will gradually strengthen further as we move ahead. As for our studios, last week, the Teamsters ratified their contract with the Alliance of Motion Picture and Television Producers, finally clearing the way for production activity to begin to normalize. This favorable resolution follows an



unprecedented 18 months of strikes and difficult negotiations, which delayed greenlighting and overshadowed typical seasonality.

Presently, we estimate that there are only about 80 productions filming in Los Angeles compared to approximately 100 during much of the second quarter, as the potential for additional strikes weighed on demand in July. While we expect some level of increased production through the balance of the year, to what levels remain unclear. Beyond the strikes, consolidation, cost cutting and shifting content mix are altering not just show counts, but also production type, number of episodes and budgets. All of these factors influence demand for our stages and services, both in Los Angeles and outside of Los Angeles.

While we believe Los Angeles will remain the epicenter of entertainment, in recent years, the city has lost some of its substantial lead in global production. Other locations have enhanced their infrastructure and implemented favorable state film tax credits and sector-specific incentives. While the strike exacerbated this trend from 2021 to 2022, growth in the Los Angeles region's total scripted production capture was up less than 1%, compared to 4% in total scripted industry output. In 2022, Los Angeles lost nearly \$1 billion of production spend due to projects leaving the state for tax credits.

While we are working closely with Los Angeles's Mayor Bass, Governor Newsom and other elected officials and industry experts on this front, Mayor Bass is committed to ensuring the industry continues to thrive in the city of Los Angeles and has established a commission to strategize on incentives and related topics. All of these dynamics are very fluid. And as a result, we currently lack the visibility to assess with reasonable certainty how and when our studio operations will normalize. But they will normalize, and we believe that by the fourth quarter, production should start to get better even as new content investment remains cautious and more globally distributed. Importantly, we do not require production to return anywhere near our 2021 peak levels for our studio businesses to create meaningful value. At a point of reference, during the fourth quarter of 2022, when we began to experience the early impacts of pending WGA and SAG-AFTRA strikes, we estimate there were approximately 120 productions filming in Los Angeles. During that same period, our in-service studios generated an annualized NOI of \$37 million, and our Quixote businesses generated an annualized NOI of \$41 million.

Finally, turning to our balance sheet. Further deleveraging remains our top priority. We have no debt maturities until the end of 2025. And while we have already seen improvements in some of our leverage metrics, which Harout will comment on shortly, we anticipate that increasing studio cash flow will further strengthen these organically. As part of our proactive, multipronged approach to managing our leverage, we will continue to pursue opportunistic dispositions and have strong buyer interest on several assets. We expect to be able to execute successfully on these type of transactions, just as we did last year.

With that, I'm going to turn it over to Mark.

Mark Lammas: Thanks, Victor. This quarter, we signed 540,000 square feet of new and renewal leases. On our first earnings call this year, we indicated our occupancy and leased percentages would likely dip in the first half with the potential to improve thereafter. The 30 basis point and 50 basis point declines in occupancy and leased percentages this quarter are consistent with those early indications. Our GAAP rents grew 2.6%, while our cash rents were off 13.3%. Excluding our 150,000 square foot, 21-year lease



with the city of San Francisco at 1455 Market, our GAAP and cash rents would have increased up 8% and 0.9%, respectively. Note that more than half of the square footage leased by the city was former blocks they signed at peak of market 80-plus dollar rents, whereas the rent delta on the yet to be leased block space, most of which were signed in the mid-2010, would be significantly less. The notable increases this quarter in both net effective rent to \$57 per square foot and termed to nine years were driven by mid-to-large sized renewal leases in the Bay Area, some signed at \$100 plus square foot rents.

We had roughly 1.4 million square feet of unique office tours again this quarter, up 20% from this time last year. Compared to first quarter, tour activity increased 60% in San Francisco and 14% in Seattle. Year-to-date at Washington 1000, we have toured tenants representing in aggregate over 600,000 square feet, a mid-to-large sized demand. We also have planned tours for that project representing another 80,000 square feet. To underscore, this represents only very early interest, but we are pursuing all prospects from the entire region with vigor. Washington 1000 is among the best, if not the best, product in the Seattle CBD.

On the heels of yet another strong leasing quarter, as Victor mentioned, our over 2 million square foot pipeline is up 8% from last quarter and 5% compared to second quarter last year. This includes 48% coverage, including deals in discussion on our remaining 2024 expirations. On our top 10 vacancies, which collectively total about 2 million square feet, we have 47% coverage. This should allow us to begin to increase occupancy at assets like 1455 Market, 505 First, Page Mill Hill, 901 Market and 83 King. To put a finer point on our upcoming office expirations, we have roughly 800,000 square feet expiring through year-end and 2 million square feet expiring in 2025.

