



Biocon

STOCK INFO.	BLOOMBERG
BSE SENSEX: 17,605	BIOS IN
	REUTERS CODE
S&P CNX: 5,209	BION.BO

21 January 2008

Buy

Previous Recommendation: Buy

Rs437

Equity Shares (m)	100.0
52-Week Range	664/357
1,6,12 Rel. Perf. (%)	-17/-20/-17
M.Cap. (Rs b)	43.7
M.Cap. (US\$ b)	1.1

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	9,863	2,002	20.0	15.1	21.8	4.1	18.7	17.0	4.5	15.7
03/08E	10,807	2,250	22.5	12.4	19.4	2.9	14.9	14.2	3.9	13.9
03/09E	12,531	2,751	27.5	22.2	15.9	2.5	16.0	15.4	3.3	11.3
03/10E	14,715	3,227	32.3	17.3	13.5	2.2	16.4	15.7	2.7	9.0

Biocon 3QFY08 results were below our estimates. Key highlights include:

- Net sales de-grew by 4% (v/s our estimate of 16% growth) while PAT de-grew by 5% (vs estimate of 10% growth). The decline was led mainly by lower licensing income (Rs20m compared to Rs140m in 3QFY07) and a 9% de-growth in contract research business to Rs430m (due to spill-over of some contract bookings to 4Q). Currency appreciation and divestment of the enzyme business also impacted performance for the quarter.
- Plans separate listing for Syngene** - Biocon is planning a separate listing of Syngene (its contract research subsidiary) in FY09. Syngene currently contributes about 15% of Biocon's consolidated revenues and 18-20% of consolidated PAT. We believe that Syngene is likely to record strong growth (30-40%) over the next 2 years with PAT margins at 25%. We believe that it can quote at a potential market capitalization of about Rs15-20b.

Traction in the company's Insulin initiative, coupled with incremental contribution from immunosuppressants should augur well for Biocon's FY09E performance. Contract Research business is expected to continue to grow strongly (30-40% growth). Licensing fees (estimated at Rs500m) is also likely to boost FY09E profits. However, divestment of Enzyme business, higher R&D costs, significant capex (leading to a 73% increase in depreciation), higher expenses linked to the scale-up of the domestic formulations business and currency appreciation, will continue to temper down earnings growth. Based on the lower than expected 3Q performance, we have reduced our earnings estimates by 7.5% and 3.6% for FY08E and FY09E respectively. Based on our revised estimates, Biocon is valued at 15.9x FY09E and 13.5x FY10E earnings. Valuations do not fully factor-in the potential upsides from Biocon's Insulin & IPR initiatives as well as the value unlocking from a potential listing of the contract research business. Maintain **Buy**.

CONSOLIDATED QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	2,120	2,490	2,470	2,782	2,710	2,790	2,370	2,937	9,862	10,807
YoY Change (%)	21.9	24.2	24.0	29.8	27.8	12.0	-4.0	5.6	25.1	9.6
Total Expenditure	1,577	1,831	1,693	1,925	1,945	1,985	1,779	2,099	7,022	7,809
EBITDA	544	659	777	857	765	805	591	838	2,840	2,998
Margins (%)	25.6	26.5	31.5	30.8	28.2	28.8	24.9	28.5	28.8	27.7
Depreciation	109.7	177.5	182.8	195.3	216.4	233.6	240.0	253.0	665.3	943.0
Interest	16.7	21.6	21.6	34.5	27.5	26.7	25.8	27.5	94.5	107.5
Other Income	13.6	8.6	2.8	11.9	9.9	19.2	210.9	106.9	31.9	346.9
PBT	431	469	576	639	531	564	536	665	2,112	2,295
Tax	42	22	36	65	15	38	18	44	165	114
Rate (%)	9.8	4.8	6.2	10.2	2.8	6.7	3.3	6.7	7.8	5.0
Minority Interest	-5	-7	-20	-33	-14	-14	-12	-30	-63	-70
PAT	394	453	560	607	530	540	530	650	2,010	2,250
YoY Change (%)	1.8	4.1	27.7	26.9	34.5	19.0	-5.3	7.1	15.5	12.0
Margins (%)	18.6	18.2	22.7	21.8	19.6	19.3	22.4	22.1	20.4	20.8

E: MOST Estimates

Lower licensing fees and Syngene slow-down drag down performance

Net sales de-grew by 4% (vs our estimate of 16% growth) to Rs2.37b while PAT de-grew by 5% (vs estimate of 10% growth). The decline was led mainly by lower licensing income (Rs20m compared to Rs140m in 3QFY07) and a 9% de-growth in contract research business to Rs430m (due to spill-over of some contract bookings to 4Q). EBITDA margins declined by 650bp to 24.9% while PAT was boosted mainly by Rs210m of other income. The company is gradually reducing its dependence on statins as its Insulin and Immunosuppressant portfolio start gaining traction (details not disclosed). Currency appreciation and divestment of the enzyme business has also impacted performance for the quarter.

