IPO Note – Krsnaa Diagnostics Limited

03-August-2021

RETAIL RESEARCH

Krsnaa Diagnostics Limited

Issue Snapshot:
Issue Open: Aug 04 – Aug 06 2021

Price Band: Rs. 933 – 954 (Discount of Rs 93 for the eligible employees)

*Issue Size: 12,718,392 eq shares
(Fresh Issue of 400 cr + Offer for sale of 8,525,520 eq sh)

Issue Size: Rs.1186.6 – 1213.3 cr

Reservation for:

QIB	atleast	75% eq sh
Non Institutional	atleast	15% eq sh
Retail	Upto	10% eq sh

Face Value: Rs 5

Book value: Rs 356.99 (Mar 31, 2021)

Bid size: - 15 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs. 13.60 cr
*Post issue Equity:	Rs. 15.69 cr

Listing: BSE & NSE

Book Running Lead Managers: JM Financial Limited, DAM Capital Advisors Ltd, Equirus Capital Private Limited, IIFL Securities Ltd

Registrar to issue: KFin Technologies Private Ltd

Shareholding Pattern

Shareholding Pattern	**Pre issue %**	**Post issue %**
Promoter and Promoter Group	31.6	27.4
Public	68.4	72.6
Total	100.0	100.0

*=assuming issue subscribed at higher band
Source for this Note: RHP

Background & Operations:

Krsnaa Diagnostics Limited (KDL) is one of the largest differentiated diagnostic service providers in India which provides a range of technology-enabled diagnostic services such as imaging (including radiology), pathology/clinical laboratory and tele-radiology services to public and private hospitals, medical colleges and community health centres Pan-India. It is the fastest growing diagnostic chain in India on multiple parameters including operating income, operating profit before depreciation, interest and tax ("OPBDIT") and profit after tax between Fiscal 2017 and Fiscal 2020 and volume of tests conducted between Fiscal 2018 and Fiscal 2021 (amongst players with revenues exceeding Rs. 1,500 million). The Company also operates one of India's largest tele-radiology reporting hubs in Pune that is able to process large volumes of X-rays, CT scans and MRI scans round the clock and 365 days a year, and allows to serve patients in remote locations where diagnostic facilities are limited. It provides quality and inclusive diagnostic services at affordable rates across various segments. Since inception, it has served more than 23 million patients.

KDL's PPP agreements are typically long-term in nature and ensure predictability of revenues from operations. As of June 30, 2021, it has deployed 1,797 diagnostic centres pursuant to PPP agreements with public health agencies. In addition to the PPP segment, it has been growing collaboration with private healthcare providers to operate diagnostic centres within its facilities, and has expanded from operating 14 diagnostic centres, as of March 31, 2019 to 17 diagnostic centres, as of March 31, 2020 and to 20 diagnostic centres as of March 31, 2021 while it operated 26 such diagnostic centres as of June 30, 2021. It has an extensive network of integrated diagnostic centres across India primarily in non-metro and lower tier cities and towns. As of June 30, 2021, it operated 1,823 diagnostic centres offering radiology and pathology services in 13 states across India. Its operating model involves diagnostic centres operated under a hospital partnership model. In Fiscal 2021 and in the three months ended June 30, 2021, it served 5.18 million patients and 1.88 million patients, respectively. In line with KSL' focus of providing inclusive and affordable services, it offers its diagnostic services at competitive rates and at significantly lower rates than players with revenues exceeding Rs. 1,500 million.

The Company offers a range of diagnostics imaging services and clinical laboratory tests that include both routine and specialized tests / studies and profiles, which are used for prediction, early detection, diagnostic screening, confirmation and/or monitoring of diseases. Its diagnostic imaging/radiology services include conducting X-rays, computed tomography ("CT") scans, magnetic resonance imaging ("MRI") scans, ultrasounds, bone mineral densitometry and mammography. In pathology segment, its primary focus includes biochemistry, haematology, clinical pathology, histopathology and cytopathology, microbiology, serology and immunology. A suite of diagnostic equipment is located at its tele-radiology hub along with a team of radiologists which provide significant operating efficiencies and scalability.

As of June 30, 2021, KDL had a team of 190 radiologists, 30 pathologists, eight microbiologists and more than 2,800 qualified professionals including clinicians, technicians and operators. It continues to make investments in equipment and in its technology platform, to ensure they meet requisite industry standards and accreditations like NABL and NABH. Its diagnostic equipment is procured from leading OEMs including Wipro GE Healthcare Private Limited, Siemens Healthcare Private Limited, Fujifilm India Private Limited, HORIBA India Private Limited and Agappe Diagnostics Limited. Its equipment is covered by comprehensive maintenance contracts with OEM suppliers to ensure requisite equipment uptime and regular servicing and calibration. In pathology segment, it obtains quality assessment reports and undertakes comparison of results across diagnostic centres.

Objects of Issue:

The Offer comprises a Fresh Issue by KDL and Offer for Sale by the Selling Shareholders.

Offer for Sale

Each of the Selling Shareholders will be entitled to the respective portion of the proceeds of the Offer for Sale, after deducting their portion of the Offer related expenses and relevant taxes thereon. KDL will not receive any proceeds from the Offer for Sale. All expenses in relation to the Offer other than the listing fees (which shall be borne by KDL) shall be shared among the Company and the Selling Shareholders on a pro rata basis, in proportion to the Equity Shares Allotted by KDL in the Fresh Issue and the respective portion of the Offered Shares sold by each Selling Shareholder in the Offer for Sale, in accordance with applicable law.

Fresh Issue

KDL proceeds of the Fresh Issue ("Net Proceeds") are proposed to be utilised in the following manner:

- Proposing to finance the cost of establishing diagnostics centres at Punjab, Karnataka, Himachal Pradesh and Maharashtra.;
- Repayment/pre-payment, in full or part, of borrowings from banks and other lenders availed by KDL; and
- General corporate purposes.

In addition to the aforementioned Objects, KDL will receive the benefits of listing of its Equity Shares on the Stock Exchanges.

Utilisation of Net Proceeds

Particulars Amount (Rs. in million)	Total estimated amount/ expenditure	Estimated utilisation from Net Proceeds	Estimated schedule of deployment of Net Proceeds in	
			Fiscal 2022	Fiscal 2023
Finance the cost of establishing diagnostics centres at Punjab, Karnataka, Himachal Pradesh and Maharashtra	1508.10	1508.10	1250.00	258.10
Funding the working capital requirements of the Company	1460.81	1460.81	1460.81	Nil
General corporate purposes	*	*	*	*

Certain key operational performance indicators in relation to our business operations are set out below:

Parameters	As of and for the year ended March 31,			As of and for the three months ended June 30, 2021
	2019	2020	2021	
Operational Parameters				
Diagnostic Centres				
- Radiology	833	897	1,365	1,370
- Pathology (including Collection Centres and Processing Centres)	440	455	465	487
Collection Centres	409	422	425	443
Processing Centres	31	33	40	44
Tests Conducted				
- Radiology	1,950,356	3,476,253	3,054,032	790,198
- Pathology	5,441,779	7,176,459	6,319,285	2,803,747
Equipment				
- CT Scan	44	53	62	62
- X-Ray	804	860	876	937
- MRI	18	23	26	27

Certain key financial performance indicators in relation to our business operations are set out below:

Parameters	As of and for the year ended March 31,		
	2019	2020	2021
Financial Parameters			
Revenue from operations (net) (₹ million)	2,092.35	2,584.27	3,964.56
- Contracts with Public Health Agencies	1,506.61	1,884.34	2,675.70
- Contracts with Private Healthcare Providers	585.74	699.93	1,288.86
Revenue from operations (net) (%)			
- Public Health Agencies	72.01%	72.92%	67.49%
- Private Healthcare Providers	27.99%	27.08%	32.51%
Adjusted EBITDA# (₹ million)	630.02	757.74	1,060.47
Adjusted EBITDA Margin##	29.40%	27.92%	25.95%

Competitive Strengths

Unique and scaled diagnostics company: KDL is one of the largest differentiated diagnostic service providers in India. It provides a range of technology enabled diagnostic services such as imaging (including radiology), pathology/clinical laboratory and tele-radiology services to public and private hospitals, medical colleges and community health centres Pan-India. In the PPP segment, it collaborates with central, state and municipal government operated health and medical facilities for the deployment and operation of diagnostic centres. It also partners with several private sector hospitals and health centres to establish diagnostic centres within their premises. As of June 30, 2021, it has been awarded 38 contracts on a PPP basis, of which 32 projects has been executed while in the private healthcare segment, it has 26 active collaborations. It operates a hospital partnership model where diagnostic centres it operates are located within existing premises of hospitals and health centres and support them with onsite testing.

