



Grasim Industries

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,858	GRASIM IN
	REUTERS CODE
S&P CNX: 3,711	GRAS.BO

18 October 2006

Buy

Previous Recommendation: Buy

Rs2,582

		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
Equity Shares (m)	91.7	03/06A	101,919	10,376	113.2	7.5	22.8	4.9	21.4	20.7	3.3	15.5
52-Week Range	2,698/1,087	03/07E	128,970	18,956	206.7	82.7	12.5	3.6	28.5	36.2	2.7	9.2
1,6,12 Rel. Perf. (%)	-3/6/62	03/08E	139,086	19,285	210.3	1.7	12.3	3.0	24.2	30.6	2.7	9.0
M.Cap. (Rs b)	236.8											
M.Cap. (US\$ b)	5.2											

Grasim reported better-than-expected 2QFY07 results (standalone) with PAT growth of 79% driven primarily by strong performance in core business (cement & VSF) coupled with higher other income.

- Revenues up 22% YoY driven by 46% growth in cement business (4% volume and 41.6% realization growth) and 15% growth in VSF revenues (15% realization growth). Other businesses dragged overall performance — sponge iron revenues declined by 17% YoY and chemical revenues declined by 26% YoY.
- EBITDA grew by 65% YoY to Rs5.32b driven by 700bp margin expansion to 26.5%. Margin expansion was restricted by cost push in cement business (due to maintenance shutdown and higher RM cost) and chemicals business (impacted by captive power plant shutdown resulting in 22pp decline in EBITDA margins). Margin expansion coupled with higher other income (up by 63% YoY to Rs502m) boosted PAT growth to 79% to Rs3.36b.
- Cement business witnessed strong performance with EBITDA margin expanding 810bp YoY (but down 310bp QoQ) to 31.2% aided by firm realizations of Rs2,822/ton (up 42% YoY and 3.3% QoQ). However, volume growth at 4% (to 3.38m ton) lagged industry's growth, as the company undertook maintenance shutdown during the quarter. VSF division's margins also improved by 570bp (to 31.1%) aided by Rs5/kg price hike taken by the company in 2QFY07.

We are upgrading our consolidated EPS estimates for FY07 by 11% to Rs206.7 and FY08 by 11.8% to Rs210.3 to factor in higher-than-expected cement realizations. We now factor in Rs5/bag price hike each in 3Q and 4Q and flat prices in FY08 over FY07 and price hikes in VSF business (Rs6/kg in 3Q and Rs5/kg decline in FY08E over 4QFY07). With both the core businesses (cement and VSF) in cyclical upturn, Grasim will report impressive growth in earnings in FY07. At 12.3x FY08E EPS and 9x EV/EBITDA, maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	15,533	16,492	16,482	18,151	18,770	20,108	21,969	20,106	66,557	80,953
YoY Change (%)	2.4	7.5	5.7	10.5	20.8	21.9	33.3	10.8	6.4	21.6
EBITDA	3,744	3,218	3,191	4,065	5,133	5,322	6,491	7,236	14,218	24,181
Margins (%)	24.1	19.5	19.4	22.4	27.3	26.5	29.5	36.0	21.4	29.9
Depreciation	705	720	733	759	741	756	766	775	2,916	3,038
Interest	265	237	235	236	235	241	244	259	973	979
Other Income	201	308	152	575	375	502	323	380	1,691	1,580
PBT before EO Items	2,975	2,570	2,376	3,645	4,532	4,827	5,804	6,581	12,019	21,744
Extraordinary Inc/(Exp)	454	0	0	0	0	0	0	0	41	0
PBT after EO Items	3,429	2,570	2,376	3,645	4,532	4,827	5,804	6,581	12,060	21,744
Tax	919	693	757	1,019	1,413	1,467	1,814	2,140	3,428	6,849
Rate (%)	26.8	27.0	31.9	28.0	31.2	30.4	31.3	32.5	28.4	31.5
Reported PAT	2,510	1,877	1,619	2,627	3,119	3,360	3,990	4,441	8,632	14,895
Adj. PAT	2,056	1,877	1,619	2,627	3,119	3,360	3,990	4,441	8,591	14,895
YoY Change (%)	-6.2	-14.7	-21.5	-3.3	51.7	79.1	146.5	69.1	-8.7	73.4

