10 February 2024

3QFY24 Results Update | Sector: Retail

Sapphire Foods

Estimate changes	↓
TP change	↓
Rating change	↔

Bloomberg	SAPPHIRE IN
Equity Shares (m)	64
M.Cap.(INRb)/(USDb)	87.9 / 1.1
52-Week Range (INR)	1568 / 1120
1, 6, 12 Rel. Per (%)	-1/-11/-13
12M Avg Val (INR M)	200

Financials & Valuations (INR b)

Y/E Mar	2024E	2025E	2026E
Sales	26.1	30.6	36.0
Sales Gr. (%)	15.2	17.3	17.5
EBITDA	4.8	5.8	7.0
Margins (%)	18.6	18.9	19.5
Adj. PAT	0.7	1.0	1.6
Adj. EPS (INR)	10.4	15.9	25.4
EPS Gr. (%)	-39.5	52.7	60.3
BV/Sh.(INR)	213.5	240.6	281.3
Ratios			
RoE (%)	5.1	7.0	9.7
RoCE (%)	6.1	7.0	8.5
Valuations			
P/E (x)	132.7	86.9	54.2
P/BV (x)	6.5	5.7	4.9
EV/Sales (x)	3.7	3.1	2.3
Pre Ind-AS EV/EBITDA (x)	30.3	23.5	18.1

Shareholding pattern (%)

As On	Dec-23	Sep-23	Dec-22
Promoter	31.3	41.7	44.9
DII	31.7	28.0	25.0
FII	30.0	23.7	16.5
Others	7.0	6.9	13.6

FII Includes depository receipts

CMP: INR1,379 TP: INR1,600 (+16%) Buy

Strong delivery in KFC; demand challenges persist

- Sapphire Foods (Sapphire) reported 11.6% YoY revenue growth in 3QFY24, despite 18% store growth. Underlying growth metrics (ADS, SSSG) remained weak, but Sapphire's KFC performance (SSSG, ROM) was better than Devyani's.
- **KFC:** Same-store sales declined 2% (flat in 2Q) vs. a 5% drop for Devyani. ROM was healthy at 20% (flat YoY, +90bp QoQ) vs. Devyani's 19% (-70bp YoY).
- **PH**: Performance further deteriorated, with same-store sales down 19% (-20% in 2Q) compared to a 13% decline for Devyani. Rising competition pressure has been impacting PH's unit economics. ROM was 4.6% (-950bp YoY, -300bp QoQ) vs. Devyani's 6% (down 800bp YoY).
- The QSR industry continues to see weakness in unit economics of both dine-in and delivery formats. KFC has been managing the headwinds more effectively, while PH has been struggling due to weak unit economics and intense competition. The company's store expansion spree is expected to slow down in FY25 (mainly in PH) to fix the profitability metrics. We maintain our cautious stance on QSR for the near term due to the ongoing demand challenges. The stock trades at 23x/18x Pre Ind-AS EV/EBITDA on FY25E/FY26E (moderate vs. QSR peers). We reiterate **our BUY rating on the stock with a TP of INR1,600**.

KFC delivers well in challenging period

- **Sluggish growth metrics:** Consolidated sales grew 11.6% YoY to INR6.7b, KFC grew 16% YoY, while PH declined 4%. Store growth was healthy at 18%, the company added 36 stores (25 KFC, 8 PH, 3 others) to 850 stores. ADS of KFC was down 8% YoY at INR125k (flat YoY), while ADS of PH was down 22% YoY at INR45k (much lower than INR80k for Domino's).
- **Expect slower store addition in FY25**: Sapphire added 107 stores in 9MFY24 (65 KFC, 33 PH, 9 others) after adding 164 stores in FY23. KFC store addition would continue at the same pace in FY25, but PH store addition would slow as the management aims to fix ADS and profitability for the existing store network. We model overall ~90 store addition in FY25.
- **Weak margin print**: Consolidated GM improved 180bp YoY/10bp QoQ to 68.9% and GP was up 15% YoY at INR 4.6b. EBITDA rose 4% YoY to INR1.2b, while margins contracted 130bp YoY to 18.3%. PBT (better metric post IND AS) declined 58% YoY, PBT margin stood at 2% (vs. Devyani's 1% and Jubilant's 6%). We model PBT margin of 4%/6% in FY25/FY26.