The Company's business is focused on providing diagnostic services to the mass segment, particularly in tier II and tier III cities and towns in India in addition to metros and tier I cities. Its patient base includes large segments of government employees and their families, including public administrative officials, defence personnel, members of the judiciary and patients covered under the National Health Scheme. Its large network of diagnostic centres, together with the quality of services at competitive rates, has been key factors in the significant growth it has experienced. Tele reporting is a critical and unique aspect of business and it operates a large tele-radiology reporting hub in Pune which is among the largest in India and equipped with sophisticated equipment and operated by a panel of experts and qualified radiologists that enable to serve patients in remote locations where diagnostic facilities are limited.

Strong brand equity*:* KDL continue to focus on, the Krsnaa brand is associated with providing quality and reliable healthcare services at affordable prices. It provides quality services at competitive rates while following accreditations and protocols in line with best industry practice. The range of diagnostic services it offers, together with the scale of operations allows to achieve economies of scale and provide competitive pricing for its operations. It ensures that the look and feel of its diagnostic centres is consistent which helps brand visibility and increase brand recall. This approach has enabled it to generate brand equity in the semi-urban and rural areas that it primarily caters to, where the presence of diagnostics chains is limited. Its internally developed quality assurance protocol together with the quality of laboratory equipment, testing reagents and qualified radiologists and pathologists at its diagnostic centres, contributes to the quality and accuracy of its test results. Its reports are peer-reviewed by independent third parties to further ensure the accuracy of its reports and results. All its diagnostic centres follow standard operating procedures to ensure standardization and quality compliance, which results in a consistent and efficient process.

Extensive footprint across India with robust infrastructure: KDL's network of diagnostic centres spans 13 states across India and as of June 30, 2021 was present in over 1,800 locations. It commenced operations in Fiscal 2011 with two radiology diagnostic centres and as of June 30, 2021, it has established 1,370 radiology diagnostic centres and 487 pathologies diagnostic centres including 443 collection centres. It has a significant presence in each state where it operates and as part of the diagnostic centres it establishes, it has deployed and operate diagnostic centres across multiple locations within a particular state. The Company attributes the growth of its diagnostic centres across India primarily to its ability to understand and analyse new markets and to its project management and execution capabilities. One of the key contributors to KDL's success in terms of accuracy, turnaround time and scale of operations is the advanced technology infrastructure that it implements as part of its operations. Its technology infrastructure is designed to support the growth of business and helps ensure reliability of its operations. Ability to deploy latest equipment and technologies ensure that its processes are efficient and scalable with minimal errors.

KDL has strong relationships with its equipment vendors which ensure timely deployment of machinery, advantageous asset pricing, fleet-wide maintenance and preferred vendor status with certain of its equipment suppliers. On account of its scale of operations, it is able to negotiate favorable terms for procurement of equipment from vendors. It is the largest customer of Wipro GE in Asia.

Business model with robust revenue visibility*:* KDL's operations across radiology and pathology provide with diversified sources of revenue. Its PPP agreements, to deploy diagnostic centres for radiology and pathology services are typically long-term contracts that ensure visibility of revenues for its operations. The term of contracts with public health agencies ranges between two years and 10 years and typically include a term extension clause based on performance and mutual agreement. Further, considering its services at competitive rates, public health agencies have expanded the coverage of the scope of its services to additional centres without any additional bidding process.

Pursuant to the terms of its PPP agreements, the medical facility typically provides rent-free space and access to its utilities and other infrastructure for installation and operations of diagnostic centres. Certain agreements also include price escalation clauses that allow KDL to revise the rates for its services periodically during the tenure of the contract. While a fresh competitive bidding process follows after the expiry of the term of the contract for a particular location, its existing spend on diagnostic equipment and infrastructure development allow it to bid competitively for such projects.

KDL's cost efficient operations also help it bid at competitive prices thereby allowing to convert more bids into projects. Its ability to ensure competitive pricing allows it to address regulatory price limits on tests that may be stipulated by the government to keep healthcare costs in check.

Well positioned to capitalize on healthcare spending across public and private sectors: The size of the diagnostic industry in India to be between Rs. 710 billion and Rs.730 billion in Fiscal 2021, clocking a CAGR of 13% to 14% between Fiscal 2017 and Fiscal 2020, mirroring the growth from healthcare delivery services. The industry is expected to grow at 14% and 17% and achieve a value of Rs.920 billion and Rs.980 billion between Fiscal 2020 and Fiscal 2023. Going forward, the government's share within the diagnostic industry is projected to grow at a CAGR of between 14% and 17% to Rs.125 billion - Rs.135 billion between Fiscal 2020 and Fiscal 2023, driven by government-led programs. The National Health Mission ("NHM") seeks to achieve universal access to equitable, affordable and quality health care services that are accountable and responsive to people's needs. Under the NHM, the PPP model has gained traction. The PPP model aids the expansion of quality healthcare services into less-developed and remote regions of the country.

Its track-record of executing PPP contracts across India with public health agencies to provide diagnostic services within public hospitals will ensure that it stands to benefit from such increased healthcare spending. Given its ability to deploy and operate diagnostic centres in tier II and tier III cities and towns, private players in the healthcare industry also engage to establish diagnostic centres in such areas within their existing facilities. As of June 30, 2021, KDL has established partnerships with six private medical colleges, 18 private tertiary hospitals and two private laboratories, reflecting its ability to provide quality diagnostic services in the private sector as well. As of March 31, 2019, 2020 and 2021 and as of June 30, 2021, it had 14, 17, 20 and 26 contracts with non-government customers to establish and operate diagnostic centres, respectively and generated Rs.585.74 million, Rs.699.93 million and Rs. 1,288.86 million in revenues from such contracts in Fiscal 2021.

Scalable and agile business model with efficient cost structure: KDL's operations across 13 states allow it to deploy new locations faster and efficiently. Its tele-reporting operations allow to centralize resources and ready-to-build locations make its operations scalable. It has deployed 1,797 diagnostic centres on a PPP basis, as of June 30, 2021. Its ability to establish and operate diagnostic centres across various segments and locations in India has contributed to its growth and leadership position in the Indian diagnostic industry. Its model also ensures that it do not pay any referral commissions to independent practitioners and private clinics, lower spend on marketing and promotions resulting in cost efficiency for its operations. KDL's existing large-scale operations has enabled to address diagnostic requirements on account of the COVID- 19 pandemic and as part of its response to the COVID-19 pandemic, its diagnostic centres has performed over 900,000 COVID-19 PCR tests in Fiscal 2021.

Consistent track record of financial performance*:* KDL is the fastest growing diagnostic chain in India in terms of operating income (amongst players with revenues exceeding Rs. 1,500 million), OPBDIT and profit after tax between Fiscal 2017 and Fiscal 2021 and volume of tests conducted and patients between Fiscal 2018 and Fiscal 2021. It has demonstrated consistent growth in terms of its revenues and Adjusted EBITDA over the years. In the last three Fiscals it has not incurred any write-offs and has or had any bad debts. It has witnessed consistent improvement in its balance sheet position in the last three Fiscals. Total assets have grown from Rs. 5,289.85 million as of March 31, 2019 to Rs. 6,299.82 million as of March 31, 2020 and were Rs. 6,045.30 million as of March 31, 2021. It has consistently generated positive cash flows from its operating activities which were Rs.582.66 million, Rs.378.09 million and Rs. 1,025.58 million in Fiscal 2019, 2020 and 2021, respectively. KDL's strong balance sheet position and healthy operating cash flows will enable to pursue growth opportunities and also fund its strategic initiatives.