Over the last three years, we have leased 470,000 square feet per quarter on average, assuming we continue to accomplish only that and nothing more, over the next six quarters, we would have leased a total of 2.8 million square feet exactly enough to address all remaining 2024 and 2025 expirations. Thereafter, our annual office expirations become substantially lower, including in comparison to majority of office peers. If our pace of leasing continues or even modestly accelerates as market conditions improve, there is a clear path whereby we will not just preserve, but achieve sustained growth in occupancy.

Turning to studios. On a trailing 12-month basis, our in-service stages were 78.1% leased, compared to 79.4% in the first quarter, which reflects an additional vacant stage at Sunset Last Palmas. Our Quixote stages were 32.8% leased, up from 29.8% last quarter due to increased stage occupancy at Quixote North Valley. We currently have signed leases on contract or have client interest on 38 of our 59 film and TV stages.

In May, we held our grand opening event for clients at Sunset Glenoaks with major studio streamers and networks in attendance. Year-to-date, we have conducted over 20 unique tours at that asset, representing 11 active requirements, which resulted in three lease stages with a fourth stage in negotiations. Transportation utilization increased approximately 300 basis points to 24% compared to first quarter. We had more activity in the early half of the second quarter and have been gaining market share even as activity declined with production levels later in the quarter. This is a testament to what our sales team and unique integrated offering can accomplish as production normalizes. Our studio revenue grew 8% relative to first quarter. This is due to \$2.1 million of additional stage and studio ancillary revenue from higher occupancy at Quixote North Valley, more Netflix production at Sunset



Gower, and initial occupancy and production at Sunset Glenoaks. It also includes \$1 million of incremental services revenue from higher transportation and location services utilization.

Finally, I'll note that construction at Sunset Pier 94 is on budget and on time for planned opening in end of 2025. As Manhattan's first purpose built studio, the project has garnered significant interest from high profile studios and productions, and we are in discussions with multiple tenants for multi and single stage leases.

And with that, I'll turn the call over to Harout.

Harout Diramerian: Thanks, Mark. Our second quarter 2024 revenue was \$218 million compared to \$245.2 million in second quarter last year, primarily due to asset sales and two move outs, one at 1455 Market and one at Sunset Las Palmas Studios. Partially offset by improved studio ancillary revenue from increased production activity at Sunset Gower. Our second quarter FFO, excluding specified items, was \$24.5 million or \$0.17 per diluted share compared to \$34.5 million or \$0.24 per diluted share in the second quarter last year. Specified items consisted of transaction-related income of \$0.1 million or \$0.0 per diluted share and a one-time derivative fair value adjustment of \$1.3 million or \$0.01 per diluted share. The year-over-year change in FFO is mostly due to the items affecting revenue along with less FFO allocated to non-controlling interests following our purchase of our partners' ownership interest in 1455 Market.

On our second quarter, AFFO was \$24.2 million or \$0.17 per diluted share compared to \$31.1 million or \$0.22 per diluted share in the second quarter last year with a change largely attributable to previously mentioned items affecting FFO. Partially improved by reduced non-cash revenue adjustment and \$4 million in recurring CapEx spent.

Our second quarter same-store cash NOI was \$105.2 million compared to \$119.3 million in the second quarter last year, mostly driven by previously mentioned tenant move outs at 1455 Market and Sunset Las Palmas. At the end of the second quarter, we had \$706 million of total liquidity comprised of \$78 million of unrestricted cash, cash equivalents and \$628 million of undrawn capacity on our unsecured revolving credit facility. There is also additional capacity of approximately \$196 million, specific to our Sunset Glenoaks and Sunset Pier 94 construction loans, our share, which represents \$54 million. We continue to take proactive steps to reduce leverage and stress related metrics. Compared to a year ago, we improved our share of net debt relative to our share of undepreciated book value by 140 basis points to 37.3%, and increased our percentage of debt, fixed or capped, by 690 basis points to 19.2%. Importantly, as Victor noted, we have no maturities until November 2025. One housekeeping matter before we discuss our outlook. With construction on Sunset Glenoaks complete as of the second quarter, we are now accounting for it as a consolidated property.

Turning to our outlook. We are providing third quarter FFO outlook of \$0.08 to \$0.12 per diluted share with no specified items. Our third quarter outlook assumes that our in-service studio and Quixote businesses NOI is lower in the third quarter given the operating conditions are currently less favorable than the first half of the year and it will take time following the recent ratification of the Teamsters agreement to greenlight and prep for new productions. Our office leasing performance in the second quarter was ahead of our expectations. However, our third quarter outlook assumes lower average occupancy and NOI driven by lease expirations in the second and third quarter. Even as we anticipate occupancy has the potential to be flat at the end of the third quarter.