TREND IN PRODUCT MIX (RS M)

	3QFY08	3QFY07	GR (YOY)	2QFY08	GR (QOQ)
Bio-Pharmaceuticals	1,940	1,800	8.0	2,120	-8.5
% of Sales	81.9	72.9		76.0	
Enzymes	0	200		250	
% of Sales	0.0	8.1		9.0	
Contract Research Fees	430	470	-9.0	420	2.4
% of Sales	18.1	19.0		15.1	
Total	2,370	2,470	-4.0	2,790	-15.1

Source: Company/Motilal Oswal Securities

Plans separate listing for Syngene

The company is planning a separate listing of Syngene (its contract research subsidiary) in FY09. Syngene currently contributes about 15% of Biocon's consolidated revenues and 18-20% of consolidated PAT. We believe that Syngene is likely to record strong growth (30-40%) over the next 2 years (partly boosted by the BMS contract) with PAT margins at 25%. We believe that such a company could command a P/E of about 25x resulting in a potential market cap of about Rs15-20b.

Ramp-up in contract research operations

Syngene's operations are growing at a robust pace led by commissioning of new facilities and ramp-up of the customer base. New client additions as well as ramp-up from existing

clients, is likely to result in an improved performance for Syngene in the coming years. Syngene has 6 of the top 10 global pharmaceutical companies as its clients. Syngene has a scientist strength of about 800 (likely to increase to almost 1,000 by end FY08E) working on various MNC projects.

Setting up dedicated research centre for BMS

Syngene has entered into an R&D partnership with Bristol Myers Squibb (BMS) for providing services for discovery and NCE development. Syngene will be dedicating part of its research facilities at the new Biocon Park for the BMS partnership, which is likely to ultimately house about 400 scientists. The scope of work for BMS will include medicinal chemistry, biology, drug metabolism and development.

We believe that this should augur well for Syngene in the long-term with the management guiding revenues of about US\$25m from this center by FY10. BMS has been a Biocon customer for the past 9 years and the relationship get further strengthened through this arrangement. We expect Syngene to commission this facility in 2HFY09.

Clinigene's operations being ramped-up

We expect Clinigene's revenues to grow by 50% (albeit on a low base of only Rs80m) in FY08E to Rs172m and grow by almost 100% in FY09E to Rs350m. This traction is likely to be led by increased assignments for clinical trials services from various MNC customers. Clinigene has recently shifted operations to its newly commissioned facility.

Enzyme business divestment

Biocon has divested its Enzyme business to Novozyme for US\$115m due to its focus on the bio-pharma business. Management indicated that the Enzyme business would have required significant investments in the coming years. This division contributed about Rs950m in sales and about Rs1.9 to EPS for FY07. Our estimates take into account this divestment. The company is likely to utilize these funds for acquiring IPR rights and for potential acquisitions.

Insulin registrations being ramped up

Biocon has filed for registering its Insulin formulation in 40 non-regulated markets and has launched it in 6 countries. Approvals for these registrations are likely to come through in FY09. It has entered into a licensing arrangement for Insulin with a US-based company, which is likely to generate licensing income for Biocon (details not disclosed). Its oral Insulin NCE has completed Phase-I clinical trials in India and the company expects to commence Phase-II trials shortly, which is likely to result in increased supplies for Biocon. Management has indicated that it will evaluate a potential out-licensing of this NCE over the next 12 months post receipt of Phase-II data. We believe that Biocon's Insulin initiative (API, formulation & NDDS) is likely to be a key growth driver for the company in the coming years.

Insulin can be a very big long-term opportunity

Biocon is targeting launch of generic insulin in regulated markets in the long-term. It has already filed a DMF for insulin with the US FDA and expects to introduce the product in the US market through the 505(b)(2) route. The company will have to conduct limited clinical trials for this product. We believe that the regulatory environment for biotech products (like insulin) is gradually becoming favourable for generic companies. Regulators in both, Europe and USA, have indicated their willingness to frame detailed guidelines for approving generic biotech products. In fact, the European authorities (EMEA) have already issued broad guidelines to be followed for approval of biogenerics.