Ability to maintain cost competitiveness through operating leverage: KDL operates diagnostic centres under a hospital partnership model, within public and private health care facilities. Under the hospital partnership model, it benefits from the captive patient base of such facilities and the large volume of diagnostics tests undertaken for these patients. The volume tests, KDL undertook between Fiscal 2018 and Fiscal 2021 grew at a CAGR of 20% which was the highest among amongst diagnostic companies with revenues exceeding Rs.1,500 million.

The Company's high diagnostics volumes in-turn help it enjoy economies of scale and thereby optimize operational costs, resulting in price competitiveness. Its ability to competitively price diagnostic services has enabled it to convert bids into actual contracts and is evident from its bid-win rate of 77.59% for tenders (by number) that it bid for since commencement of operations. KDL is, therefore, well positioned to withstand pressures on account of any pricing caps on diagnostic services that the government may mandate in the future to keep healthcare costs in check.

Experienced promoters and management team supported by strong employee base: KDL attribute its growth to the experience of its Promoter and senior management team. Its Promoter and Chairman, Rajendra Mutha, is a first generation entrepreneur and has over 10 years of experience in the field of pharmacy and diagnostics. Its senior management team has significant experience and has been with the Company collectively for over 30 years.

Business Strategy:

Continue to expand presence across India: KDL intends to continue to expand its network of diagnostic centres and services within India and in particular increase its presence in geographies where it is currently present. It intends to grow its network across all states in India by leveraging its experience of deploying and operating diagnostic centres. The scale of its operations, presence in tier II and tier III locations, ability to offer competitive pricing to customers, accuracy of diagnostic test results and service delivery including through tele-reporting coupled with brand-building activities will allow it to grow its customer base. It also intends to grow focus on the private sector across both business-to-business and business-to-consumer segment by partnering with more private sector healthcare providers, establishing standalone diagnostic centres, integrated brand building campaigns, raising awareness among doctors on the quality and comprehensive nature of its service offerings and focusing on customer experience and improvement.

Expand offering of diagnostic services with a focus on specialized diagnostics: Going forward KDL intends to enhance its capabilities in specialized diagnostic services such as molecular diagnostics and genomics. It can leverage its presence in multiple states, its extensive network of centres and advanced infrastructure to offer additional diagnostic services. Further, at its diagnostic centres where it offers radiology services, it intends to create additional infrastructure to offer pathology services as well. It also intends to expand capabilities at its existing diagnostic centres to provide a wide range of services including healthcare screening and chronic and lifestyle disease management services. It also intends to offer additional value added services, such as customer care services, home collection of specimens and home delivery of reports.

Grow digital footprint: KDL actively implement technologies for customer engagement, service provision and interaction with its vendors. It intends to increase its touch points and engagement with customers through various digital and technology initiatives. Certain of these measures include developing online initiatives such as bookings, receiving reports and availability of patient and family history as part of its mobile application and teleconsultation. It also intends to leverage its data analytics capabilities by creating an intelligent dashboard that will be able to analyse historical trends and provide more value-added services. The granularity of data available with the Company, both geographically and across various segments will enables it to develop and support artificial intelligence based solutions in radiology and pathology. It also intends to leverage its relationships with equipment vendors to ensure that it has access to advanced technologies. It plans to invest in implementing artificial intelligence and machine learning to be able to continue to provide quality and reliable diagnostic services at affordable prices.

Maintain high social impact: KDL intends to continue to grow its operations by increasing customer footfalls at its diagnostic centres. It intends to increase its branding and marketing initiatives to promote the Krsnaa brand further. It also intends to grow revenues by entering into additional contracts with private healthcare operators to establish diagnostic centres.

Continue to improve profitability and efficiency: In order to maintain profitability and owing to the highly competitive nature of the industry in which KDL operate, it is critical for it to rationalize its costs to improve margins. It proposes to explore vendor financing, whereby it intends to leverage its relationships with its equipment vendors to reduce financing costs of equipment. To increase efficiency of its operations, it intends to continue to upgrade its diagnostic equipment and technology. It intends to negotiate competitive rates with its equipment vendors for its diagnostic equipment and maintenance contracts. It also intends to source quality reagents at competitive rates given the volume of tests it offers and conduct.

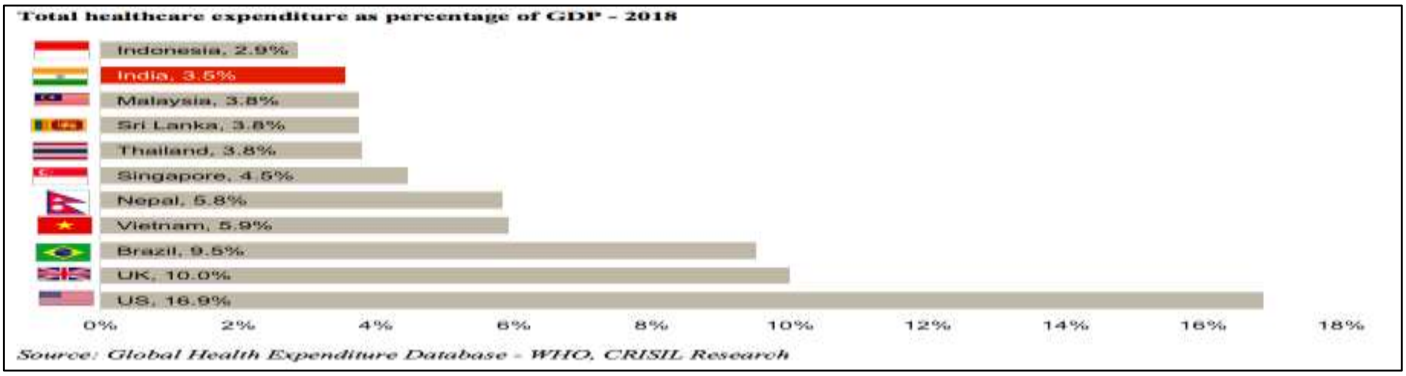
Expand business and geographical footprint through opportunistic acquisitions: KDL intends to augment its growth by pursuing selective acquisitions and strategic alliances that provides access to technology expertise, specialised services, market share and geographical reach and allow it to expand its offerings and grow customer base. It has historically expanded its business through organic growth only and intends to evaluate inorganic growth opportunities going forward. It may opportunistically consider acquisitions to selectively expand in the segments it operates. It intends on executing bolt-on acquisitions and expediting post-acquisition integrations through standardized protocols, IT infrastructure integrations, logistics, financial and equipment servicing capabilities.

Industry

Government Expenditure On Healthcare in India

Potential for public spending on healthcare services to increase over the coming years

Despite structural demand existing in the country and the potential opportunity it provides for growth, provision of healthcare in India is still riddled with challenges. Key challenges include inadequate health infrastructure and inequality in the quality of healthcare services provided based on affordability and financing.



Public healthcare expenditure in India is aiming to grow steadily from 1% to 2.5% - 3% of the GDP which can significantly reduce the out-of-pocket-expenditure from 65% to 35% of the overall healthcare spend. India's current healthcare expenditure is skewed more towards private as against public expenditure. Government expenditure on healthcare has remained range bound at 20% - 30% of the current healthcare expenditure from 2010 to 2018. The rest of the expenditure is private in nature (expenditure from resources with no government control such as voluntary health insurance and direct payments for health by corporations (profit, not-for-profit and non-governmental organisations) and households. However, the government aims to increase public healthcare expenditure to 2.5% of GDP from the current 1.2%, according to the National Health Policy - 2017. In Union Budget 2021 – 2022, allocation to healthcare (including grant to states) has seen an improvement but the increased fund is to tackle the immediate COVID-19 emergency and long-term continuation of such allocation needs to be monitored.