Regarding our full year FFO assumptions, we are lowering the range of same-store property cash NOI growth to negative 12.5% to 13.5% due to the same-store studios, specifically lower absorption at Sunset Las Palmas. A reminder that our same store portfolio excludes our Quixote business and now consolidates Sunset Glenoaks Studio. As always, our outlook, excludes the impact of any potential dispositions, acquisitions, financings and/or capital market activity. We'll return to providing full year FFO guidance outlook once we believe production levels have normalized to a point that we can more accurately anticipate and project future cash flows related to show-by-show, leased studio and service assets, primarily at our Quixote business. Now, we'll be happy to take questions. Operator?

Question And Answer Section

Operator: Thank you. We will now begin the Q&A session. [Operator Instructions] Our first question today comes from Blaine Heck with Wells Fargo. Your line is now open.

Blaine Heck: Great. Thanks. Good afternoon. Victor, I was hoping you could comment maybe a little bit more on the asset sales that you had talked about last quarter and again, a little bit this quarter. Maybe just how the reception's been, where you guys might be in that process and maybe any, any color on potential pricing?

Victor J. Coleman: Yeah, Blaine, thanks. Good to hear your voice. So the asset sales, we are still in active discussions and in beyond just conversations on at least a few assets. I don't want to get into details on the numbers, and I don't want to go into details on the amounts, but we're confident that we're going to execute on our asset sales like we did last year.

Blaine Heck: Okay, that's helpful. Just to quickly follow-up on that. Are these the same assets that you were targeting last quarter or has there been any change to kind of the composition of those potential sale?

Victor J. Coleman: Let me think about it. They are predominantly the same assets, with the exception of one...

Blaine Heck: Okay. That's helpful.

Victor J. Coleman: ...one new asset. That's helpful. And then...

Blaine Heck: And then – okay, got it. And then I had asked last quarter about whether there were any kind of strategic alternatives you guys might be exploring. And I thought you gave a very candid answer that essentially all options were still on the table. So just want to follow up there and maybe get any update to your thoughts on that subject and whether larger changes are still a consideration for you guys.

Victor J. Coleman: Well, as I said last time, listen, as a company, as the Chairman, as the board of directors always evaluate all potential opportunities, we're going to determine whether they're viable. And obviously, they're going to be acutely discussed to look at what we maximize long-term value for our shareholders. There is nothing imminent at all that is currently in place today. But as I said, we're always evaluating and looking at alternatives.

Blaine Heck: Great. Thanks. I'll leave it there.

Victor Coleman: Thanks, Blaine.



Operator: Our next question today comes from Ronald Kamdem with Morgan Stanley. Your line is now open.

Ronald Kamdem: Hey, just two quick ones for me. Just one, is there a quick way to sort of bridge going from \$0.17 to \$0.10 quarter-to-quarter, just what are the components of that? Just trying to figure out what pieces are driving that.

Harout Krikor Diramerian: Sure. So the main drivers are lower same-store NOI at Quixote and our same-store studios. And that's related to drop in activity at Gower and lower show counts in general, and then also lower office NOI related to the second and third quarter expirations, which results in lower average occupancy in the quarter. We still expect, however, that by the end of the third quarter, we could be in line with what we reported in the second quarter in occupancy.

Ronald Kamdem: Got it. That makes sense. And then we noticed that you disclosed 239,000 square feet of early terminations in the quarter. Just curious, what was that driven by and were there's sort of any one-timers in the office rent figures that we should be thinking about? Thanks

Arthur X. Suazo: Yeah, this is Art. There were really two major drivers. One was WeWork in totality for 112,000 square feet and then there was a default for 40,000 square feet. And those are the big ones. The good news on those is – there is good news on those is that we already have pipeline behind that or negotiations to backfill most of that space.

Harout Krikor Diramerian: And to answer the second half of that question, we did not get any lease termination from WeWork. So that's not in any of the numbers.

Ronald Kamdem: Okay, great. That's it for me. Thanks so much.

Operator: Our next question comes from Nick Yulico with Scotiabank. Your line is now open.

Nicholas Yulico: Thanks. I think earlier, Mark, you said something about the coverage on the expirations for this year. I thought you said 48%. I just want to make sure that was right. And then I don't know if you have a number you could share on 2025 expirations.

Mark Lammas: Yeah. So you're right on the 48%, that's the coverage on the 800 or so expiring debts back half of the year. On 2025, I'm just looking at Art.