Highlights from the management commentary

- The macro environment remains tough for the QSR category. The company will slow down its store expansion pace but continue to invest in refurbishments to maintain the customer experience.

Naveen Trivedi – Research Analyst (Naveen.Trivedi@MotilalOswal.com

Research Analyst: Pratik Prajapati (Pratik.Prajapati@MotilalOswal.com) | **Tanu Jindal** (Tanu.Jindal@MotilalOswal.com)

- KFC store expansion will be steady; however, PH store expansion will be muted in FY25 as the company focuses on ADS and profitability.
- Sapphire recognizes that in a highly competitive space, it must make more efforts on PH to revive consumer interest.
- KFC can sustain ~20% ROM if demand does not decelerate further.
- For PH, the growth rate is slowing down as the company is planning to double the store count in four years rather than in three years; targeting to close only 3-5% non-performing stores; and refurbishing restaurants to enhance the customer experience.

Valuation and view

- We cut our FY25/FY26 EPS estimates by 35%/42% as we expect weak unit economics and a longer slowdown impact on growth and profitability.
- Sapphire added 107 stores in 9MFY24 (65 KFC, 33 PH, 9 others) after adding 164 stores in FY23. KFC store addition will sustain in FY25 but PH store addition will be muted as the management plans to fix ADS and profitability for the current network. We model combined ~200 stores addition during FY25 and FY26.
- PBT (better metric post IND AS) declined 58% YoY, PBT margin stood at 2% (vs. Devyani's at 1% and Jubilant's 6%) in 3Q. We do not see near-term respite in profitability; however, with a gradual stability in growth metrics in FY25, we expect better unit economics. A higher mix of KFC would also improve PBT margin for Sapphire in FY25 and FY26. We model PBT margin of 4%/6% in FY25/FY26.
- The QSR industry continues to see weakness in unit economics in both dine-in and delivery formats. KFC has been managing the headwinds more effectively, while PH has been struggling due to weak unit economics and intense competition. Sapphire's store expansion spree is expected to slow in FY25 (mainly in PH) to fix profitability metrics. We maintain our cautious stance on QSR for the near term due to the ongoing demand challenges. The stock trades at 23x/18x Pre Ind-AS EV/EBITDA on FY25E/FY26E (moderate vs. QSR peers). **Retain our BUY rating on the stock on with a TP of INR1,600 (22x FY26E Pre Ind-AS EV/EBITDA)**.

Quarterly Performance (INR m)