According to Global Health Expenditure Database compiled by WHO, India's expenditure on healthcare was 3.5% of GDP in calendar year 2018. India's nominal GDP in Fiscal 2018 was Rs.131.7 trillion (constant Fiscal 2012 prices). Accordingly, the current healthcare expenditure in India in Fiscal 2018 is estimated at around Rs.4.66 trillion. Though India's current healthcare expenditure has increased over the years, it is skewed towards private compared with public expenditure. Still, India's expenditure is less on account under-penetration of healthcare services and lower consumer spending on healthcare. Further, the share of public spending on healthcare services remains much lower than global peers. For example, India's per capita total expenditure on healthcare (at an international dollar rate, adjusted for purchasing-power parity) was only USD 73 in 2018 compared with USD 10,624 for the US, USD 4,315 for the UK and USD 2,824 for Singapore.

Government hospitals account for the highest share towards diagnostic in India

An analysis of the expenditure towards diagnostic reveals that these expenses form an average of approximately 10% across medical institutes and regions. The highest share of these spends is in urban government hospitals (approximately 19%). In the same category, it is approximately 16% and approximately 18% for rural and overall (urban rural combined) government hospitals. Diagnostic spends form nearly 9% of the average medical expenditure across rural in the charitable hospitals, private hospitals and the overall category.

Free diagnostic service initiative by the government of India aimed to strengthen availability and access to essential diagnostic facilities

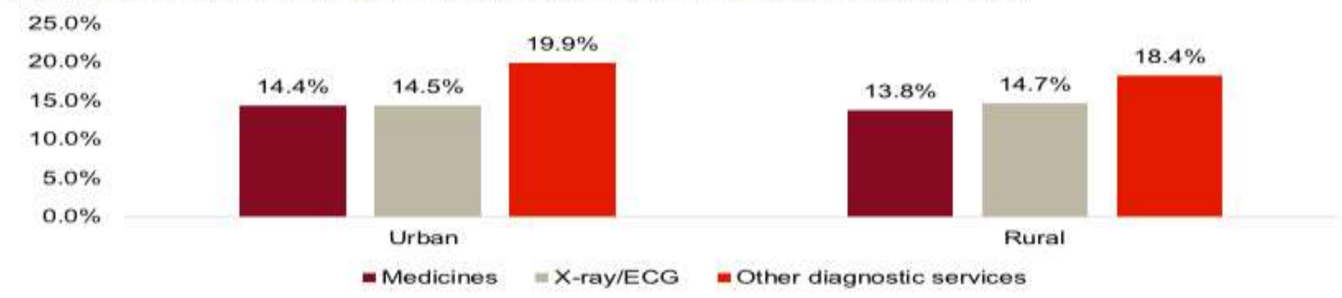
The Health Systems Strengthening Program is of special focus for the NHM. It involves the Free Diagnostic Service initiative which has been vital in boosting the PPP model in diagnostic. The scheme is also implemented through the in-house mode wherein the government set-ups and manages the diagnostic centre. The initiative was announced in the union budget of Fiscal 2015 to tackle the issue of high out-of-pocket expenses on diagnostic. The major objective of this initiative is to ensure availability and access to essential diagnostic tests at public health facilities in order to reduce direct costs and out of pocket expenditure incurred by economically weak patients.

The PPP Model and its Potential

Huge potential for PPP model diagnostics in an underpenetrated rural India

The National Sample Survey ("NSS") data on the percentage of cases that receive free medicines and diagnostic services, reveal that the statistics does not vary significantly between urban and rural areas. As per the NSS report, the percentage of cases receiving free medicines in urban areas is 14.4% and that in rural stood at 13.8%. However, the trend differs slightly for other diagnostic services as the percentage is higher for urban areas (19.9%) compared with rural (18.4%). This can be attributed to low penetration of diagnostic services in rural India. This offers a huge potential for government to get into partnerships with diagnostic players in order to tap the highly under penetrated rural areas of India.

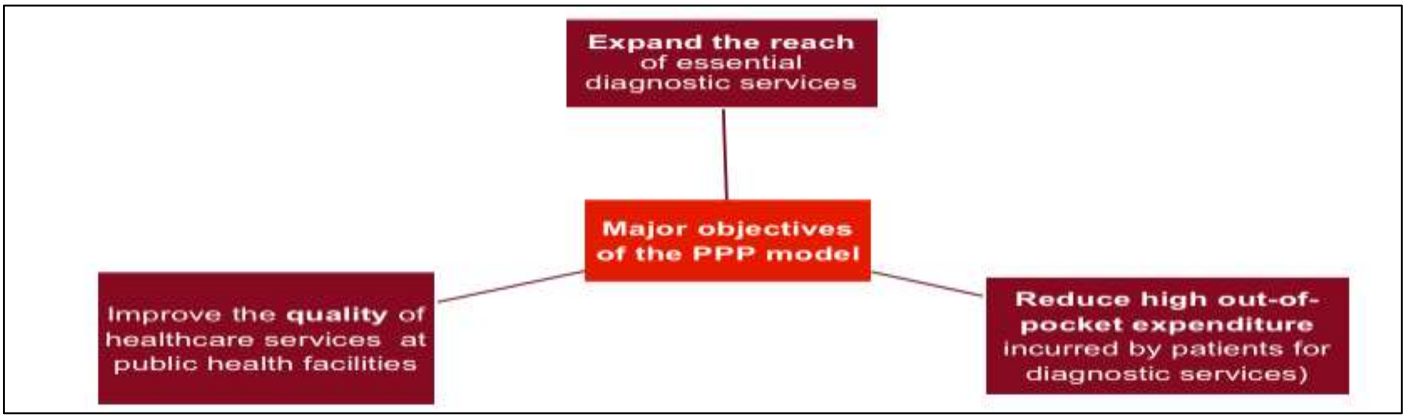
Percentage of cases receiving free medicines, X-ray/ECG and other diagnostic tests



Source: NSS Report (75th round), CRISIL Research

PPP model aims to expanding reach of services and reduce out-of-pocket expenditure

The government has realised the importance of private participation in the healthcare industry and hence, PPP models in diagnostic have gained traction over the past five years. The model is expected to see further growth as India focuses more on strengthening primary healthcare centres, increasing the number of health and wellness centres and making a policy shift towards preventive care from curative care.



The PPP model involves the development of a greenfield or brownfield diagnostic centre by the private player (service provider) across various hospitals in the country and, in certain cases, such a model involves the setting up of collection points in sub-centres, primary health centres, community health centres and other remote regions (hub-and-spoke model). The gamut of services provided by these centres involves both pathology and radiology. However, the service provider may only be involved in one aspect of the diagnostic services such as X-ray, CT scan or laboratory services. The physical premise for the development is provided by the authority and, largely, these PPP implementations are in existing hospitals and require improvement by the private player.

Growth Drivers for the PPP model

Apart from the fundamental factors that the healthcare delivery market is driven by, like conducive government policies, rising NCDs in the country, increasing share of aged population along with the other growth drivers such as rising health awareness, growing health insurance coverage and improving affordability, the PPP model thrives on growth drivers such as the below:

Growth drivers for the government-led (PPP model) diagnostic

Source: CRISIL Research

Increasing prevalence of central healthcare-related schemes

With the rising prevalence of central schemes like Ayushman Bharat, the shift seems likely, which will boost the PPP model in the diagnostic industry. The Prime Minister has also voiced his support for private sector participation in creating a network of public health laboratories under the AB-PMJAY scheme. The NITI Aayog has also come up with draft guidelines for a PPP model in healthcare that involve the private player designing, building, financing, operating and maintaining the medical college and also upgrading, operating and maintaining the associated district hospital.

