



Research Report

25th March, 2019

Key Data

Industry:	Capital Goods
CMP:	181.55
Market Cap:	Rs. 117 Cr.
52 –Week High/Low:	Rs. 145.2/ 218.95
Investment Horizon:	2-3 Years
Outlook:	Positive

Shareholding Pattern

Promoters:	50%
Public:	50%

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The company is involved into the manufacturing of Glass Lined Equipments which are used in Pharma, Agro and Fine Chemicals Industry.

1. Investment Rationale

Demand for Glass Lined Equipment

The demand for Glass Lined Equipment is directly correlated to capex cycle of Pharma, Agro and Fine chemicals. These equipments are replacing the existing steel equipments which are generally reactive in nature. The demand has also risen in the recent times because of the shift in the production capacity of Pharma and chemicals happening from China to India because of stringent an environmental norm that has come up there.

Change in Promoters

The company witnessed a change in management as HLE Engineering (a Gujarat- based company) (PATEL GROUP) acquired stake of Mr. Sudharshan Amin – the former promoter of SGEL in FY2017.HLE Engineering is one of the largest producers of Agitated Nutsche Filters, Hastelloy Agitated Filters and Filter-Dryers, Rotary Vacuum Paddle Dryers. The company has strong established customer network, which can help Swiss Glascoat to grow in size and provide service to diversified customers.

Lower Valuation The company is available at a trailing PE multiple of 15x and EV/EBITDA of 8x which is less than its publicly listed peer GMM Pfaudler. The valuation is low in reference to the growth opportunity that lies ahead. Swiss Glascoat is expected to generate better profitability margins in the coming period, which would help the company expand the RoE and thus get better multiple.

2. About Product

Glass Lined Equipment (GLE) are used where lot of chemical reactions are to take place. Any other material like steel would get corroded in those harsh conditions. Glass lined equipment is a corrosion resistant material used in varying processes of operation (mixing, filtration, reaction, storage, etc.) from production of pharmaceuticals to specialty chemicals and polymers. Glass lined equipment prevents materials exposed to harsh chemicals (acids, alkalis, water, and other chemicals) from getting corroded and thereby preventing failure in the equipment.

These equipments can both be a standardised as well as, customized according to the needs of the buyer and generally have a useful life of 7-10 years.

The demand of Glass- Lined Equipment is directly correlated with the capital expenditure happening in industries like Pharmaceuticals, Agrochemicals, Fine Chemicals, etc. In the past few quarters, production capacity of Chemical and Pharma, has been moving away from China and has come to India, which has been the **major growth driver for the Glass Lined Equipment industry.**

The Asset building in these sectors, especially Pharmaceuticals has been on a higher side (in the past 15 years), and is expected to remain so in the coming future, as India has become a hub for production of generic drugs, and as more of them are expected to get generic in the next 4-5 years, the industry is definitely going to benefit from it. The further growth rate can be attributed to the development of **“Pharma city”** (over the next 5 years) in Telangana is expected to attract investments from Pharma companies, which could boost the demand for Glass Lined Equipment.

Approximately, **10% of the total CAPEX of Pharma and Chemical** is spent on Glass lined equipment, and related equipment, and as per the recent data, around 1,40,000 crores (INR) kind of a project are in pipeline which are at different stages like clearing stages or planning stages.

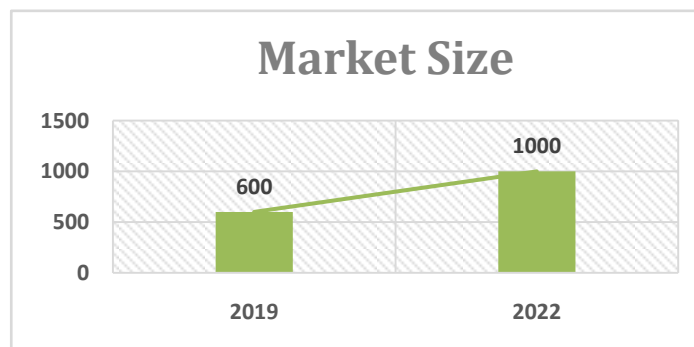
The **niche industry** benefiting from the gradual shift from stainless steel reactors to glass- lined reactors as they are safer and are non- corrosive and offers flexibility also possesses industry barriers. One of them is the **“years of experience the existing players have” and the skill sets the manpower needs to possess.** This eliminates new players to enter into the market, as the experienced players have **established customers networks.** This has been **further witnessed** in the industry as the small-scale producers have been acquired by their larger counterparts.