Arthur X. Suazo: Yeah. So, on 2025 right now we're sitting at about 25% coverage on it. Finer point on the 48%. Our average tenant size is below 7,000 square feet. A lot of these guys are just barely engaging right now. So that number – that 48% can go up very clearly.

Nicholas Yulico: Okay, thanks. And then I guess turning to AI, you talked about that a bit earlier. What we've heard is that in many cases, these firms will want to have more pre-built space so that they've taken sublease space because of that issue. They don't want to put much capital in. Can you just talk about maybe how you've situated your portfolio, whether it's spec suites or anything else that you think you could be competitive to grab that tenant in city of San Francisco versus the Valley?

Arthur X. Suazo: Yeah. So it's bifurcated, right, so you're talking about AI with the big – with the large growth and you're talking about kind of the early stage AI that we deal with on the Peninsula and through the Valley. I'll deal with the second one first. In the Valley, our pre-built space, which we have about 300,000 square feet of in the Valley, and we've – it's been our bread and butter, that space is



attracting these tenants because they don't have to have to plan it, they don't have to think about it and we get immediate move-in. So, we're doing really well in those. On the larger spaces, oftentimes we'll pre-built a single floor. In this case, if they're looking for multiple floors, we haven't built out multiple floors, which is why – nor has anyone for that matter, which is why they've been gravitating to really top end sublease space.

Nicholas Yulico: Okay, thanks. And anything that you're able to just share, just following up on in terms of like the pipeline or some of the leasing activity you've done, what the composition has been of AI firms?

Arthur X. Suazo: AI, I'll share with you. So as we mentioned in our prepared remarks, it's still a little bit more than 2 million square feet. It's grown quarter-over-quarter. It's chiefly 65% new to renew deals. And I will say this, year-over-year our tech is the composition of the pipeline has grown 15% to almost 40%, right. So, we're starting to see more tech in the pipeline. We're also seeing the size of the tenant grow. So kind of the mid-sized tenant is carrying the day 20,000 to 60,000 square feet and that's up actually 40% year-over-year. Of that – most of that is in the city. Most of the AI as you've seen is in the city for the larger users. We've seen it in the Valley, again, in really the startup realm. We've seen maybe three or four mid-sized AI deals in Seattle, but the preponderance of all of that is in San Francisco. And of the tech that I just mentioned to you, I would say that maybe 20% of that is AI.

Nicholas Yulico: Okay. That's helpful. Thanks a lot, guys.

Arthur X. Suazo: Right. So, if we carry 40 – yeah, if we carry 40% tech, 20% of that is AI.

Nicholas Yulico: Appreciate it.

Operator: Our next question comes from Caitlin Burrows with Goldman Sachs. Your line is now open.

Caitlin Burrows: Hi. Good afternoon, everyone. I was wondering if you could talk a little bit about office retention, what it's been this year, maybe how it compares to history, the expectation for the rest of the year. And then as you look forward into 2025, whether you have any insight yet one way or the other on any of the maybe larger lease expirations.

Arthur X. Suazo: Sure. This is Art. Mark had mentioned that it's about 48% the retention. We think we can get it better than that. Why? Because there's a lot of smaller tenants that still haven't engage yet in the fourth quarter. So, we can get that north of 50%, we feel we can get it north of 50%. That stacks up to the last, I would say, the last three or four years for sure, but 2025 – 2025, again, it's very early, and we have about 25% coverage on those expirations. So, obviously, that number is going to grow.

Caitlin Burrows: And just to clarify that 48% retention, is that just coincidentally? I think you mentioned 48% coverage for the second half expirations. Are there two different stats that just happened to be 48%?

Arthur X. Suazo: Yeah.

Caitlin Burrows: Okay. And then, just...but two different stats that happen to both be 48%.

Arthur X. Suazo: No, no, no, no. Cover – he is just saying we have coverage on the 800,000 feet that represents the ability to retain that expiration.



Caitlin Burrows: Okay. I think I got that. Maybe I'll catch – circle back on that, but then maybe on the dividend. So it's at \$0.05 a quarter now. Wondering if you can comment on how that compares to your expected taxable income for the year and what could cause any incremental change to the dividend one way or the other at this point?

Harout Krikor Diramerian: Sure, it's a bit early to compare to taxable only because there's half the year left like we always evaluate the dividend every quarter, it's really the board's decision when it comes to the status of our dividend.

Caitlin Burrows: Okay. So early in the year. Got it. Thanks.

Operator: Our next question comes from John Kim with BMO. Your line is now open.

John P. Kim: Thank you. I still don't really understand guidance for third quarter. You have it at \$0.10 the midpoint, that's down 41% sequentially. Your original guidance provided six months ago implied \$0.29 per quarter in the second to fourth quarter. And I understand studios down, but at its peak the studio is only 11% of NOI. So, I guess a lot of this is from occupancy, but the expirations was known a few months ago. So I just don't really understand how it could drop so much in one quarter. And I was wondering if there was anything that surprised you or anything incrementally new looking at the third quarter?