E: MOST Estimates

SEGMENTAL PERFORMANCE (RS M)

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Revenue Mix					
Fibre	5,596	4,851	15.4	4,411	26.9
Cement	11,412	7,791	46.5	10,968	4.0
Sponge Iron	1,408	1,704	-17.4	1,754	-19.7
Chemical	765	1,039	-26.4	715	7.0
Textile	848	707	19.9	528	60.6
Total	20,108	16,492	21.9	18,770	7.1
PBIT					
Fibre	1,567	1,073	46.0	979	60.0
Cement	3,138	1,322	137.3	3,342	-6.1
Sponge Iron	-33	-82	-60.1	56	-158.4
Chemical	48	310	-84.5	134	-64.1
Textile	-1	19	-106.8	1	-
Total	4,718	2,642	78.6	4,512	4.6
EBIT Margins (%)					
Fibre	28.0	22.1		22.2	
Cement	27.5	17.0		30.5	
Sponge Iron	-2.3	-4.8		3.2	
Chemical	6.3	29.8		18.7	
Textile	-0.2	2.7		0.2	
Unallocated	0.0	0.0		0.0	
Total	23.5	16.0		24.0	

Source: Company/Motilal Oswal Securities

Core businesses perform strongly – Cement and VSF

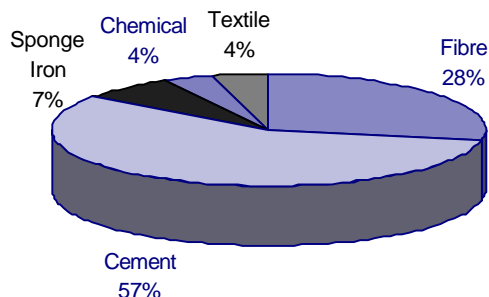
Operating performance in line with expectation: Grasim's 2QFY07 performance was better than our expectation as significant improvement in the Cement and VSF division's performance more than compensated for the decline in sponge iron and chemical profits. Operating margins for Grasim improved by 700bp YoY on account of 810bp margin expansion in cement business and 570bp margin expansion in VSF business. However, PAT growth of 79% (to Rs3.36b) was boosted by 63% higher other income (to Rs502m).

Revenue mix improved significantly in favor of core businesses (Cement and VSF division) which accounted for 84.6% of revenues v/s 76.6% in 2QFY06. Also PBIT mix also improved significantly with core business accounting for 99.7% (v/s 90.6% in 2QFY06) of PBIT.

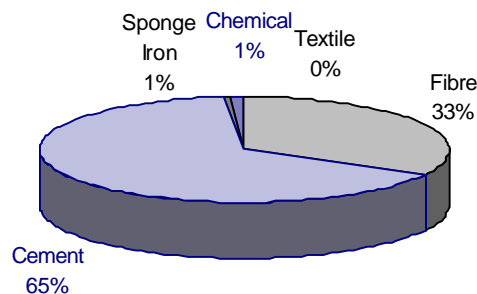
Cement and VSF businesses drive revenue growth ...

Revenues up 22% YoY to Rs20.1b driven by 46% growth in cement revenues (4% volumes growth and 41.6%

REVENUE MIX



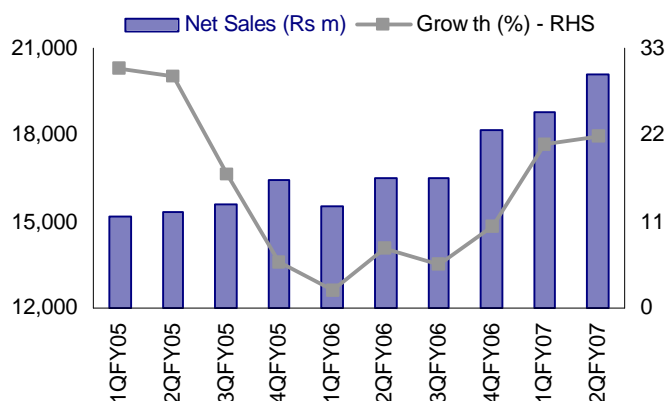
PBIT MIX



Source: Company/Motilal Oswal Securities

realization growth) and 15% growth in VSF revenues (~15% realization growth). Other businesses dragged overall performance, as sponge iron revenues declined by 17% and chemicals business revenues were lower by 26%.