Dependent Industries

Pharmaceuticals	Agrochemicals	Specialty Chemicals
<p>Low cost of production in India compared to Rest of the World has led to competitive pharma exports with exports reaching US\$ 17.27 billion in FY18 and is expected to grow.</p> <p>Increasing Private sector investments in R&D. In FY18, Indian Pharma companies invested 8.8% of their Sales in R&D. It can soon be expected that the expenditure will start on Equipments as well.</p> <p>Medicine spending is projected to grow 9-12% over the next 5 years.</p> <p>LAST 15 YEARS ASSET BUILDING CAGR: 22%</p>	<p>The long-term growth drivers are declining arable land coupled with lower penetration of agrochemicals, poor crop yields and rising farmer income.</p> <p>The market is expected to grow at a CAGR of 3.5-4% in the coming years, to reach out a market size of 270 billion USD by the year 2022.</p>	<p>The domestic specialty chemical is expected to grow by about 10% annually to almost double the market size by FY25.</p> <p>Specialty chemicals segment represent about 32 billion USD currently.</p> <p>It is expected that there will be a continued increase in demand from end-user industries and tight global supply due to stringent environmental norms in China will benefit India.</p> <p>Subdued Oil prices will only push the speciality chemical sector to grow.</p> <p>LAST 15 YEARS ASSET BUILDING CAGR: 10%</p>

Size of Opportunity and Growth

The **Glass-lined Equipment industry** seems to be on a high growth trajectory with **overall growth** in market size expected to remain intact for the next 2-3 years because of the investments happening in the Pharma and Chemical Industry. For instance, if the industry size grows from 600 crores to 1000 crores in three years, and stabilizes there, the companies involved in the manufacturing of Glass-Lined Equipment can grow at very high rates along with the industry and then settle down at a sustainable growth rate. Therefore, Swiss Glascoat doing a turnover of Rs. 100cr can be expected to grow in tandem with the industry at least. The reason for this substantial growth rate is the shift of production capacity of Chemical and generic Pharma from China to India due to stringent pollution norms there.



The **opportunity size** that lies ahead is huge and **even when the incremental demand tapers out, demand will continue to be there to take care of the replacements and Brownfield projects**. Moreover, it can be expected that the company might gain some market share as well tapping into the customers of HLE Engineers Pvt. Ltd.

The producers of Glass Lined Equipment in India are:

GMM Pfaudler (50% market share) – based out of Gujarat
Swiss Glascoat (20% market share) – based out of Gujarat
Sachin Industries
DeDietrich – entered India by acquiring Nile Ltd for 58.3 crores (10-15% market share) – based out of Hyderabad
Standard Glass Lining Technology

The producers of Glass Lined Equipment at global level are:

Pfaudler – inventor of Glass Lined Equipment technology (based out of USA and Germany) – 25% market share
De Dietrich Process Systems (based out of France) - biggest competitor for Pfaudler globally.
Zibo Taiji Glass Lined Equipment (based out of China) – largest manufacturer in China (doesn't have plants outside China, but still exports through Agents)
3V Tech S.p.A – one of the divisions is Glass Lined Equipment (based out of Italy) division is considerably new – started in 2008 only.
Buchiglas – very small glass reactors (250-400 liters) – based out of Switzerland
Jiangsu Liyang Yunlong – based out of China
Huanghe Chemical Equipment – based out of China (some exports to India)
THALETEC – based out of Germany
Zibo Zhongsheng Machinery – based out of China