Harout Krikor Diramerian: No, it's a good question. So, like we said, our office is actually a little bit improved compared to our previous guidance or even our full year guidance that we provided earlier in the year. It is really due to the both Quixote business and the same-store studio business. They're just not performing in line with our projections both full year and next quarter, that's the driver. But I know again from the percentage you're quoting in terms of percentage of the company, that's a percent of NOI, but that's not a percentage of FFO, the FFO is also driven by the interest and the G&A, which there's a larger movement as a result. So, it's not just if you just look at the percentage NOI, yes, it feels large, but when you compare it to FFO, it's a bigger number. And assuming our understanding is correct and our – the recoveries, like that is going to turn around pretty drastically once studio activity picks up and number of shows increase.

John P. Kim: So same-store studio NOI was \$7.6 million in the second quarter. Does that become a significantly negative number in the third quarter?

Harout Krikor Diramerian: No, no, the \$7.6 million is the, I think, in-service studio number. So we expect that to come down. And same with Quixote.

Mark Lamm: Let me just, maybe take just somewhat different tack on it. Harout gave you the drivers of the difference between the \$0.17 or \$0.16 under NAREIT definition and the \$0.10 midpoint, right, that's half studio related, half average office occupancy related. Hopefully, that's fairly clear. As it relates to your sort of the reach back to the earlier guidance and sort of trying to –bridge, if you will, to that early, early number, and the \$0.10, I think what you have to appreciate is that the Quixote business especially is highly, highly leveraged to its fixed cost. And so, if show counts and the other drivers that really drive that business markedly improved, you can generate a heck of a lot of incremental FFO off that. And if they don't improve, which for the time being at least show counts are pretty stagnant, what you realize is that you're kind of bumping along not too far away from, say, where we reported NOI negative \$3 million bucks. And as we sit today, our third quarter expectations is that it's going to take a



little while for the show counts to meaningfully improve. And so, we just haven't been able to really get the real lift off, if you will, in terms of the impact that Quixote has the potential to make on FFO.

John P. Kim: Mark, you mentioned the fixed cost nature of Quixote. I just wanted to ask about same-store studio expenses being up 33% this quarter. I would've thought it would be a lower number than that.

Mark Lammas: Oh. The sequential – Harout is looking at it.

Harout Krikor Diramerian: I apologize, I wasn't prepared for that specific question.

John P. Kim: Just the same-store studio expenses was up a lot.

Mark Lammas: Yeah, it could be – we did enjoy pretty high production levels at Sunset Gower in the quarter, in fact you know higher than we had initially projected. Lighting and grip, when production levels are high it tends to mean the lighting and grip is high and they carry with it higher operating expenses. So that's likely the reason for the sequential increase.

John P. Kim: Okay, great. Thank you.

Operator: Our next question comes from Alexander Goldfarb with Piper Sandler. Your line is now open.

Alexander Goldfarb: Hey, good afternoon. Good afternoon down there. Just two questions, first, and sort of piggybacking on John Kim's question on the earnings. It seems like the earnings this year, have come down pretty quickly, just given the issues that you guys have been dealing with, especially on the studio front. When things right size and occupancy for office improves, studios rebound, should we think about the quarterly progression of earnings rebound to be as sharp and upward as it has been on the down? Just trying to get a sense of how long it will take to get earnings back to where it was with expectations at the beginning of the year versus where we stand right now.

Harout Krikor Diramerian: Yeah. I mean, it, it could be very sharp what I was just walking you through in the prior question points to that, I mean, Quixote has the potential as you know, to generate, you know, considerably higher NOI and then, you know, the negative three or previous quarters before that. And if you just run the math, I mean, there's not that much incremental cost associated with improving that NOI. And so, it essentially drops to the bottom line and FFO would, you know, could go up pretty quickly and significantly when that happens.

Alexander Goldfarb: Okay. And then the second question is, Victor, on the asset sales that you're contemplating, as you guys look at the portfolio and especially where some of the assets may have been weaker as of late, is there – do you envision a scenario where maybe surgically you can remove some of the weaker assets and that way you end up with a Hudson that has – is much more concentrated in the top tier assets across the portfolio and that the laggards you can remove or it's easier done than – said than done

Victor J. Coleman: Alex, so, listen, on a general comment, as you know, once the debt markets open up, the disposition market is going to increase. And so, we have allocated our energy around two tiers, right, the assets that we don't think are long-term assets for the portfolio going forward, which will make the enterprise a much higher quality enterprise, and those assets are already identified, and to some extent are in conversations. We've looked at them. There are a couple of assets that are in that bucket that



clearly are not saleable in this market, given where the debt markets are. The other alternative is for us to also look at where we get a much higher capital amount to the bottom line of the company. And as a result, we would look at couple of the maybe better assets in the portfolio. But the goal is exactly how you sort of stated it. We're looking at having a much higher quality portfolio with high quality assets that are going to be performing. It's just taking us some time to get through that, but they have already been identified.