The model helps reduce capital outlay by the government

As per obligations cited usually in PPP concession agreements, the private player has to procure, finance and undertake the planning, design, development, operation and maintenance of the diagnostic centre. It also involves gaining appropriate proprietary rights, licences, agreements and permissions for materials, methods, processes, and systems which are to be incorporated at the centre, at the expense of the private player. The PPP model defers immediate capital expenditure on the part of the government, and hence, the authorities can manage their budgetary allocations more effectively. The private player gets reimbursed on a timely basis as per its performance over the course of the concession period.

Adoption by more states and municipal corporations

Health comes under the state list and hence, most of the development in the PPP model of diagnostic has been through state government initiatives. The PPP model has gained traction with the pushing of the NHM’s Free Diagnostic Initiative. The scheme involves strengthening the diagnostic capabilities and reach of government facilities via the PPP model or in-house. Either way, the private player is involved in the process. Not only states but even municipal corporations are taking advantage of PPP model to boost their healthcare goals.

PPP model to link new or existing private medical colleges with functional district hospital

To address the shortage of qualified doctors and improve the medical education infrastructure, NITI Aayog proposed the PPP model to link new or existing private medical colleges with functional district hospitals to augment medical seats. Under this envisioned model, a concessionaire will design, build, finance, operate and maintain the medical college and also upgrade, operate and maintain the associated district hospital with a minimum annual student intake of 150 MBBS seats. The concessionaire will provide all healthcare services to patients free of cost after the beneficiaries pay the registration fee of Rs.10. The scheme, if implemented, will further boost opportunities for diagnostic service providers to facilitate required services under the PPP model. This is because the model concession agreement also aims to provide free/cheap diagnostic services to patients covered under the Ayushman Bharat Yojana or any other state insurance scheme.

COVID-19 has acted as a boost for the PPP scheme

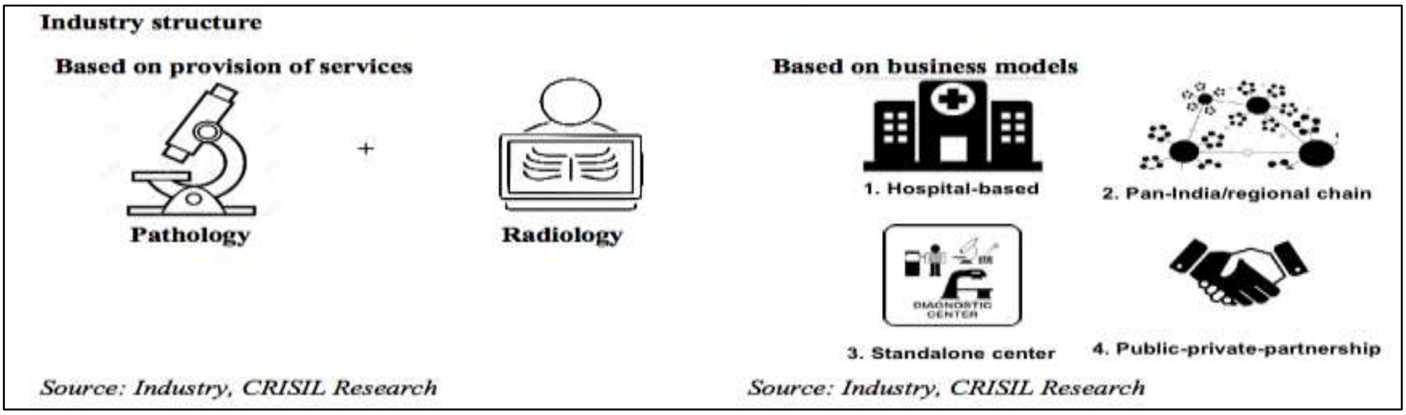
The COVID-19 pandemic has also highlighted the importance of private participation in diagnostic. To ramp up the testing for COVID-19, the government of Karnataka announced the establishment of RT-PCR labs under the PPP model and has set targets to expedite testing by 3 times. The country saw opening of new labs to tackle the rising volume of testing requirements and to incorporate swiftness in result delivery. One such lab, Krsnaa Diagnostics, was set up in Kalyan, Maharashtra under the PPP model, with capacity of approximately 3,000 tests per day.

Recent Trends in PPP Model across States in India

As of February 2020, under the Free Diagnostic Initiative, Jammu and Kashmir announced implementation of teleradiology services, in agreement with Krsnaa Diagnostics. As of January 2020, Punjab also expressed plans for a hub and spoke PPP model to set up diagnostic facilities across civil hospitals the tender for which has been won by Krsnaa Diagnostics. Around September 2019, Uttar Pradesh announced plans for setting up 500 diagnostic centres under this model where HLL Lifecare and Krsnaa Diagnostics are present. The state of Jharkhand had also proposed the implementation of diagnostic centres across 24 districts and three medical colleges. The private players in this PPP project in Jharkhand are Healthmap Diagnostics, SRL Ltd and Medall Healthcare. Karnataka also has a PPP model in place for diagnostic. As of January 2020, Karnataka had CT scan services in 14 district hospitals, MRI facilities in six district hospitals, and radiology services in one medical college (Vijayapura) under the PPP model with Krsnaa Diagnostics.

Assessment of The Indian Diagnostic Industry

Structure and business models of the diagnostic industry in India



Hospital-based Diagnostic Centres

Usually, secondary and tertiary hospitals have their own pathology labs and radiology centres in-house, but some outsource the management of their diagnostic facilities to third-party players. Major hospital chains such as Apollo, HCG, Max, Fortis, etc., have their diagnostic arm, which caters to their requirements. Generally, hospitals prefer to outsource their tests rather than set up an in-house laboratory testing facility. Tertiary hospitals, which may not have the equipment to conduct advanced tests, may also send samples to other high-end labs. Given that equipment for advanced tests is expensive, many hospitals find it economically unviable to operate them owing to low testing volume.

Diagnostic Chains

Diagnostic chains like Dr Lal PathLabs, Krsnaa Diagnostics, Metropolis, SRL Diagnostic and Thyrocare are present either in a specific region/geography or have multi-regional presence and offer either or both pathology and radiology services. There are also prominent regional chains spread across different geographies, such as Vijaya Diagnostic, Medall Healthcare, Suraksha Diagnostic, Suburban Diagnostic, Aarthi Scans, etc, which have been successful in creating a space and brand resonance for themselves. Diagnostic chains adopt a hub-and-spoke model (usually for pathology-centric services), helping them increase their catchment area. Tele-reporting is another new technology offering which has helped increase coverage of players as it provides scope for reporting from any corner of the country. Specialised testing has seen many new entrants such as iGenetics, CORE Diagnostic, etc., since substantial growth is expected in this area owing to the shift in disease epidemiology in the country.

Standalone Centres

Standalone diagnostic centres, which have a single centre, make up for 45-50% share of the market. Low entry barriers and the absence of stringent regulations have helped small pathology labs and radiology centres proliferate. They carry out basic tests that require minimal investment and space and typically have a conventional X-ray and an ultrasound machine.

Other Business Models in the Diagnostic Industry in India

Different business models are being introduced in the diagnostic industry. These are hospital partnerships, PPP model, aggregator model, chained model (via franchisee), players with focus only on niche tests, etc. Diagnostic chains provide a bouquet of services to a diversified clientele, process samples from smaller hospitals and diagnostic centres, and offer corporate wellness programmes. Players such as Healthians operate more on an aggregator-based model, controlling the logistics and quality with partner labs.

Government-led (PPP model) diagnostic is an emerging trend in the country

The government-led (PPP model) diagnostic involves diagnostic players entering into a public-private-partnership agreement with the government to provide specific diagnostic services (pathology, radiology or both) for a specific concession period at predefined rates. The government-led PPP model for diagnostic is meant to improve health facilities and facilitate accessible healthcare to all, especially to the bottom of the pyramid. In a PPP model, government contributions can vary from providing land lease, upfront capital infusion, to giving financial concessions on the capital infused by the private players, rent-free land and captive customers. Players with established track records and most competitive prices have the chances of winning such PPP tenders. As a provider, the government can contribute towards building infrastructure and managing operations of hospitals and diagnostic centres and, as a payer, it can pay for healthcare services provided by the private sector. The concession period for such agreements is generally long term, for a duration of 10 years. Entities such as Krsnaa Diagnostics operate primarily on a PPP model, which represents a market opportunity of Rs.95 billion to Rs.100 billion as of Fiscal 2021. Players who have multi-regional presence and players who have a regional presence are also involved in the PPP model. Amongst these players, Krsnaa Diagnostics has the largest presence in the diagnostic PPP space in India.