Process of Manufacturing Glass- Lined Equipment

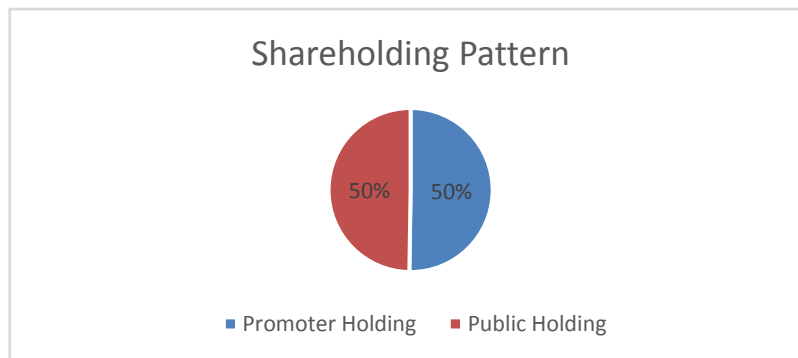


There are 3 major players producing GLE in India. Out of the three, two are listed, **GMM Pfaudler and Swiss Glascoat** and one private company, **De Dietrich(MNC)**. **De Dietrich** came into the Indian markets through acquisition of glass- lined equipment and pressure vessel division of Nile for 58 crores in 2011.

3. Holding Structure

Swiss Glascoat

The company witnessed a change in management as **HLE Engineering** (a Gujarat- based company) (PATEL GROUP) acquired stake of **Mr. Sudharshan Amin** – the former promoter of SGEL in FY2017. **Mr. Amin** went for a strategic sale of the business because of **succession issues**. However, the new promoter, HLE Engineering, brings in synergy as it also caters to the same set of customers. HLE is also one of the leading supplier of drying and filtration equipment to the chemical industry. A wider product basket and larger scale will help the group achieve cost synergy in sourcing and revenue synergy by tapping into the customer base of both companies. The company (HLE Engineering) acquired 50.25% stake.



The acquisition took place through open offer of shares (17.86 lakhs) at price of Rs 130 and issue and allotment of

Flat steel plates (thickness 3-6 cm) are rolled.

Pilot holes (made of Enamel) are cut at the nozzle positions (which are used for connecting to the pipings of the chemical industry).

- Later these are welded to the original cyliner made in first step.

Quartz Sand, Soda and ingredientis are added, which are heated at 1390 degree celsius to form Solid Glass.

This is done in order to give corrosion resistance property to the Equipment.

The Top and the cylinder are welded. Then, manually the Solid Glass is sprayed inside the cylinder (7 layers), then it is put into the furnace to heat up so that it gets completely glass lined.

convertible warrants (15 lakhs) into equal number of Equity shares of the company in FY2016-17.

HLE Engineers Pvt. Ltd. – New Promoter group of the company

The company was established in 1981, and has specialized in exotic metal equipments, and is one of **the largest producers of Agitated Nutsche Filters, Hastelloy Agitated Filters and Filter-Dryers, Rotary Vacuum Paddle Dryers. De Dietrich and MAVAG (subsidiary of GMM Pfaudler)** are also into the production of these filters as a part of their non-glass lined equipment business.

The following are the **group companies** of HLE Engineering Pvt. Ltd.:

a) Yashashvi Rasayan Pvt. Ltd.: manufacturer of bulk intermediates for agrochemicals, pesticides and pigments. The company specializes in **catalytic hydrogenation**.

b) Newpar Aromatics: Producer of **BON Acid (Beta HydroxyNaphthoic Acid)** with a present production capacity in excess of 2000 TPA.

c) Heerasons Chemicals: Producer of **Alpha Naphthyl Amine (ANA)** and **Sodium Naphthionate (SN)**.

d) H.L. Equipments: key focus on engineering and production.

However, there is scheme of Amalgamation and Demerger provided by the company (Swiss Glascoat) for further consolidation by undergoing the following:

a) **Amalgamation of Yashashvi Agrochemical Pvt. Ltd. With HLE Engineers Pvt. Ltd.**

b) The Demerger of the Operating Business of HLE Engineers Private Limited and vesting of the same into Swiss Equipments Limited.