Agreement with Bayer for Insulin in China

Biocon has signed an agreement with Bayer to market Insugen (Biocon's human insulin) in China. Bayer would have exclusive marketing rights of Insugen for Chinese market. Biocon expects Insugen's launch in China in CY08. Bayer also has option to expand the marketing rights to other countries in Asia Pacific. Biocon has received some upfront (bonus) payment, which it would be accounting on pro-rata basis over the 10-year period (life of the contract). The Chinese insulin market size is about US\$100m, dominated by Novo Nordisk (~65% market share) and Eli Lilly (~35%). As per the agreement, all the registration process/cost would be incurred by Bayer.

The global insulin market is currently worth US\$4-5b and can be a very big opportunity for generic suppliers like Biocon as very few generic players are prepared for exploiting this opportunity (particularly in regulated markets).

Signs G-CSF biogeneric licensing deal with Abraxis

Some months back, Biocon signed a licensing deal with Abraxis Bioscience (USA) for licensing of G-CSF biogeneric, which, it is currently developing. The deal envisages that the partner will be bearing the entire cost of clinical trials for this product and will have exclusive marketing rights for the US and EU markets. Biocon will be supplying the product and will earn licensing fees and royalties on the product. It expects the product to be commercialized in the regulated markets over the next 24 months. We believe that the partners are also exploring the possibility of expanding this agreement to more biogeneric products.

Biogenerics can be big opportunity but lacks visibility as of now

Biocon expects to file its first biogeneric (Insulin) in EU in CY08/09. It is currently proceeding as per the EMEA guidelines for getting its generic version registered with the latter. We believe that, although biogenerics can be a significant opportunity, the time-line of the launch remains uncertain. Biocon has already launched BioMab (monoclonal anti-body) for treating head & neck cancer in the domestic market and is planning to launch EPO, GCSF and Streptokinase over the next few quarters in the domestic market. It should be noted that Biocon did not have any presence in the domestic formulations market (till the launch of its Insulin) and hence it may not be easy for the company to garner significant market share in the initial years.

Building future growth engines – But visibility still poor

Biocon is in the process of building future growth engines to reduce its dependence on Statins. Biocon is building strengths in other biopharmaceutical products (immunosuppressants and anti-diabetes) as well as its own drug discovery and contract research efforts. The company's

efforts to launch human insulin in India and in semi-regulated markets as well as a supply tie up with Bristol Myers Squibb (for the latter's NDDS version) are also likely to scale up over the next couple of years.

The company gradually progressing on the research front, with the knowledge gained through its custom and clinical research activities coming in handy in its own efforts to develop non-infringing processes. Biocon also has its own R&D program focusing on improving efficiencies and developing new biological entities (NBEs). Although, the progress on any of these fronts could lead to higher growth and a re-rating, the visibility on these is still poor.

Long-term generic pipeline is exciting

The company is building its pipeline of immunosuppressants and has filed DMFs for Mycophenolate Mofetil and Tacrolimus. We believe that immunosuppressant's will be one of the key growth drivers for the company in the long-term (FY09 onwards). We believe that this segment is likely to witness relatively less competition due to the technological entry barriers. Launch of bio-generics could be another exciting opportunity in the long-term, although, currently the visibility on this opportunity is poor.

Specialty pipeline is also being strengthened

Biocon expects to enter the specialty segment of the pharmaceutical market by developing proprietary products based on its developmental efforts with Monoclonal Antibodies (Mab). Its JV with a Cuban organization focuses on developing products using Mab. It is currently working on developing Mab for the immunosuppressant, arthritis and cancer segments. The JV has a pipeline of three Mab and three anti-cancer vaccines.

Aggressive plans to invest in domestic formulations business – may impact margins

Biocon is planning to give significant thrust to its domestic formulations business which would be having two niche products in form of human insulin and BIOMAb. It is planning to launch EPO, GCSF and Streptokinase over the

next few quarters in the domestic market. The company currently employs about 360 personnel for this division and expects to ramp-up this number significantly in FY08E. The company intends to double its current market share of 10% in human insulin in next two years. Although Biocon would be investing resources in domestic formulations form current year onwards, the pursuant benefits would be reflected only in the long-term, thereby impacting margins in FY08-09E.