TREND IN NET SALES



Source: Company/Motilal Oswal Securities

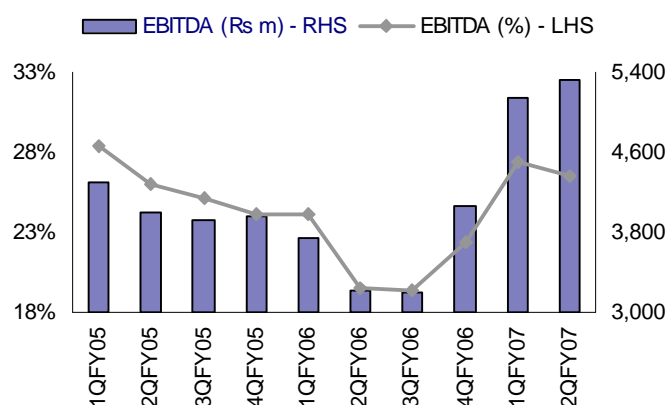
... as well as margin expansion

EBITDA grew by 65% YoY to Rs5.32b, driven by 700bp margin expansion to 26.5% (v/s estimate of 27.1%). Margin expansion was restricted by cost push in cement business

(due to maintenance shutdown and higher RM cost) and chemicals business (impacted by captive power plant shutdown resulting in 22pp decline in PBDIT margins).

Cement business witnessed strong performance with PBIDT margin expanding 810bp YoY (but down 310bp QoQ) to 31.2%, aided by firm realizations to Rs2,822/ton (up 42% YoY and 3.3% QoQ). However, volume growth at 4% (to 3.38m ton) lagged industry's growth as the company undertook maintenance shutdown during the quarter. VSF division's margins also improved by 570bp (to 31.1%) aided by Rs5/bag price hike taken by the company at the beginning of the quarter.

TREND IN EBITDA



Source: Company/Motilal Oswal Securities

Margin expansion coupled with higher other income (up by 63% YoY to Rs502m) boosted PAT growth to 79% to Rs3.36b. Consolidated PAT for the quarter grew by 109% to Rs4.2b, on account of sharp improvement in operating performance of UltraTech Cement.

Segmentwise performance

VSF division: Price hikes boost realizations and margins

VSF business' 2QFY07 revenues grew by 15% YoY to Rs5.6b, primarily driven by Rs5/kg (~15%) price hike at the beginning of the quarter. During the quarter, VSF division

was operating at full capacity, after 1QFY07 where production got impacted due to water shortage. However, volume grew marginally to 63,000 tons on the high base of last year. Strong demand from both domestic and exports segment due to high prices of competing fibres has enabled the company to increase price during the quarter, for the fourth time in last four quarters. On account of higher realization, operating margins improved by 570bp YoY to 31.1%, despite 9% increase in pulp prices.

VSF DIVISION PERFORMANCE

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Production (ton)	65,083	50,231	29.6	45,194	44.0
Sales Volume (ton)	63,119	62,776	0.5	51,957	21.5
Net Turnover (Rs m)	5,596	4,851	15.4	4,411	26.9
Avg Realiz. (Rs/ton)	83,279	72,160	15.4	78,983	5.4
PBDIT (Rs m)	1,743	1,234	41.2	1,143	52.5
PBDIT Margin (%)	31.1	25.4		25.9	

Source: Company/Motilal Oswal Securities

Demand for VSF is expected to grow based on strong demand from the Indian textile industry post quota. Also, the company is taking initiatives to introduce VSF based non-woven products in the domestic market. Higher volumes backed by strong VSF demand supported by firm prices of competing fibres augur well for VSF business. Margins are expected to improve, despite rise in pulp prices, based on Rs6/kg price increase in October 2006.