	Swiss Glascoat Equipments Limited	HLE Engineers Private Limited	Yashashvi Agrochemical Pvt. Ltd.
Turnover (as on 31st March)	98.76 crores	189.2818 crores	Nil
Net worth (as on 31st March, 2018)	51.48 crores	49.63 crores	0.0029 crores

- The valuation is carried out by M/s. R U Kamath & Co.
- The existing shareholders will get the shares of the resulting company as per the valuation report developed by the Independent Valuator.
- **Under the scheme of arrangement, no cash consideration is proposed. The resulting company will issue its 309 fully paid up equity shares and 60 fully paid up 9.50% non convertible, cumulative, redeemable preference shares for every 100 equity shares held by the shareholders in the Demerged company.**
- No consideration for Yashashvi Agrochemical Private Limited as it wholly owned subsidiary of HLE Engineers Private Limited.

Pre and Post scheme holding - Swiss Glascoat Equipments Ltd.:

	Pre-Merger	Post-Merger
Promoters	32,66,243 (50.25%)	96,00,744 (74.25%)
Public	32,33,757 (49.75%)	33,30,332 (25.75%)

GMM Pfaudler

Pfaudler is the **parent company** of **GMM Pfaudler** which holds approximately 51% of the total company. Pfaudler is the world leader in glass lined Equipment, with a global market share of around 25%, **competing with DeDietrich** at

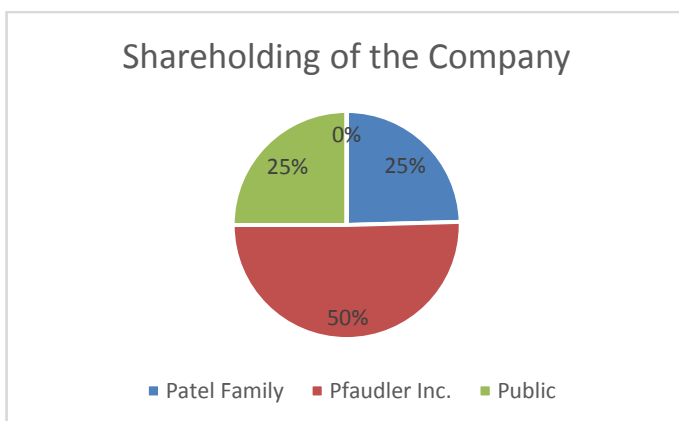
the global level. Pfaudler also provides spare parts and repair services as well as planning and constructing complete production lines.

Pfaudler was acquired by **DBAG (Germany based listed PE fund)** from a “**US based supplier to Oil- and Gas Industry, National Oilwell Varco**” in November, 2014. Since DBAG is a PE firm, the expected investment horizon would be of 5-7 years in which they will try to realize synergies and cash out. There will again be a change in the promoters after 3 to 4 years.

MAVAG (Fully owned subsidiary): Company has a 100% owned subsidiary based in Neunkirch, Switzerland which was acquired in 2008, supplying Engineered products in Europe, to industries like Biotech, Pharmaceuticals, and fine chemical industries. These are majorly non- glass lined equipments like dryers and filters.

MAVAG over the years, has become an outsourcing hub, where GMM Pfaudler is supplying the manufactured equipment to the subsidiary. This will slowly bring down the production cost and make MAVAG more competitive in the European markets.

Structure:



After the resignation of Mr. Ashok Patel from the position of MD in May, 2015, Tarak Patel (2nd generation) took over as the MD of the company. Mr. Tarak Patel has changed the remuneration policy and now a major component of total remuneration of key managerial positions come from the performance salary, rather from the fixed component.