Revising estimates

Based on the lower than expected 3Q performance, we have reduced our earnings estimates by 7.5% and 3.6% for FY08E and FY09E respectively. The table below gives our revised estimates:

REVISED FORECAST (RS M)

	FY08E			FY09E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	10,807	11,663	-7.3	12,531	13,268	-5.6
Net Profit	2,250	2,432	-7.5	2,751	2,855	-3.6
EPS (Rs)	22.5	24.3	-7.5	27.5	28.55	-3.6

Source: Motilal Oswal Securities

Valuation and view

Traction in the company's Insulin initiative, coupled with incremental contribution from immunosuppressants should augur well for Biocon's FY09E performance. Contract Research business is expected to continue to grow strongly (30-40% growth). Licensing fees (estimated at Rs500m) is also likely to boost FY09E profits. However, divestment of Enzyme business, higher R&D costs, significant capex (leading to a 73% increase in depreciation) and higher expenses linked to the scale-up of the domestic formulations business and currency appreciation, will continue to temper down earnings growth. Based on the lower than expected 3Q performance, we have reduced our earnings estimates by 7.5% and 3.6% for FY08E and FY09E respectively. Based on our revised estimates, Biocon is valued at 15.9x FY09E and 13.5x FY10E earnings. Valuations do not fully factor-in the potential upsides from Biocon's Insulin & IPR initiatives as well as the value unlocking from a potential listing of the contract research business. Maintain **Buy**.

Biocon: an investment profile

Company description

Biocon is an integrated biotechnology company encompassing all the three critical stages of drug development – drug discovery, development and manufacturing, and commercialization of biopharmaceuticals and enzymes. With over 25 years of expertise in fermentation technology, the company has built a strong presence in lucrative high-growth segments like statins, immuno-suppressants and anti-diabetes.

Key investment arguments

- Strong expertise in the complex fermentation process and decision to stay out of formulations in regulated markets make it the best positioned to capitalize on the lucrative statins opportunity.
- Biogenerics, immuno-suppressants and contract research to be the key long-term growth drivers.

Key investment risks

- Higher than estimated fall in prices of *Simvastatin* and *Pravastatin* post-generic launch would result in lower profitability for Biocon.
- Significant capex and investments to fund future initiatives may temper down earnings growth in the short-term.

COMPARATIVE VALUATIONS

		BIOCON	CIPLA	DRL
P/E (x)	FY08E	19.4	24.1	13.5
	FY09E	15.9	20.1	14.9
P/BV (x)	FY08E	2.9	4.0	2.2
	FY09E	2.5	3.4	2.0
EV/Sales (x)	FY08E	3.9	3.7	2.2
	FY09E	3.3	3.2	1.9
EV/EBITDA (x)	FY08E	13.9	18.5	13.7
	FY09E	11.3	15.9	10.8

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	60.9	60.9	60.9
Domestic Inst	9.3	7.9	2.7
Foreign	8.3	9.0	13.6
Others	21.6	22.2	22.8

Recent developments

- Has entered into an agreement with Abraxis for G-CSF biogeneric in regulated markets.

Valuation and view

- Traction in the company's Insulin initiative, coupled with incremental contribution from immunosuppressants should augur well for Biocon's FY09E performance. Contract Research business is expected to continue to grow strongly (30-40% growth) over the next 2 years.
- Biocon is valued at 15.9x FY09E and 13.5x FY10E earnings. Valuations do not fully factor-in the potential upsides from Insulin and value unlocking in the contract research business. Maintain **Buy** with price target of Rs550.

Sector view

- Regulated markets to remain the key sales and profit drivers in the medium term. Europe to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

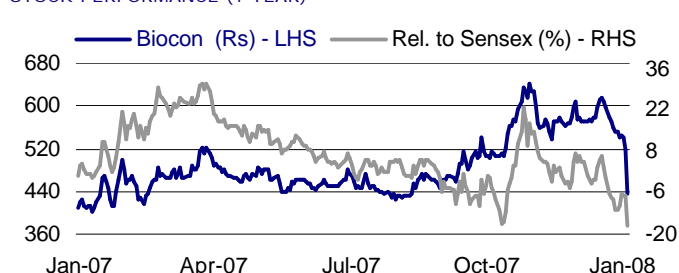
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY08	22.5	23.1	-2.5
FY09	27.5	27.0	1.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
437	550	25.9	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATE INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2010E
Exports	3,584	4,194	5,067	5,097	5,370
Net Domestic Sales	3,291	4,037	3,951	4,795	5,674
Net Sales	6,875	8,230	9,018	9,893	11,044
Contract Research Fees	1,006	1,632	1,790	2,638	3,671
Net Income	7,881	9,863	10,807	12,531	14,715
Change (%)	10.6	25.1	9.6	15.9	17.4
Total Expenditure	5,593	7,022	7,809	8,864	10,360
EBITDA	2,288	2,840	2,998	3,667	4,355
Change (%)	2.2	24.1	5.6	22.3	18.8
Margin (%)	29.0	28.8	27.7	29.3	29.6
Depreciation	297	665	943	1,122	1,291
Int. and Finance Charges	18	98	108	104	122
Other Income - Rec.	51	32	347	370	370
PBT	2,025	2,109	2,295	2,811	3,313
Tax	306	169	114	141	166
Tax Rate (%)	15.1	8.0	5.0	5.0	5.0
Minority Interest	-19.7	-61.8	-70.0	-80.0	-80.0
Adjusted PAT	1,739	2,002	2,250	2,751	3,227
Change (%)	-2.5	2.8	2.4	22.5	17.8
Margin (%)	21.8	19.7	20.2	21.3	21.4