Y/E March	FY23				FY24E				FY23	FY24E	FY24	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			3Q	(%)
KFC - No. of stores	281	301	325	341	358	381	406	426	341	426	401	
PH - No. of stores	235	249	274	286	302	311	319	326	286	326	319	
KFC - SSSG (%)	65.0	15.0	3.0	2.0	0.0	0.0	-2.0	-2.0	15	-1.0	0.0	
PH - SSSG (%)	47.0	23.0	-4.0	-4.0	-9.0	-20.0	-19.0	-12.0	12	-15.0	-15.0	
Net Sales	**5,463**	**5,628**	**5,961**	**5,604**	**6,544**	**6,426**	**6,656**	**6,477**	**22,656**	**26,103**	**6,763**	-1.6
YoY change (%)	80.3	35.9	17.5	12.8	19.8	14.2	11.6	15.6	31.6	15.2	13.5	
Gross Profit	**3,707**	**3,737**	**3,998**	**3,807**	**4,483**	**4,417**	**4,583**	**4,461**	**15,249**	**17,944**	**4,638**	-1.2
Margin (%)	67.9	66.4	67.1	67.9	68.5	68.7	68.9	68.9	67.3	68.7	68.6	
EBITDA	**1,104**	**1,032**	**1,167**	**981**	**1,214**	**1,151**	**1,217**	**1,264**	**4,284**	**4,847**	**1,240**	-1.8
EBITDA growth %	223.9	82.2	1.9	-1.7	10.0	11.6	4.3	28.8	40.4	13.1	6.3	
Margin (%)	20.2	18.3	19.6	17.5	18.6	17.9	18.3	19.5	18.9	18.6	18.3	
Depreciation	609	628	681	724	727	768	874	877	2,642	3,246	791	10.5
Interest	197	206	217	249	226	245	263	250	869	984	252	4.5
Other Income	59	71	67	114	75	75	60	77	311	287	75	-19.8
PBT	**356**	**269**	**336**	**123**	**336**	**214**	**140**	**213**	**1,084**	**904**	**273**	-48.5
Tax	-25	1	9	9	88	62	42	53	-7	244	68	
Rate (%)	-7.1	0.3	2.6	7.0	26.0	28.9	30.0	24.6	-0.6	27.0	25.0	
Adjusted PAT	**381**	**269**	**327**	**114**	**249**	**152**	**98**	**161**	**1,091**	**660**	**204**	-51.9
YoY change (%)	-244.5	-626.1	-35.9	-56.9	-34.8	-43.4	-69.9	40.7	137.2	-39.5	-37.5	

E: MOFSL Estimates

Brand- wise Performance

KFC: Decent performance, better than Devyani

- Sales grew 16% YoY to INR4.4b. Same-store sales declined 2%.
- GP grew 19% YoY to INR3.0b and margins rose 190bp YoY/50bp QoQ to 68.4%.
- ROM increased by 15% YoY to INR889m and margin was flat YoY at 20.1%.
- ADS declined to INR125k vs. INR136k in 3QFY23.
- Added 25 stores for KFC, taking the total to 406 stores.

Pizza Hut (PH): Pain continues due to high competition, weaker performance than Devyani

- Sales declined 4.3% YoY to INR1.3b. Same-store sales fell 19%.
- GP declined 3% YoY to INR1b, while margins increased by 130bp YoY to 75.7%.
- ROM was down 69% YoY at INR60m and margins decreased by 950bp YoY to 4.6% due to weak SSSG.
- ADS declined to INR45k vs. INR58k in 3QFY23.
- Added 8 stores for PH, taking the total to 319 stores.

Sri Lanka: Improving trends

- Sales grew 22% YoY (+7% in LKR term) to INR892m. SSSG was 1%.
- GP grew 32% YoY to INR551m and margins increased by 450bp YoY to 61.8%.
- ROM grew 19% YoY to INR132m and margins contracted 40bp YoY to 14.2%.
- ADS of INR81k vs. INR75k 3QFY24.

Brand-wise Performance	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24
KFC									
No. of stores	250	263	281	301	325	341	358	381	406
Net store addition	31	13	18	20	24	16	17	23	25
SSSG (%)	29	15	65	15	3	2	0	0	-2
Net sales (INR m)	3,031	2,966	3,537	3,491	3,810	3,691	4,286	4,165	4,421
YoY growth (%)	52.8	42.5	97.9	36.1	25.7	24.4	21.2	19.3	16.0
ADS (INR '000)	144	132	144	134	136	127	138	125	125
Gross Margins (%)	68.0	67.9	67.3	65.6	66.5	66.8	68.1	67.9	68.4
Restaurant EBITDA Margin (%)	22.5	19.0	20.3	17.9	20.2	19.1	20.8	19.2	20.1
Channel mix (%)									
Delivery	37	40	35	36	36	38	36	38	38
Dine-in + Takeaway	63	60	65	64	64	62	64	62	62
Pizza Hut									
No. of stores	209	219	235	249	274	286	302	311	319
Net store addition	10	10	16	14	25	12	16	9	8
SSSG (%)	22	3	47	23	(4)	(4)	(9)	(20)	(19)
Net sales (INR m)	1,134	1,032	1,219	1,410	1,364	1,221	1,362	1,330	1,305
YoY growth (%)	51.0	32.8	84.6	59.5	20.3	18.3	11.7	(5.7)	(4.3)
ADS (INR '000)	64	55	61	64	58	50	52	48	45
Gross Margins (%)	75.4	74.8	75.3	74.7	74.4	74.3	75.1	76.1	75.7
Restaurant EBITDA Margin (%)	17.3	11.5	14.8	15.1	14.1	8.6	9.0	7.6	4.6
Channel mix (%)									
Delivery	49	52	47	50	50	52	50	49	49
Dine-in + Takeaway	51	48	53	50	50	48	50	51	51
Sri Lanka									
No. of stores	89	95	98	106	114	114	114	118	121
Net store addition	16	6	3	8	8	-	-	4	3
SSSG (%)	44	29	53	37	18	-3	0	1	1
Net sales (INR m)	858	917	650	669	731	667	825	864	892
YoY growth (%)	50.5	82.3	17.1	2.5	(14.8)	(27.3)	26.9	29.1	22.0
ADS (INR '000)	121	112	75	73	75	65	81	81	81
Gross Margins (%)	67.2	64.9	58.8	55.4	57.3	61.0	60.5	66.2	61.8
Restaurant EBITDA Margin (%)	26.4	24.4	15.5	15.0	14.6	14.2	13.0	15.3	14.2