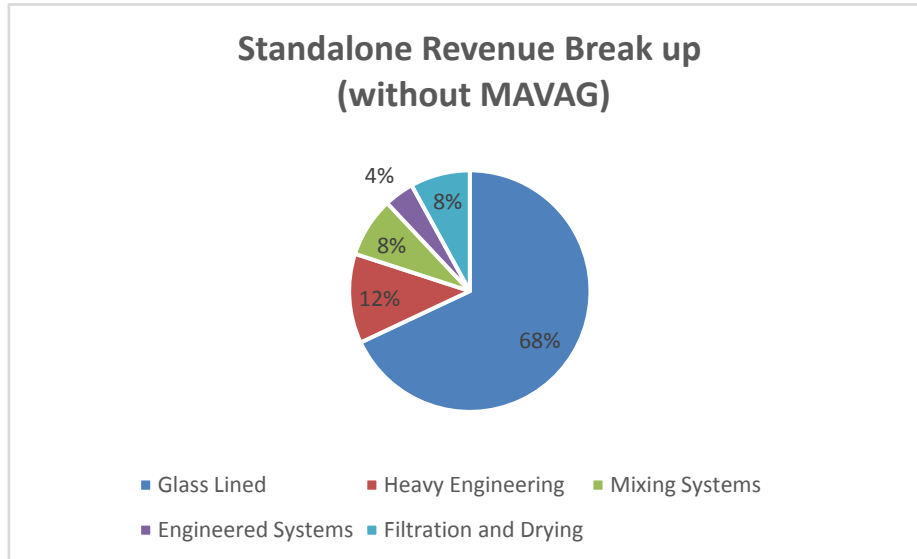
4. Product Lines and Customers

Swiss Glascoat

The company operates from its sole manufacturing facility at **Anand, Gujarat** and was incorporated in 1991. **SGEL (Swiss Glascoat Equipment Ltd)** manufactures glass- lined Equipment which are largely used by the

Pharmaceutical, chemical and food processing industries. The company client base is entirely domestic and is not focusing on exports and is currently the 2nd largest player after GMM Pfaudler in the glass- lined equipment space with a market share of 20%.

GMM Pfaudler:



Glass- Lined Equipment: The company is the **market leader** in the **Glass- Lined Equipment** business with a **market share of greater than 50%**. This segment contributes approximately **68%** of the **total Standalone Revenue** generated. The rest 32% comes from Heavy Engineering, Mixing Systems, Filtration and Drying equipments which are the non- glass lined Equipment.

The average size of the glass lined Equipment produced by GMM Pfaudler has a capacity of 10,000 liters, with the average price being around 10-15 lakhs. The company has an order book of 300- 350 crores which is sufficient till the 2nd quarter of next year.

The company's Glass- lined **sales volume in FY18** was **1530 equivalent units** with **capacity utilization of 80%**, which increased to 93% by 9M FY2019. Management has the target of 1850 Equivalent units by the end of FY19. The company is planning to expand the current capacity from 170-180 units per month to 220/230 levels next year.

Revenue contribution from pharmaceutical industry was restricted to 30% during Q3 FY2019, which used to be more than 50% (a year back). However, a revival is expected by the Management in the capex cycle of the sector. The company has started to get enquiries from few companies from the Telangana region for the Hyderabad Pharma City which would come on ground in not more than 5 years.

The company has 5 furnaces, 3 electric and 2 natural gas.

Natural Gas Furnaces save power cost, which the company is planning to add one more for the planned increased capacity.

Non- Glass Lined Equipment: The Non- GLE business contributes approximately 30% to the total standalone revenue. This segment is helped by MAVAG's high- end technology for filtration, mixing and drying applications.

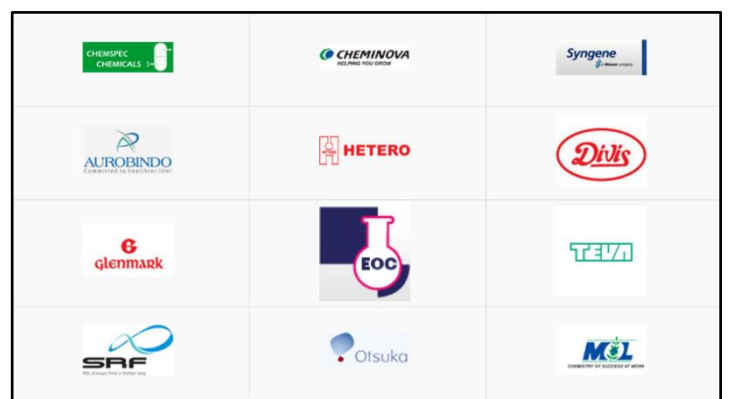
The plant is located in **Karamsad, Gujarat.**

On the **Consolidated** statement, **MAVAG (Switzerland subsidiary)** contributes approximately 20% of the revenue, which brings down the share in revenue of Glass Lined Equipment to 50%.