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2009E
Equity Share Capital	500	500	500	500	500
Revaluation Reserves	13	11	9	9	9
Other Reserves	8,368	10,175	14,589	16,696	19,167
Net Worth	8,881	10,686	15,098	17,205	19,677
Loans	1,050	1,868	1,440	1,440	2,040
Minority Interest	32	-8	-78	-158	-238
Deferred liabilities	297	448	425	397	364
Capital Employed	10,261	12,994	16,885	18,884	21,843
Gross Block	4,070	10,662	12,912	15,412	16,412
Less: Accum. Deprn.	1,061	1,713	2,656	3,778	5,069
Net Fixed Assets	3,010	8,949	10,256	11,634	11,343
Capital WIP	5,260	708	500	500	500
Investments	1,002	790	3,340	3,725	6,536
Curr. Assets	3,601	5,296	5,833	6,763	7,942
Inventory	1,105	1,613	1,777	2,060	2,419
Account Receivables	2,237	3,065	3,405	3,948	4,636
Cash and Bank Balance	20	87	89	103	121
Loans & Advances	239	530	563	652	766
Curr. Liability & Prov.	2,613	2,749	3,044	3,738	4,479
Account Payables	2,184	2,324	2,487	2,849	3,427
Provisions	429	425	557	889	1,052
Net Current Assets	989	2,547	2,789	3,025	3,464
Appl. of Funds	10,261	12,994	16,885	18,884	21,843

E: MOST Estimates

RATIOS					
Y/E MARCH	2006	2007	2008E	2009E	2009E
Basic (Rs) EPS	17.4	20.0	22.5	27.5	32.3
Cash EPS	20.4	26.7	31.9	38.7	45.2
BV/Share	88.7	106.7	150.9	172.0	196.7
DPS	2.5	3.0	4.5	5.5	6.5
Payout (%)	16.4	17.5	23.4	23.4	23.4
Valuation (x)					
P/E		21.8	19.4	15.9	13.5
Cash P/E		16.4	13.7	11.3	9.7
P/BV		4.1	2.9	2.5	2.2
EV/Sales		4.5	3.9	3.3	2.7
EV/EBITDA		15.7	13.9	11.3	9.0
Dividend Yield (%)		0.7	1.0	1.3	1.5
Return Ratios (%)					
RoE	19.6	18.7	14.9	16.0	16.4
RoCE	19.9	17.0	14.2	15.4	15.7
Working Capital Ratios					
Asset Turnover (x)	0.8	0.8	0.6	0.7	0.7
Debtor (Days)	104	113	115	115	115
Inventory (Days)	51	60	60	60	60
Working Capital (Days)	45	91	91	85	83
Leverage Ratio (x)					
Current ratio	1.4	1.9	1.9	1.8	1.8
Debt/Equity	0.1	0.2	0.1	0.1	0.1

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2009E
Oper. Profit/(Loss) before	2,288	2,840	2,998	3,667	4,355
Interest/Dividends Recd.	51	32	347	370	370
Direct Taxes Paid	-243	-18	-138	-169	-199
(Inc)/Dec in WC	-722	-1,491	-240	-222	-421
CF from Operations	1,374	1,363	2,967	3,646	4,106
(Incr)/Dec in FA	-2,785	-2,053	-2,042	-2,500	-1,000
(Pur)/Sale of Investments	1,347	212	-2,550	-385	-2,811
CF from investments	-1,437	-1,841	-4,592	-2,885	-3,811
Issue of Shares	21	155	2,688	0	0
(Inc)/Dec in Debt	330	839	-428	0	600
Interest Paid	-18	-98	-108	-104	-122
Dividend Paid	-285	-351	-527	-644	-755
CF from Fin. Activity	49	545	1,627	-747	-277
Inc/Dec of Cash	-14	67	2	14	18
Add: Beginning Balance	34	20	87	89	103
Closing Balance	20	87	89	103	121

E: MOST Estimates

N O T E S



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Biocon

- | | |
|---|----|
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| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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