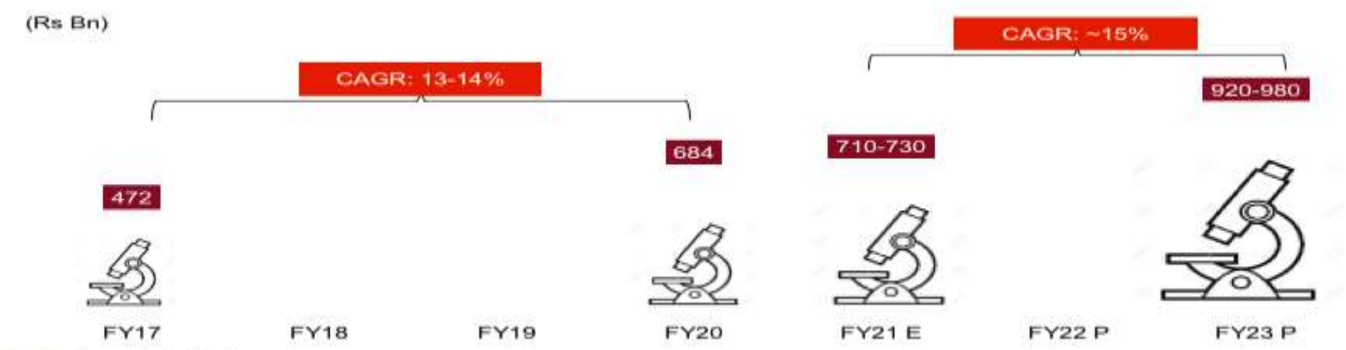
Hospital-partnership model an emerging trend for the radiology business

From a radiology business perspective, the hub and spoke model works for player who have multiple centres in a region. In recent times, the hospital-partnership model is an emerging model for radiology players. In this model a hospital typically refers its patients to a radiology player which they have tied-up with. The model gives hospitals an opportunity to reduce their capital outlay towards in-house radiology equipment, offers hospitals better managed services and helps go away with maintenance cost towards radiology equipment too. It also aids hospitals with quality output without having to employ dedicated professionals to run the services for them. Since diagnostic companies have a singular focus they are able to provide better service thereby ensuring better footfalls which in turn also helps generate more footfalls for the hospitals. Diagnostic companies not only get an advantage of the hospital’s captive footfalls but also help them attain a brand image since they get an opportunity to cater to a large audience. This partnership model also enables a diagnostic to cut down/avoid real estate related expenses in cases where a diagnostic company establishes its service within the hospital premise itself. In such cases the diagnostic company enters into a revenue sharing model with the hospital. The revenue sharing model bodes well for the diagnostic company as the hospital takes an equal responsibility of footfalls.

Market Size of the Indian Diagnostic Industry

The Indian diagnostic industry has grown consistently over the past three fiscals and is projected to grow at a CAGR of approximately 15% between fiscals 2021 and 2023 The size of the diagnostic industry is estimated to be approximately Rs.710 billion to Rs.730 billion in Fiscal 2021, registering a healthy CAGR of 13% to 14%, echoing the growth from healthcare delivery services, over Fiscal 2017’s industry size of approximately Rs.472 billion. The industry is expected to grow at approximately 15% and achieve a value of Rs.920 billion to Rs.980 billion in Fiscal 2023 (gaining a gentle push from government expenditure on testing).

Indian diagnostic industry outlook holds potential for medium term



E: Estimated; P: Projected

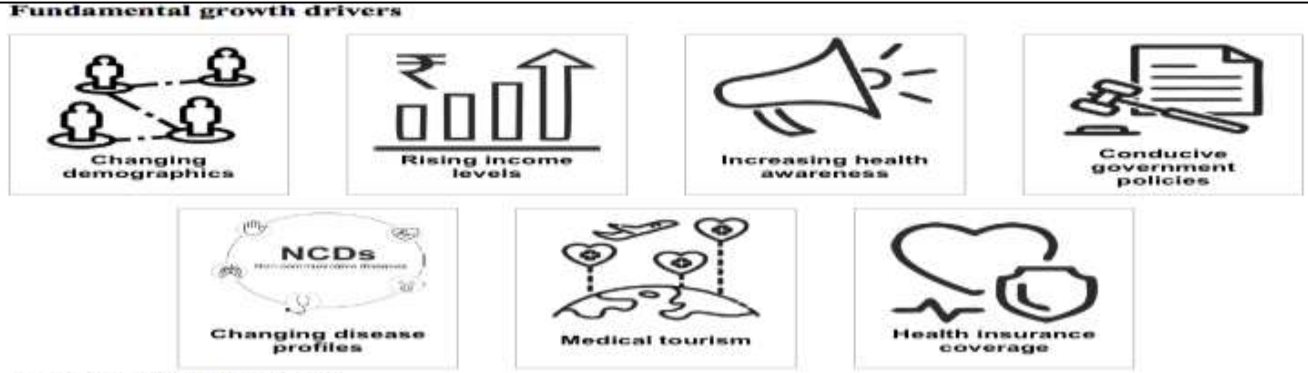
Source: CRISIL Research

There was a significant decline in revenue in April and May 2020, however, the demand experienced a certain amount of revival from June 2020. The pending demand of healthcare contributed to revenues during a traditionally lean quarter from the diagnostic perspective. There was a recovery to pre-COVID-19 levels in the third quarter, with a shift towards specialised testing, increased home collection business and business to customers (B2C). However, a robust medium-term growth is expected going forward, both from an increase in demand for in-patient treatments (who get treated while being admitted in a hospital) and out-patients (non-hospitalised treatments, including consultancy and day surgeries at hospitals). Moreover, as literacy rates and disposable incomes rise, individuals increasingly demand better healthcare facilities and quality of care, leading to high volume growth of in-patients and out-patient treatments. The rise in healthcare demand has also received a lift from the increase in urbanisation and lifestyle-related diseases, such as cardiac diseases, diabetes and cancer, prompting many healthcare-service providers to enhance their offerings in metropolitan areas and Tier-I and II cities.

COVID-19 has been a growth boost for private labs and PPP players:

While regular business took a backseat during the first half of Fiscal 2021, COVID-19 testing helped larger players. Large pan-India chain players disclosures revealed that most players were able to revive non-COVID-19 revenues by the second and third quarter of Fiscal 2021. However, the second wave caused a re-emergence of COVID-19 test in the fourth quarter of Fiscal 2021 for most players. Average realisation per test and per patient witnessed a declining trend in Fiscal 2021 primarily due to reduction in COVID-19 test pricing across various states in India. Indian Council of Medical Research ("**ICMR**") has approved approximately 1,457 private labs for COVID-19 testing as of July 14, 2021). With the requisite permission from ICMR to venture into COVID-19 testing, these are large accredited labs who have reverse transcription polymerase chain reaction ("RT-PCR") testing capabilities, leaving small labs with minimal revenue during these times.