Cement division: Strong realizations on both YoY and QoQ basis

Cement business reported significant growth with revenue growing by 46.5% (to Rs11.4b) and PBIDT growing by 106% (to Rs3.56b), driven by significant improvement in grey cement realizations (up 42% YoY and 3.3% QoQ). While grey cement volumes grew by 4% to 3.38m ton, with realizations of Rs2,822/ton, whereas white cement volumes and realizations were up by 11% and 14% respectively. Impact of higher realizations was to a certain extent nullified by cost push (in form of higher RM cost due to blending and planned maintenance shutdown), resulting in PBIDT margins of 31.2% (up 810bp).

CEMENT DIVISION PERFORMANCE

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
A. Grey Cement					
Production (m ton)	3.3	3.21	3.1	3.56	-7.0
Sales Volume (m ton)	3.4	3.25	4.0	3.50	-3.4
Net Turnover (Rs m)	10,496	7,132	47.2	10,214	2.8
Avg Realiz. (Rs/ton)	2,822	1,993	41.6	2,731	3.3
B. White Cement					
Production (ton)	92,766	87,763	5.7	83,045	11.7
Sales Volume (ton)	90,253	81,557	10.7	81,143	11.2
Net Turnover (Rs m)	916	659	39.0	754	21.5
Avg Realiz. (Rs/ton)	6,614	5,815	13.7	6,213	6.5
PBDIT	3,560	1,725	106.4	3,765	-5.4
PBIDT Margin (%)	31.2	23.1		34.3	

Source: Company/Motilal Oswal Securities

Grasim is expected to have muted volume growth of around 4%-5% until its new capacity comes on-stream (in October 2007). Cement prices are likely to remain firm which will result in strong operating performance for the company. Also, Grasim is taking initiatives to control cost through improving rail-road mix and increasing blending.

Sponge iron division: double squeeze continues

Dismal performance of sponge iron division continued in this quarter also. While production declined by 10% YoY, sales volume declined by 21% to 1,11,000 tons. Sponge iron realization improved by 3.3% to Rs12,354/ton, in line with higher global scrap prices.

SPONGE IRON DIVISION PERFORMANCE

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Production (ton)	113,567	125,944	-9.8	126,941	-10.5
Sales Volume (ton)	110,933	140,275	-20.9	140,912	-21.3
Net Turnover (Rs m)	1,408	1,704	-17.4	1,754	-19.7
Avg Realiz. (Rs/ton)	12,354	11,956	3.3	12,054	2.5
PBDIT	54	40	35.0	142	-62.0
PBIDT Margin (%)	3.8	0.2		8.1	

Source: Company/Motilal Oswal Securities

Grasim's sponge iron business is expected to continue to perform poorly as its operating cost per ton is much higher due to poor raw material linkages. Although sponge iron realization going forward is expected to remain stable, due to the inflated cost structure, Grasim's sponge iron division will continue to operate at break even levels.

Mega expansion plan in cement sector with a capital outlay of Rs63.4b:

Grasim has announced capex of Rs63.4b for cement (Rs36.4b in Grasim and Rs27b in Cemco) to expand capacity by 13.5m ton, set up captive power plant and modernize and de-bottleneck all plants. Post-expansion Grasim's standalone capacity will increase from 14m ton to 23.5m ton (single largest capacity) by end-FY08. On a consolidated basis, AV Birla group will have direct control of 46m ton of capacity.

Revising estimates upward

We are upgrading our consolidated EPS estimates for FY07 by 11% to Rs206.7 and for FY08 by 11.8% to Rs210.3 to factor in higher-than-expected cement realizations. We now factor in Rs5/bag price hike each in 3Q and 4Q and flat prices in FY08 over FY07 and price hikes in VSF business (Rs6/kg in 3Q and Rs5/kg decline in FY08E over 4QFY07).

Valuation and view

With outlook on both its core businesses (cement and VSF) being positive, Grasim will continue to report impressive earnings growth in FY07. Being the largest cement player, Grasim would be biggest beneficiary of any further increase in cement prices. Valuations at 12.3x FY08E EPS and 9x EV/EBITDA are attractive for the largest cement player in the industry. Maintain **Buy**.

Grasim Industries: an investment profile

Company description

Grasim is a diversified company with cement and VSF the core business, accounting for 60.4% and 23.1% of FY06 revenue. Its other business includes sponge iron, chemicals and textiles. The acquisition of UltraTech Cement, the cement division of L&T, by Grasim catapulted it to number one position in the Indian cement industry with total capacity under control of 31mt.