MAVAG, acquired in 2008 is a supplier of **Filtration and Drying Equipment** to the Pharma, Biotech and Fine Chemical Industries is considered to be a technology leader in Europe and now has become a low- cost supplier due to sourcing from the Parent company, GMM Pfaudler. This has made MAVAG’s competitors difficult because the labor cost in Europe is comparatively very high compared to that of India. However, the management is not expecting very high growth rates from MAVAG in the turnover in the coming years.

Customers:

Swiss Glascoat:



GMM Pfaudler:



5. Financials

Operating Profit Margins for GMM Pfaudler and Swiss Glascoat:

		2018	2017	2016	2015
Gross Sales	GMM Pfaudler (Glass Lined Business)	214.1	178.0	160.8	162.1
	GMM Pfaudler (Standalone)**	312.4	266.3	229.6	224.0
	Swiss Glascoat	98.76	89.49	100.65	95.72
EBIT	GMM Pfaudler (Glass Lined Business)	43	35.8	26.2	25.6
	GMM Pfaudler (Standalone)**	37.9	33.4	25.3	23.3
	Swiss Glascoat	8.5	7.34	9.65	9
EBIT Margins	GMM Pfaudler (Glass Lined Business)	20.1%	20.11%	16.3%	15.8%
	GMM Pfaudler (Standalone)**	12.1%	12.5%	11.0%	10.4%
	Swiss Glascoat	8.6%	8.21%	9.6%	9.4%

** includes business of GLE and Non- GLE, without MAVAG

The **Operating Profit margins** have remained constantly higher for GMM Pfaudler for Glass Lined Equipment business. However, the acquisition of SGEL by HLE Engineers Ltd. would help both the companies realize cost and revenue synergies in the times to come which could help the Operating margins to improve.

The major differences in both the companies that are affecting the Operating margins (**Swiss Glascoat Vs. GMM Pfaudler Standalone**):

- **Raw Material Cost (Steel):** The Steel cost as a percentage of Sales, for both the companies has been around 40-50% (as a percentage of Sales), depending upon the steel prices, and the variability depicts the lack of pricing power these companies have over the steel suppliers.
- **Power and Fuel Expenses:** This expense for GMM Pfaudler has been in the range of 5-7% (as a percentage of Sales), whereas for Swiss Glascoat, it has been in the range of 8-12%. This maybe attributed to the **Natural Gas Furnaces** used by GMM Pfaudler.
- **Employee Cost:** The Employee cost for GMM Pfaudler has remained constant at 11% (as a percentage of Sales), whereas for Swiss Glascoat, it has been rising from 3-4% level (2007) to 7% (2018).
- **Selling and Distribution Expenses:** These costs are negligible for GMM Pfaudler, whereas Swiss Glascoat incurs a cost of 3-4% on this.

Debt, Cash and Cash Conversion Cycle

In crores (FY2018)	GMM Pfaudler (Consolidated)	Swiss Glascoat
Total Debt	No debt	5.91
Market Cap (as on 5th March, 2019)	1742.41	115.6
Book Value	227.75	51.48
D/E (Total Debt to Equity)	0.00	0.115
Cash and Cash Equivalents (including short term loans and advances):	166.82	9.58

Cash Conversion Cycle (FY2018)		
Receivable Days	53.48	20.04
Inventory Days	79	173.26
Payable Days	62.26	66.08
Cash Conversion Cycle	70.22	127.22
Sales (FY2018)	410.96	98.76
Sales/ Working Capital	2.5x	3.49x

Swiss Glascoat carries inventory worth half of its sales, which leads to unnecessary short term borrowings.