Fundamental growth drivers and risks for the diagnostic industry in India

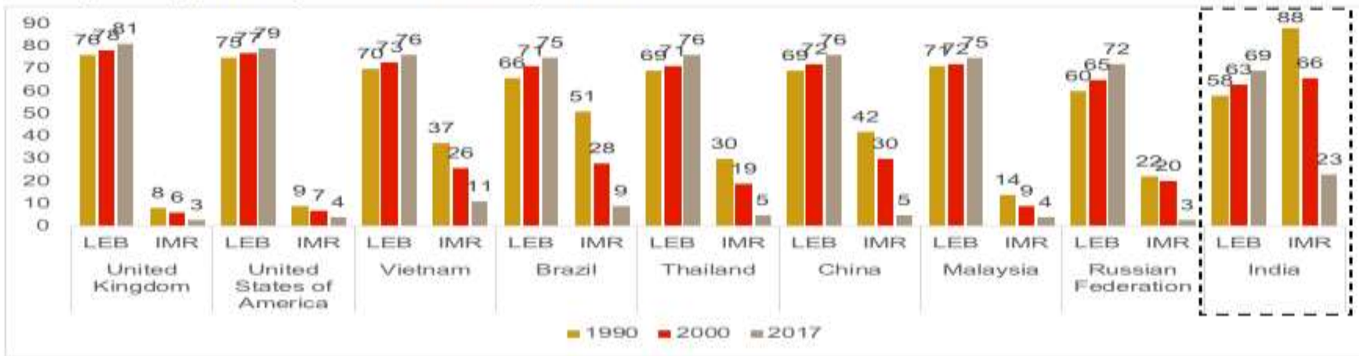


Source: CRISIL Research

A combination of economic and demographic factors is expected to drive healthcare demand in India. The Ayushman Bharat Pradhan Mantri Jan Arogya Yojana ("**PMJAY**") scheme launched by the Government would also support these drivers in the long term. Health and wellness packages focussing on preventive healthcare amid rising NCD-related deaths are likely to fuel demand for healthcare services in general, and diagnostic services in particular. NCDs are believed to exhibit a tendency to increase along with rising income levels. Moreover, the WHO projects an increase in NCDs by 2030. The demand for healthcare services associated with lifestyle-related diseases such as cardiac ailments, cancer and diabetes to increase, is forecasted to likely be the driving force for the Indian diagnostic industry.

With improving life expectancy, the demographic of the country is also experiencing a change. As of December 31, 2011, approximately 8% of the Indian population was of 60 years or more, and this is expected to increase to 12.5% by 2026. Higher vulnerability of this age group to health-related issues is an accepted fact.

Life expectancy (at birth) and infant mortality rate: India vs other

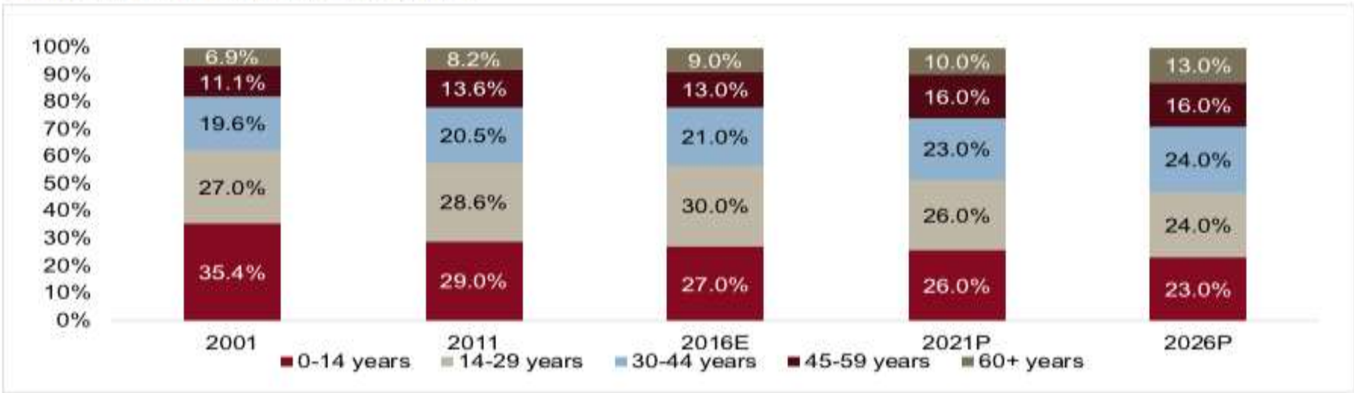


Note: LEB – Life expectancy at birth; IMR – Infant mortality rate (probability of dying by age of 1 per 1000 live births)

Source: WHO World Health Statistics 2020

According to the Report on Status of Elderly in Select States of India, 2011, published by the United Nations Population Fund ('UNFPA') in November 2012, chronic ailments, such as arthritis, hypertension, diabetes, asthma, and heart diseases, were commonplace among the elderly, with approximately 66% of the respective population reporting at least one of these. In terms of gender-based tendencies, while men are more likely to suffer from heart, renal and skin diseases, women showed higher tendencies of contracting arthritis, hypertension, and osteoporosis.

Population in 60+ age group to grow faster



Source: Census, CRISIL Research

With the Indian population is expected to grow to approximately 1.4 billion by 2026 and, considering the abovementioned factors, the need to ensure healthcare services to this vast populace is an imperative which provides a huge opportunity to expand into a space that bears huge potential. Rising income levels to make quality healthcare services more affordable and preferred Growth in household incomes and, consequently, disposable incomes are critical to the overall growth in demand for healthcare delivery services in India. The share of households falling in the income bracket above Rs.0.2 million is expected to go up to 35% in Fiscal 2022 from 23% in Fiscal 2017, providing potential target segment (with more paying capacity) for hospitals. The rising income levels also fares in favour of diagnostic industry. As income levels increase, it emphasises higher spending on preventive and wellness tests, and accordingly, is expected to turn out to be beneficial for the diagnostic industry. Increasing health awareness to boost the hospitalisation rate and preventive and wellness tests With increasing urbanisation (migration of population from rural to urban areas), awareness among the general populace regarding presence and availability of healthcare services for both preventive and curative care is expected to increase. The hospitalisation rate for in-patient treatment as well as walk-in out-patients is expected to improve with increased urbanisation and increasing literacy, and therefore, paving way for the growth of diagnostic industry as well. With increase in penetration to rural India through various Government schemes and programmes, the opportunity for players involved in PPP shall also increase significantly going forward. Union Budget allocation towards healthcare experienced a growth at a CAGR of 11% between Fiscals 2011 to 2022.

The healthcare budget has experienced increases year-on-year. Between Fiscals 2011 and 2022, the budget for the MoHFW registered a growth at a CAGR of 11%. In recent years, the utilisation rate has been 100% or above, as has been the case since Fiscal 2016. This is also a strong growth driver for the industry and particularly the PPP initiative from Government in order to achieve the Government's goal of providing healthcare services to all.

Key Concerns:

- A substantial portion of the revenue from operations depends on payments under contracts with public health agencies. If KDL is unable to negotiate and retain similar fee arrangements, if the contracts are cancelled, or if it is unable to realize payments due to it, its business may be materially and adversely affected.

- Most of KDL' diagnostic centres have been established and are operated under public private partnership contracts awarded by government agencies through a competitive bidding process. There can be no assurance that KDL will qualify for, or that it will successfully compete and win such tenders.

- The COVID-19 pandemic may significantly affect the results of operations, financial position and cash flows.

- Rely on information technology systems and the telecommunication network in India in providing diagnostic services and managing operations, and any disruption to such systems or networks could adversely affect the business operations, reputation and financial performance.

- Business interruption at KDL' diagnostic centres and its tele-radiology reporting hub could result in significant losses and reputational damage to its business.

- The prices that KDL can charge for its diagnostic services are dependent on recommended or mandatory fees fixed under the terms of the agreements entered into with public and private healthcare providers.

- Derives substantial portion of its revenue from the states of Maharashtra, Rajasthan and Karnataka, and any loss of business in such regions could have an adverse effect on the business, results of operations and financial condition.

- Delays in the establishment of diagnostic centres could lead to termination of the agreements or cost overruns, which could have an adverse effect on the cash flows, business, results of operations and financial condition.

- KDL is required to furnish bank guarantees as part of its business. Inability to arrange such guarantees or the invocation of such guarantees may adversely affect the cash flows and financial condition.

- Business is capital intensive. If it experiences insufficient cash flows from its operations or are unable to borrow to meet capital requirements, it may materially and adversely affect the business and results of operations.