Alexander Goldfarb: Okay. Thank you, Victor.

Victor Coleman You're welcome

Operator: Our next question comes from Tom Catherwood with BTIG. Your line is now open.

Thomas Catherwood: Thank you. And good afternoon, everybody. Maybe Mark and Harout, sorry to keep sticking with guidance here, but following up on John's question, if we do a quick back of the envelope on the guidance swing quarter-over-quarter, it implies studio performance could be pretty close to in-line with the 4Q 2023 numbers, which was the peak of the strike impact. Is that really what you're building into guidance for next quarter?

Harout Krikor Diramerian: I don't think it's exactly that low, like I said, but I don't know if I gave estimates around the numbers. We expect a sequential drop. I don't think we expect one to be as low as Q4 2023.

Mark Lammas: I don't think so either. I mean, just if you look at Q4, Quixote NOI, it was 11.8 negative, the most recent quarters, 3.9, same show count sort of stay at around you know, we're, you know, in the 80-ish level which they did in July and probably don't really start showing meaningful improvement until maybe late September. You're not – even at that level, I don't think you're approaching 10, negative 11.8 on Quixote. And that's, so we're not making that level of assumption on the Quixote business. We're really assuming it sort of stays more or less where it is today.

Harout Krikor Diramerian: Maybe similar to Q1 for Quixote.

Victor J. Coleman: Yeah.

Thomas Catherwood: All right. Thank you for that clarification. And then, Victor, following up on your response to Blaine's question about the asset sales, you mentioned one more being added to the bucket. Just to clarify, was that one in addition to kind of what has been expected before or did something fall out of the potential sales pool?

Victor J. Coleman: That – something fell out of the sales pool and this was the reverse inquiry by a user that we're talking to. And they're almost – almost roughly the same valuation. This one's a little higher.

Thomas Catherwood Got it. Appreciate that. Last one for me just quickly, if I can. Art, in terms of the lease in your pipeline, specifically in Silicon Valley and the Peninsula, do you have a sense of how much of that is tenants relocating from properties within the market or submarket versus tenants maybe relocating from other markets?

Arthur X. Suazo: Yeah, generally there, it's not relocating from other markets. Generally, it's growth, right, because our bread and butter is kind of the 5,000 foot perhaps a startup high growth company,



that we're banking on. And those are taking more space. Beyond that, it's space within the market. But we're seeing more and more of that growth users taking additional space.

Thomas Catherwood: Appreciate the answers. That's it for me. Thanks, everyone.

Operator: Our next question comes from Michael Griffin with Citi. Your line is now open.

Michael A. Griffin: Great. Thanks. Victor, I want to go back to your opening comments around how you don't think studio production needs to return to peak levels for it to start contributing to your business. I was wondering if you could expand on this a bit. Does this mean that just the rate of change in the recovery is going to be beneficial? And I recall when you initially did the Quixote deal, I think it was about \$80 million of run rate EBITDA kind of initial expectations. Do you think that's still possible as the business recovers?

Mark Lammas: This is Mark. I'm going to try to tackle that. It really starts with LA show counts improving to levels consistent with periods less affected by either a pandemic or a strike such as 2019 or 2022, the average of which is about 120 shows. Even if we assume that current production budgets, which are reflecting real cost cutting measures, even if we assume those cost cutting measures continue to limit the number of trailers and other production vehicles, let's say, seven vehicles per production, and also hinder our ability to push stage in service rates back to more historic norms. As long as LA show counts simply reach something like 115 or 120 shows, our Quixote stages should get to about 65% to 70% occupied, and our projected annual NOI for Quixote should reach between \$45 million and \$50 million.

From there, any number of improvements have the potential to push NOI to \$60 million and above \$60 million. For example, if you get to 75% Quixote stage occupancy, that drives another \$5 million NOI increase. And if trailer and other vehicle counts go from the current seven or so vehicles to back to historic levels of 8 to 8.5 vehicles that drives another \$7 million to \$10 million of NOI. And then, of course, obviously, as market conditions tighten with show counts improving, we could then look to potentially push rates. It may – we might be able to increase our market share a little bit. And all of those would ultimately contribute to getting that NOI number not just to \$60 million but somewhere, well, north of that

Michael A. Griffin: Appreciate the color on that, Mark. And then maybe for Harout, just updated thoughts maybe around issues with potential covenants. I imagine that EBITDA is expected to decrease with the third quarter relative to the second quarter. I think you might be pushing up on a couple of covenants there. So any thought or update around how we should think about that?