CONFERENCE CALL

Highlights from the management commentary

Business environment

- Demand conditions in the QSR industry have generally been subdued, with muted growth.
- The company is confident that the macro environment is stabilizing, which is expected to result in an improved growth outlook later in the year.
- Despite intense competition, this performance is still relatively stronger, driven by the success of KFC and stability in Sri Lanka.
- The company will slow down on its expansion pace but continue to invest in refurbishments to maintain customer experience.
- There is a MOM improvement in the number of orders served within 20 minutes.

Cost and margins

- The company aims to reduce labor costs by evaluating store performance and encouraging underperforming stores to align with the cost efficiency of better-performing ones.
- The company is dedicating resources to innovation, marketing, and enhancing customer experience in order to revitalize the Pizza Hut brand.

Segmental information

KFC

- It added 25 stores during the quarter.
- During the quarter, the dining mix accounted for 43%, while delivery comprised 38%, which is 200bp higher than last year.
- Same-store sales declined 2%, despite overall restaurant growth of 16%.
- Average daily sales (ADS) amounted to INR135,000, inclusive of 25% new store additions.
- KFC's primary focus is to enhance the relevance of fried chicken and expand its lunch and snacking menus.
- KFC store expansion will be steady; however, PH store expansion will be muted in FY25 as the company focuses on ADS and profitability.
- KFC can sustain ~20% ROM if demand does not decelerate further.

Pizza Hut

- PH continues to face challenges in this quarter.
- It added 8 stores India and 3 store in Sri Lanka during the quarter.
- The company intends to reduce the pace of expansion.
- The dining mix accounted for 35%, while delivery stood at 49%.
- Same-store sales declined 19%, with an overall revenue decline of 4%.
- ADS amounted to INR58,000.
- Focusing on late-night deliveries and the lunch day part activation. The rollout of lunch activations has been completed, and now over 90% of stores are open for late-night deliveries.
- The brand has been facing competition from local players.

Sri Lanka business

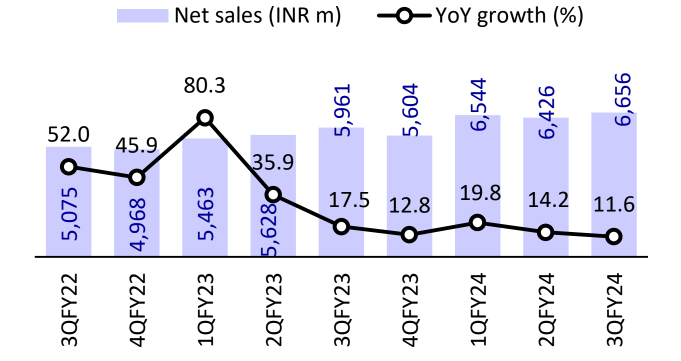
- SSSG was 1%, while overall revenue growth stood at 7%.