Key investment argument

- Being the largest player with total capacity of 31MT (existing capacity) in its control and highest organic growth visibility, Grasim would be biggest beneficiary of any further increase in cement price.
- Potential cost savings, apart from pricing power, arising out of synergies with UltraTech Cement could add an additional Rs1b to consolidated profits.

Key investment risks

- Cement sector is likely to add huge capacities in the coming year which can result in significant softening in cement prices.
- Poor performance of non-core business will remain a drag on Grasim's overall operating performance.

COMPARATIVE VALUATIONS

		GRASIM	ACC	GACL
P/E (x)	FY07E	12.5	17.4	13.3
	FY08E	12.3	15.3	12.4
P/BV (x)	FY07E	3.6	6.0	4.6
	FY08E	3.0	4.6	3.7
EV/Sales (x)	FY07E	2.7	3.4	3.1
	FY08E	2.7	3.0	2.8
EV/EBITDA (x)	FY07E	9.2	12.2	7.7
	FY08E	9.0	10.5	7.1

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	25.1	25.1	25.0
Domestic Inst	22.3	23.3	23.0
Foreign	36.1	34.8	35.2
Others	16.5	16.8	16.9

Recent development

- Formed a JV (along with other group companies) with Hubei Jing Wei Chemical Fibre, China, to get entry into China, world's largest VSF market.

Valuation and view

- The stock trades at valuation of 12.3x FY08E EPS and 9x EV/EBITDA.
- Grasim will be one of the biggest beneficiaries of the current upturn in cement prices as well as its organic expansion plan. **Maintain Buy** with target price of Rs2,950 (~14x FY08E EPS).

Sector view

- Volume expected to grow by 8% driven by continuous momentum in housing and infrastructure projects.
- Improved supply-demand dynamics due to limited capacity addition in previous years. However, greenfield capacity addition can disturb the tight supply-demand scenario.
- Near term outlook for sector remains positive but longer-term prospects will be determined by sector's allocation of cash flow.

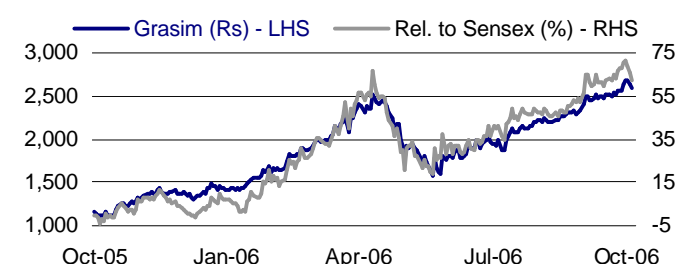
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	206.7	168.5	22.7
FY08	210.3	192.4	9.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,582	2,950	14.2	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	92,917	101,919	128,970	139,086	148,203
Change (%)	23.8	9.7	26.5	7.8	6.6
Total Expenditure	72,645	81,138	90,040	98,094	106,643
EBITDA	20,272	20,781	38,929	40,992	41,560
Margin (%)	21.8	20.4	30.2	29.5	28.0
Depreciation	5,562	5,631	5,267	6,493	7,456
EBIT	14,709	15,150	33,662	34,499	34,103
Int. and Finance Charges	2,846	2,122	1,929	1,898	1,761
Other Income - Rec.	2,452	2,524	1,980	2,005	1,989
PBT & EO items	14,316	15,552	33,713	34,606	34,331
Change (%)	36.4	8.6	16.8	2.6	-0.8
Extra Ordinary items	-1,281	41	0	0	0
PBT but after EO items	13,035	15,593	33,713	34,606	34,331
Tax	4,421	4,027	10,871	11,169	11,108
Tax Rate (%)	33.9	25.8	32.2	32.3	32.4
Reported PAT	8,614	11,566	22,842	23,437	23,222
PAT Adj for EO items	9,461	11,536	22,842	23,437	23,222
Change (%)	22.0	21.9	98.0	2.6	-0.9
Margin (%)	10.2	11.3	17.7	16.9	15.7
Less: Minority Interest	-190	1,160	3,886	4,151	4,549
Consolidated PAT	9,651	10,376	18,956	19,285	18,673
Change (%)	26.9	7.5	82.7	1.7	-3.2