- KDL is subject to numerous legal and regulatory requirements governing its activities, and if it fails to comply with such requirements, it may face substantial fines and penalties, which could have a material adverse effect on the business, financial condition and results of operations.

- Any inadequacy in packaging, collection of, or failure or delay in the delivery of, specimens to its diagnostic centres could compromise or destroy the integrity of such specimens, which could adversely affect its business, results of operations and financial condition.

- Failure to establish and comply with appropriate quality standards when performing imaging, testing and diagnostics services could result in litigation and liability for KDL and could materially and adversely affect its reputation and results of operations.

- Relies on third parties for certain aspects of KDL's operations, and any deficiency in services provided by them could adversely affect the business and reputation.

- Require certain approvals, licenses, registrations and permits for conducting business and inability to obtain, retain or renew them in a timely manner, or at all, may adversely affect the business, results of operations and financial condition.

- The diagnostics industry in India is highly competitive and inability to compete effectively may adversely affect the business, results of operations and financial condition.

- KD: may be unable to retain or recruit trained professionals, which may adversely impact the reputation of the brand and materially and adversely affect the results of operations and cash flows.

- Depends on third-parties to provide testing equipment and reagents, and any failure to continue to do so or recall of existing testing equipment and reagents could adversely affect the business, results of operations and financial condition.

- Disruption to or failure of transportation services for samples or test kits and other materials could materially and adversely affect the business and financial results.

- Some of KDL' diagnostic centres are required, and other diagnostic centres may be required in the future, to provide free or subsidised diagnostic services to patients belonging to economically disadvantaged sections of the society and certain other patients.

- KDL may be subject to liabilities and negative publicity arising from the risks of providing diagnostic services including those resulting from claims of malpractice and medical negligence.

- Failure to introduce new tests, services, equipment and technologies could adversely affect the business, results of operations and financial condition.

- Technological advancement may lead to more cost-effective technologies or non-invasive diagnostic healthcare tests that can be performed without the use of specialized diagnostic healthcare service centres or laboratories, which could adversely affect KDL's business, financial condition, results of operations and cash flows.

- Employee misconduct or failure of internal processes or procedures could harm KDL by impairing its ability to attract and retain patients and subject it to significant legal liability and reputational harm.

- Failure or malfunction of KDL's equipment could adversely affect the ability to conduct its operations.
- Financial difficulties of patients or third-party payers may result in payment delays or require it to write off debts.
- KDL could be exposed to risks relating to the handling of personal information, including medical data.
- The Company is subject to risks associated with expansion into new geographic regions.
- The loss of accreditation required to operate one or more of KDL' diagnostic centres could impact its revenues and also damage its reputation.
- KDL's operations are human capital intensive and its operations may be materially adversely affected by strikes, work stoppages or increased wage demands by its employees.
- Significantly dependent on the patients and customers of the healthcare facilities within which it deploys and operates its diagnostic centres. A failure to obtain and retain new customers by such facilities or the loss of existing customers could impact the ability to successfully grow its business.
- Inability to protect or use intellectual property rights or comply with intellectual property rights of others may adversely affect the business.
- KDL may be unable to successfully implement or manage its growth strategy.
- KDL's business and prospects may be adversely affected if it is unable to maintain and grow its brand image.
- KDL is are subject to risks arising from interest rate and foreign currency exchange rate fluctuations, which could adversely affect the business, financial condition and results of operations.
- Various challenges currently faced by the healthcare industry in India may also adversely affect the business, results of operations and financial condition.
- Faces significant competition from standalone diagnostic centres.
- Dependent on government policies and budget allocations for diagnostic centres that it intends to establish in future and its overall growth.
- Fluctuation in the exchange rate between the Indian Rupee and foreign currencies may have an adverse effect on the value of Equity Shares, independent of its operating results.

Profit & Loss

Particulars (Rs in million)	FY21	FY20	FY19
Revenue from Operations	3964.6	2584.3	2092.4
Gain on fair value movement of compulsory convertible preference shares	2527.8	0.0	0.0
Other Income	122.4	129.5	50.8
Total Income	**6614.8**	**2713.8**	**2143.2**
Total Expenditure	**3026.5**	**3726.4**	**2468.3**
Cost of materials consumed	837.5	277.2	173.4
Fees to hospitals and others	1082.0	755.3	623.2
Loss on fair value movement of compulsory convertible preference shares	0.0	1770.3	955.2
Employee benefits expense	295.9	231.3	183.0
Other expenses	811.1	692.2	533.5
PBIDT	**3588.3**	**-1012.6**	**-325.2**
Interest	259.4	246.6	195.7
PBDT	**3328.9**	**-1259.2**	**-520.9**
Depreciation and amortization	374.4	324.1	256.4
PBT	**2954.5**	**-1583.3**	**-777.3**
Tax (incl. DT & FBT)	**1105.2**	**-463.8**	**-196.7**
Current tax	76.5	21.9	39.2
Deferred Tax	1028.8	-485.7	-235.9
PAT	**1849.3**	**-1119.5**	**-580.6**

EPS (Rs.)	320.70	-216.94	-120.28
Diluted EPS post-split Rs.	24.51	-216.94	-120.28
Equity Share Capital	65.0	51.6	51.6
OPM (%)	87.4	-44.2	-18.0
PATM (%)	46.6	-43.3	-27.7

(Source: RHP)

Balance Sheet

Particulars (Rs in million) As at	FY21	FY20	FY19
Assets			
Non-current assets			
Property, plant and equipment	3072.8	2735.8	2223.9
Right-of-use assets			
Capital work-in-progress	37.2	91.3	416.6
Intangible Assets	12.3	15.1	7.0
Intangible Asset Under Development	0.0	0.0	1.3
Financial assets			
- Investments	2.9	2.9	2.9
- Loans	135.4	104.3	55.6
- Other financial assets	24.1	60.2	146.5
Deferred tax assets (net)	0.0	921.7	435.8
Other non-current assets	279.2	232.1	114.4
Total non-current assets	**3563.9**	**4163.5**	**3404.0**
Current assets			
Inventories	72.1	50.7	42.1
Financial assets			
- Trade Receivables	724.7	614.3	562.2
- Cash and cash equivalents	246.8	83.6	86.0
- Bank balances other than Cash and cash equivalents	1282.4	1189.2	1030.2
- Other financial assets	90.1	183.6	137.7
Other current assets	65.3	14.9	27.6
Total current assets	**2481.4**	**2136.3**	**1885.9**
Total assets	**6045.3**	**6299.8**	**5289.9**
Equity and Liabilities			
Equity			
Equity Share Capital	65.0	51.6	51.6
Instruments entirely equity in nature	2423.9	150.2	150.2
Other equity	-170.2	-2171.6	-1051.1
Total equity	**2318.7**	**-1969.8**	**-849.2**
Liabilities			
Non-current liabilities			
Financial liabilities			
- Borrowings	1679.5	1227.1	920.2
- Liability on compulsory convertible preference shares	0.0	4951.8	3181.4
- Other financial liabilities	63.9	233.5	251.4
Employee benefit obligations	5.2	3.2	1.6
Other non-current liabilities	33.0	46.0	51.2
Deferred tax liabilities	107.0	0.0	0.0
Total non-current liabilities	**1888.6**	**6461.6**	**4405.8**
Current liabilities			
Financial liabilities			
- Borrowings	347.4	922.8	539.6
- Trade payables			
total outstanding dues of micro enterprises and small enterprises	5.4	3.4	0.8
total outstanding dues of creditors other than micro enterprises and small enterprises	780.2	377.5	416.5
Other financial liabilities	665.5	479.4	746.3
Employee benefit obligations	9.3	7.2	5.5
Other current liabilities	30.2	17.7	24.6
Total current liabilities	**1838.1**	**1808.0**	**1733.2**
Total equity and liabilities	**6045.3**	**6299.8**	**5289.9**

(Source: RHP)

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600
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