Harout Krikor Diramerian: Hey, Michael, good question. So, we always project out our covenants and like this quarter, our projections came in, our actuals came in better than our projections. And all of our covenants and our results, so given that even though our lower expectations in the future, we don't think we're going to break any covenants. I think maybe next quarter might be similar to this quarter, so we feel pretty confident but our projections are solid in terms of our expectations.

Michael A. Griffin: Great. That's it for me. Thanks for the time.

Victor J. Coleman: Thanks, Mike.

Operator: Our next question comes from Dylan Burzinski with Green Street. Your line is now open



Dylan Burzinski: Good afternoon and thanks for taking the question, guys. Just wanted to go back to your comments around tenant demand or tenant requirements picking up in San Francisco, can you kind of talk about some of the drivers of that? Obviously, I'm sure some of it's a pickup in activity from AI companies, but if you can sort of give any other details as to the other drivers of that and then sort of a parallel to that, a lot of the reason why market vacancies have continued to go higher in San Francisco is because those space givebacks by big tech. Can you kind of just talk about expectations for there to be a continuation of this, a change in this? Because as we sort of think about where big tech is investing their capital today, it's primarily in the AI and datacenter infrastructure. And so, just curious if you can give us any insight into any potential further space givebacks in this segment of the market?

Arthur X. Suazo: Sure, Dylan. This is Art. Listen, AI has been clearly driving the market. Last year that was responsible for about 1.7 million square feet. We started off the first half of the year strong with about 600,000 – just a little over 600,000 square feet. And the active AI pipeline, the demand sits – I mean, think we reported it was somewhere around seven, but it's – since this quarter went to print. I mean, we're literally looking at and pushing up against another 1 million square feet. So, we're tracking as we did last year. But don't forget, yes, AI is driving the market now. Tech is coming back in the market in a more meaningful way. But the bread and butter, not just for San Francisco, but for all the markets through the pandemic, was professional service law, law firms leasing space. That continues, it's just been overshadowed in the headlines because of AI and because of tech coming back. Everybody's anxiously awaiting. But that sector has continued to grow as well, not at the same rate, but it also, like I said, it's going to bolster the market.

Relative to tech, big tech give back, we were seeing them wholesale for a while. I think these give backs have become more measured. I think some of these big tech have just made decisions about how they're going to give back or how they're going to utilize space and how they're going to give it back. Listen, they're up against some expirations in the next year-and-a-half, and I think they're going to deal with it then, but I think we've seen a more – far more measured approach about what that means going forward. And I think the demand that you're seeing in the market when executed is going to hopefully more than offset any of those give backs.

Victor Coleman: Hey, Dylan, it's Victor. Also, I just want to just give some macro highlights in the city. I know you guys are on top of this stuff, but we follow this very closely. And when I made in my prepared remarks the reduction in crime, I mean, we're seeing that it's hitting its lowest mark in the last five years. We're seeing obviously activation centers, areas that are being capitalized for activation centers in the city that is going well. Bart exits have gone up almost 7%. The San Francisco tent counts are down since 2018, their lowest levels. They're a 41% reduction in tents. And the homelessness is down 13%. So these are all factors that are helping the macro basis for growth in San Francisco. And I've always said when San Francisco churns, it will churn quicker than people think. And I think that's what's driving some of this activity.

Arthur X. Suazo: And one more thing, Dylan. Other than the obvious demand drives growth leasing and things like that, the number I'm looking at is sublease availability. It was – excuse me, the net absorption, which was negative 290,000 square feet, which seems like normally a high number, it's been trending through the pandemic. It's been trending to about 1.1 million, right. So if you think about it, it's come down over the last few quarters, but it was trending in 1.1 million. It's now kind of moving back to a manageable number.



Dylan Robert Burzinski: Appreciate those comments. And then maybe just a follow-up to some of that. I mean, are you seeing – and I know Governor Newsom recently ordered the state agencies to address homeless encampments. Are you seeing that sort of be, obviously, that's recent news, but are you seeing that sort of be talked about in leasing discussions? And then, obviously, it seems like recession odds are higher today than they were two or three weeks ago. And so, are you at all hearing any discussions on that with tenants or?