Others

- Two years ago, the company successfully launched Momo Pizza. Additionally, it introduced Flavor Fund, which experienced a significant upside for six to nine months.
- The company recognizes that in a highly competitive space, it must start upping the ante to revive consumer interest in PH.
- The business will become profitable within three years. Break-even has occurred in the first quarter of its operation, with double-digit profitability achieved by year one. By year three, profitability approaches the brand average, albeit slightly below. The cycle continues as older stores contribute to profitability, while new stores are added.

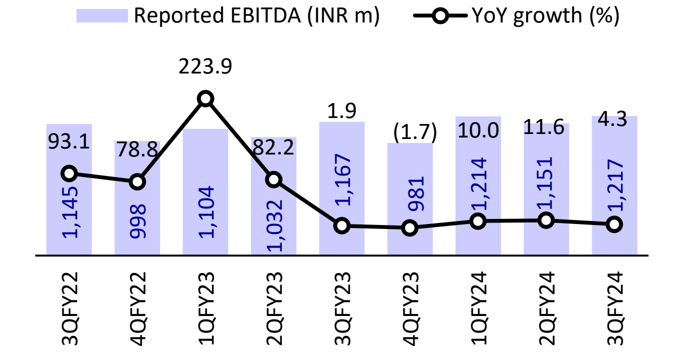
Key exhibits

Exhibit 1: Net sales grew 11.6% YoY to INR6.7b led by KFC



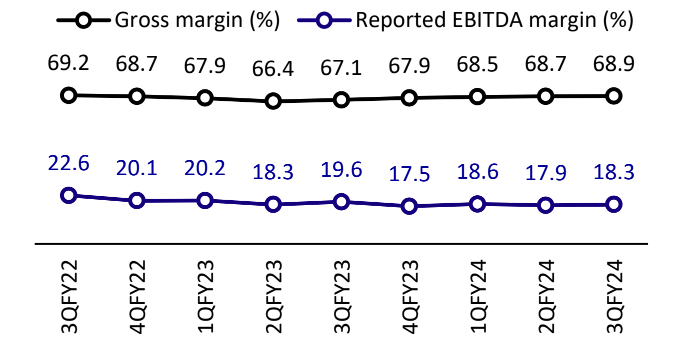
Source: Company, MOFSL

Exhibit 2: EBITDA grew 4.3% YoY to INR1.2b



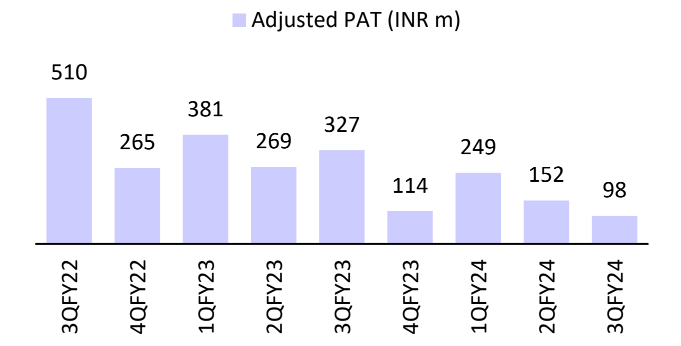
Source: Company, MOFSL

Exhibit 3: Gross margin showing signs of recovery



Source: MOFSL, Company

Exhibit 4: Adjusted PAT came in at INR98m



Source: MOFSL, Company

Exhibit 5: We reduced our EPS estimates by 35%/42% for FY24/FY25

	New		Old		Change (%)	
(INR b)	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net Sales	26.1	30.6	27.5	34.0	-5.1	-10.0
EBITDA	4.8	5.8	5.0	6.8	-2.5	-14.8
Adjusted PAT	0.7	1.0	1.0	1.7	-34.6	-41.5