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	917	917	917	917	917
Reserves	39,943	47,459	65,705	78,912	91,161
Net Worth	40,859	48,376	66,622	79,829	92,078
Loans	39,339	36,833	31,882	39,500	28,500
Deferred liabilities	11,793	11,583	12,325	12,243	12,849
Minority Interest	5,002	5,136	9,022	13,173	17,723
Capital Employed	96,993	101,927	119,851	144,745	151,150
Gross Block	111,116	114,836	127,965	159,890	175,760
Less: Accum. Deprn.	50,181	55,160	54,218	59,899	67,355
Net Fixed Assets	60,935	59,676	73,746	99,991	108,405
Capital WIP	2,053	4,480	5,815	7,370	2,500
Investments	7,690	13,521	16,422	13,223	14,510
Goodwill	19,577	17,728	17,728	17,728	17,728
Curr. Assets	23,971	26,185	32,107	34,179	37,441
Inventory	10,567	11,645	13,025	14,058	14,963
Account Receivables	7,232	5,908	9,531	9,773	10,451
Cash and Bank Balance	1,635	2,374	2,592	3,087	4,282
Others	4,537	6,259	6,960	7,261	7,745
Curr. Liability & Prov.	17,233	19,663	25,968	27,745	29,434
Account Payables	8,982	11,382	19,460	21,074	22,359
Other Liabilities	5,209	5,003	2,664	2,720	2,747
Provisions	3,043	3,277	3,844	3,951	4,328
Net Current Assets	6,738	6,523	6,139	6,434	8,007
Appl. of Funds	96,993	101,927	119,851	144,745	151,150

E: MOSSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	105.3	113.2	206.7	210.3	203.7
Cash EPS	162.0	172.3	269.7	284.8	254.2
BV/Share	445.7	527.7	726.6	870.6	1,004.2
DPS	16.5	20.0	20.0	20.0	20.0
Payout (%)	18.3	18.4	9.1	8.9	9.0
Valuation (x)					
P/E		22.8	12.5	12.3	12.7
Cash P/E		15.0	9.6	9.1	10.2
P/BV		4.9	3.6	3.0	2.6
EV/Sales		3.1	2.4	2.3	2.0
EV/ EBITDA		15.1	8.0	7.8	7.5
Dividend Yield (%)		0.8	0.8	0.8	0.8
Return Ratios (%)					
RoE	23.6	21.4	28.5	24.2	20.3
RoCE	21.4	20.7	36.2	30.6	29.9
Working Capital Ratios					
Debtor (Days)	28	21	27	26	26
Asset Turnover (x)	1.0	1.0	1.1	1.0	1.0
Leverage Ratio					
Debt/Equity (x)	1.0	0.8	0.5	0.5	0.3

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
OP/(Loss) before Tax	25,274	20,914	42,816	45,143	46,109
Interest/Dividends Recd.	2,452	2,524	1,980	2,005	1,989
Direct Taxes Paid	1,047	-4,237	-10,129	-11,251	-10,502
(Inc)/Dec in WC	-1,881	954	601	201	-379
CF from Operations	26,892	20,155	35,268	36,098	37,217
EO Items	1,281	-41	0	0	0
CF from Op. incl EO	25,611	20,197	35,268	36,098	37,217
(inc)/dec in FA	-36,368	-6,798	-20,672	-34,293	-11,000
(Pur)/Sale of Investments	-1,861	-3,981	-2,902	3,200	-1,287
CF from Investments	-38,229	-10,780	-23,574	-31,093	-12,287
Issue of Shares	-2,128	-1,929	-2,510	-8,144	-8,887
(Inc)/Dec in Debt	18,687	-2,506	-4,951	7,618	-11,000
Interest Paid	-2,846	-2,122	-1,929	-1,898	-1,761
Dividend Paid	-1,735	-2,121	-2,086	-2,086	-2,086
CF from Fin. Activity	11,978	-8,678	-11,476	-4,510	-23,735
Inc/Dec of Cash	-640	739	218	495	1,195
Add: Beginning Balance	2,275	1,635	2,374	2,592	3,087
Closing Balance	1,635	2,374	2,592	3,087	4,282

N O T E S

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