Arthur X. Suazo: I think with – on the recession, it's too early to tell, right. This is – it's sort of new news that's come out in the last 30 – less than 30 days. In terms of the governor's movement to move the encampments, it's absolutely affected San Francisco, I think, more so than it has for sure in Los Angeles because, listen, there's an election in San Francisco, right? So, London Breed is up for reelection. And so, she's going to push on that as a platform where Karen Bass, Mayor Bass, doesn't have to do that. She's got another two-plus years to go.

Dylan Robert Burzinski: Great. Thanks for the details, guys. Really appreciate it.

Arthur X. Suazo: Thanks, Dylan.

Operator: Our next question comes from Peter Abramowitz with Jefferies. Your line is now open.

Pete Abramowitz: Yes. Thank you for taking the questions. Just wanted to go back to those comments about kind of the ability to drive some meaningful value in the studio portfolio even if things don't get back to where they were before the strike. I guess is there anything you can do or anything you're expecting to do on the expense side to kind of close some of the gap and get back to the NOI run rates you sort of underwrote when you did the Quixote deal, just to sort of close that gap? Because obviously demand in the revenue side is not going to be quite where you were probably expecting it a couple of years ago.

Victor J. Coleman: Yeah, there are some measures we can do and are doing. I mean, we did on the heels of the acquisition of Quixote, the third of the three companies in the fall of 2022. We did implement a lot of efficiency measures, including two pretty sizable rifts. And so, we believe we've largely rightsized the head count. There are other things we are looking into really at the operations level, looking at our footprint, in terms of our various facilities, ways to save cost there, looking at efficiencies on the manufacturing side in terms of our trailer manufacturing and so. We'll just continue to pursue those and try to make inroads on the cost side to try to help improve those margins.

Pete Abramowitz: Okay, that's helpful. And then you published an interesting chart, I think in your NAREIT presentation that utilization – transportation utilization in the studio business had gone from about 10% during the back half of last year, up close to 30% by April. Apologies if I missed this upfront, you already covered it, but can you just provide an update on where that is as of July?

Victor J. Coleman: Yeah. Well, we mentioned in our prepared remarks the 24%, I would – that – if you think about where we finished the quarter at 82 shows in LA, to be at 24% utilization at show counts at that level really points to a lot of potential here. I mean, 30% was back when show counts were in the low 100 range. To put a finer point on it, we averaged 96 in the second quarter and we only just taper down to 80 in towards the end of June. We're sitting at about 80 as of the end of July. We might – hopefully we'd start coming off that bottom soon. But if we're at 24% and 80, we could easily get to 30% quickly, but we think we are picking up market share on the trailer side through a very— credit to our



sales team, picking up on improving relations, picking up just more sales. So, well, I think 30% is something we can get to quickly. And then if show counts get to the levels we were just talking about the one 150 and 120 level, we should be back above 50-plus percent utilization.

Pete Abramowitz: Right. That's all for me. Thank you.

Operator: Our next question comes from Rich Anderson of Wedbush Securities. Your line is open. Please go ahead.

Richard Anderson: Thanks. Good afternoon. I was asked a similar question on Quixote, specifically on the expense side, the \$25 million you run roughly per quarter, assuming a lot of that is leased expense. Have you inquired or thought about sort of a rent restructure for the 23 leased studios or is it not gotten that bad?

Victor J. Coleman: Rich, hey – no. But Rich, what we have done is we are – I mean, you're absolutely right. A lion's share of that is lease costs, but we are also looking at some consolidations that are not studio lease cost but transpo storage lease costs and the like for that and consulting. We're in conversations on that. We do have several leases that expire in the next, what, 24 to 36 months that we're working on a master plan around that. So that will also help the overhead process.

Richard Anderson: Is there any scenario where you could own some of those studios at some point down the road?

Victor J. Coleman: Yeah, yeah.

Richard Anderson: All right. That's all I need out there. And then last question, the – someone brought up recession and I had it on my list, too. Let's put all the noise with everything that's happened to – in terms of strikes and so on aside, what does a recession do to production business generally? Like how – if you look back in history, what happens?

Victor J. Coleman: I mean, historically, the entertainment industry has performed exceptionally well during recessionary times because it's providing a cheaper form of entertainment, clearly. And so, not to say that anybody wants a recession, but at the end of the day, it's always performed well. And that was sort of part of the prepared remarks was saying even in a downturn, content will be produced.

Richard Anderson: Yes. Okay. That's all I had. Thanks very much.

Victor J. Coleman: Thanks, Rich.

Operator: This concludes the Q&A session. So, I'll turn the call back over to Victor Coleman for any closing remarks.

Victor J. Coleman: Thank you so much for participating in our second quarter call and we look forward to speaking to you guys all soon.

Operator: That will conclude today's conference call. Thank you all for your participation. You may now disconnect your lines.