Source: Company, MOFSL

Financials and valuations

Income Statement consol.							(INR m)
Y/E March	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Net Sales	**13,404**	**10,196**	**17,216**	**22,656**	**26,103**	**30,617**	**35,980**
Change (%)	12.3	-23.9	68.8	31.6	15.2	17.3	17.5
Raw Materials	4,317	3,099	5,278	7,407	8,159	9,684	11,300
Gross Profit	**9,087**	**7,097**	**11,938**	**15,249**	**17,944**	**20,933**	**24,680**
Margin (%)	67.8	69.6	69.3	67.3	68.7	68.4	68.6
Operating Expenses	7,232	5,853	8,888	10,965	13,097	15,134	17,646
EBITDA	**1,856**	**1,244**	**3,050**	**4,284**	**4,847**	**5,800**	**7,033**
Change (%)	27.1	-33.0	145.2	40.4	13.1	19.6	21.3
Margin (%)	13.8	12.2	17.7	18.9	18.6	18.9	19.5
Depreciation	1,913	2,091	2,135	2,642	3,246	3,694	4,091
Int. and Fin. Charges	722	756	781	869	984	1,082	1,196
Other Income	113	616	380	311	287	323	412
Profit before Taxes	**-666**	**-987**	**514**	**1,084**	**904**	**1,346**	**2,158**
Change (%)	-2.5	48.2	-152.1	111.0	-16.6	48.9	60.3
Margin (%)	-5.0	-9.7	3.0	4.8	3.5	4.4	6.0
Total tax	-17	12	54	-7	244	339	543
Tax Rate (%)	2.6	-1.2	10.5	-0.6	27.0	25.2	25.2
Adjusted PAT	**-649**	**-999**	**460**	**1,091**	**660**	**1,008**	**1,615**
Change (%)	-6.6	54.0	-146.0	137.2	-39.5	52.7	60.3
Margin (%)	-4.8	-9.8	2.7	4.8	2.5	3.3	4.5
Minority Interest	0	0	0	0	0	0	0
Exceptional/Prior Period inc	-944	0	0	1,274	0	0	0
Reported PAT	**-1,592**	**-999**	**460**	**2,364**	**660**	**1,008**	**1,615**

Balance Sheet							(INR m)
Y/E March	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Share Capital	502	528	635	635	635	635	635
Reserves	4,742	4,271	9,436	11,924	12,933	14,655	17,238
Net Worth	**5,245**	**4,799**	**10,071**	**12,559**	**13,568**	**15,290**	**17,873**
Loans	712	757	612	443	443	443	443
Other Liability	5,744	5,692	7,280	9,185	10,473	11,651	13,340
Minority Interest	3	-12	-17	-20	-20	-20	-20
Deferred tax liability (net)	117	107	87	-1,184			
Capital Employed	**11,820**	**11,343**	**18,034**	**20,983**	**24,464**	**27,364**	**31,636**
Gross Block	6,567	6,905	8,948	12,134	14,911	17,821	21,083
Less: Accum. Depn.	2,221	2,974	3,487	4,428	6,050	8,096	10,430
Net Fixed Assets	**4,346**	**3,932**	**5,462**	**7,706**	**8,860**	**9,725**	**10,653**
Capital WIP	184	213	320	550	565	565	565
Goodwill	1,622	1,622	1,622	1,622	1,622	1,622	1,622
Other Intangible assets	719	642	573	661	712	783	861
Right to Use Assets	4,953	4,739	6,249	7,915	8,867	9,684	10,881
Investments	**155**	**267**	**1,525**	**659**	**2,500**	**3,000**	**4,000**
Non-current	155	267	1,525	659	2,500	3,000	4,000
current	0	0	0	0	0	0	0
Curr. Assets, L&A	**1,828**	**2,074**	**5,890**	**5,607**	**4,392**	**5,700**	**7,568**
Inventory	444	474	652	993	1,206	1,491	1,838
Account Receivables	46	78	141	179	218	270	332
Cash and Bank Balance	392	500	2,546	2,204	336	833	1,733
Others	947	1,022	2,551	2,231	2,632	3,106	3,665
Curr. Liab. and Prov.	**1,987**	**2,147**	**3,605**	**3,738**	**3,054**	**3,714**	**4,513**
Account Payables	1,307	1,440	1,991	2,170	2,636	3,258	4,017
Other Liabilities	529	544	1,438	1,391	224	242	261
Provisions	151	163	176	177	194	214	235
Net Current Assets	**-158**	**-73**	**2,285**	**1,870**	**1,338**	**1,986**	**3,055**
Application of Funds	**11,820**	**11,343**	**18,034**	**20,983**	**24,464**	**27,364**	**31,636**

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	**-12.9**	**-18.9**	**7.2**	**17.2**	**10.4**	**15.9**	**25.4**
Cash EPS	25.2	20.7	40.8	58.7	61.5	74.0	89.8
BV/Share	104.4	90.9	158.5	197.7	213.5	240.6	281.3
Valuation (x)							
P/E	N/M	N/M	190.4	80.3	132.7	86.9	54.2
Cash P/E	54.7	66.6	33.7	23.5	22.4	18.6	15.3
EV/Sales	5.6	7.7	5.3	4.2	3.7	3.1	2.3
P/BV	13.2	15.2	8.7	7.0	6.5	5.7	4.9
Return Ratios (%)							
RoE	-14.0	-19.9	6.2	9.6	5.1	7.0	9.7
RoCE	0.5	-2.0	7.9	10.1	6.1	7.0	8.5
RoIC	-0.6	-7.8	6.3	9.9	5.6	6.4	8.0
Working Capital Ratios							
Debtor (Days)	1	3	3	3	3	3	3
Asset Turnover (x)	1.1	0.9	1.0	1.1	1.1	1.1	1.1
Leverage Ratio							
Debt/Equity (x)	0.1	0.2	0.1	0.0	0.0	0.0	0.0

Cash Flow Statement **(INR m)**

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Profit before Tax	-1,610	-987	514	1,084	1,345	2,296	3,453
Depreciation	1,913	2,091	2,135	2,642	3,048	3,733	4,427
Net interest	722	756	781	869	578	779	912
Others	950	-409	-10	-86	0	0	0
Direct Taxes Paid	0	-28	-63	-21	-336	-574	-870
(Incr)/Decr in WC	155	118	592	-669	-153	-150	-170
CF from Operations	**2,130**	**1,541**	**3,949**	**3,818**	**4,482**	**6,084**	**7,753**
Incr in FA	-1,430	-740	-2,853	-3,842	-2,842	-2,981	-3,341
Free Cash Flow	**701**	**801**	**1,096**	**-23**	**1,640**	**3,103**	**4,412**
Pur of Investments	1,409	-39	-4,063	1,806	-1,841	-500	-1,000
Others	-2,063	-159	1,884	-176	433	395	472
CF from Invest.	**-2,083**	**-938**	**-5,032**	**-2,212**	**-4,249**	**-3,087**	**-3,868**
Issue of Shares	0	444	4,690	0	0	0	0
Incr in Debt	-822	-180	-780	-1,084	0	0	0
Dividend Paid	0	0	0	0	0	0	0
Net interest Paid	-699	-758	-780	-864	-62	-62	-62
Others					-2,039	-2,438	-2,923
CF from Fin. Activity	**-1,520**	**-494**	**3,130**	**-1,948**	**-2,101**	**-2,500**	**-2,985**
Incr/Decr of Cash	**-1,473**	**109**	**2,046**	**-342**	**-1,868**	**497**	**899**
Add: Opening Balance	1,865	392	500	2,546	2,204	336	833
Closing Balance	**392**	**500**	**2,546**	**2,204**	**336**	**833**	**1,733**

E: MOFSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Grievance Redressal Cell:

Contact Person	Contact No.	Email ID
Ms. Hemangi Date	022 40548000 / 022 67490600	query@motilaloswal.com
Ms. Kumud Upadhyay	022 40548082	servicehead@motilaloswal.com
Mr. Ajay Menon	022 40548083	am@motilaloswal.com

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