Valuation and Return Ratios:

(according to current numbers)	GMM Pfaudler (Consolidated)	Swiss Glascoat
PE Multiple (as on 5th March, 2019)	40.82	15.35
RoE	20.06%	10.88%
EV/EBITDA	23.40	8.20
RoCE	29.00%	14.62%

DuPont Analysis (GMM Pfaudler):

	2018	2017	2016
Net Profit Margin	9.48%	8.29%	6.50%
Asset Turnover	1.04	1.25	1.26
Financial Leverage (Asset to Equity)	1.87	1.54	1.54
RoE	18.49%	17.39%	12.68%

DuPont Analysis (Swiss Glascoat):

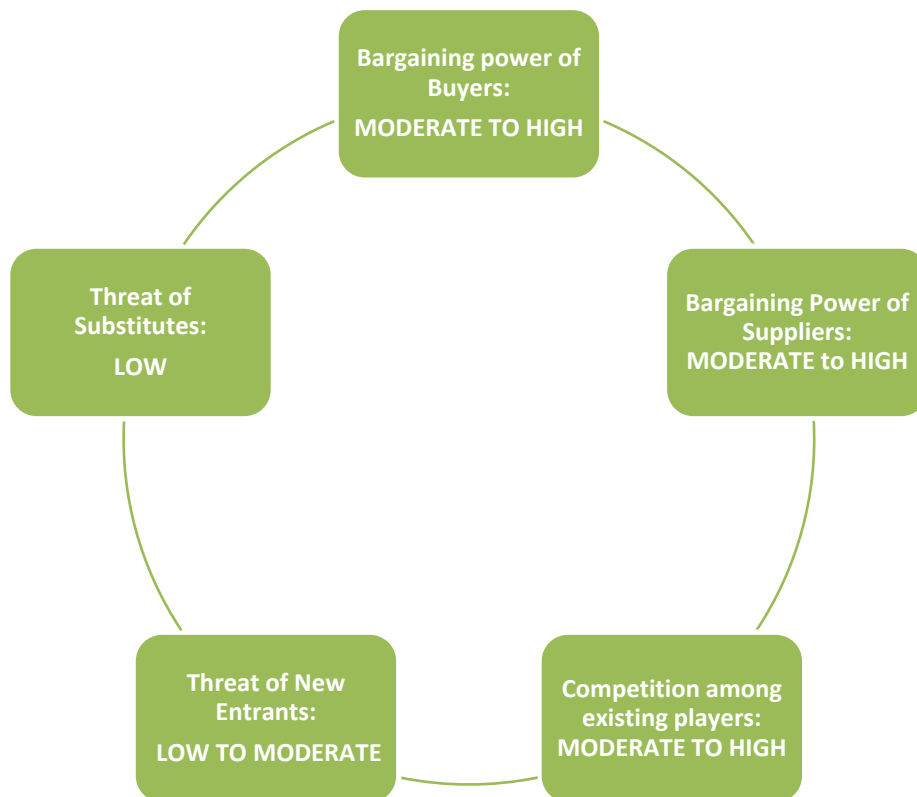
	2018	2017	2016
Net Profit Margin	5.43%	3.49%	4.13%
Asset Turnover	1.03	1.03	1.23
Financial Leverage (Asset to Equity)	1.94	2.36	3.26
RoE	10.87%	8.49%	16.59%

6. Quality of Management

	GMM Pfaudler	Swiss Glascoat
Family Run Business or Professional Management	Promoters is the Management (25%) (Tarak Patel and Ashok Patel), but major holding with Pfaudler (Professional) (50.44%) which is a positive sign.	Professional Management as the company is managed by HLE Engineers Pvt. Ltd.
Compensation of Management	Compensation is not very high, most portion is variable as per performance. (5% of Net Profit for MD).	Compensation is not very high, and greater portion is fixed.
Confidence of Management in different modes of Communication	Management is confident about the growth prospects for future.	Management is confident in making full use of available capacity.

Family Disputes	No	No
Background check	50.44% of the company is owned by Pfaudler, whereas 24.56% is owned by Patel Family (Tarak and Ashok Patel) who have been into the business for 5 decades.	Patel Group of HLE Engineers Pvt. Ltd have been in the equipment industry and are expected to bring Management expertise and the takeover would bring synergies.
Issuance of ESOPs	No	No
Issuance of Warrants	No	Issue and allotment of 15,00,000 Warrants convertible to equivalent shares
Capital allocation decision of past	In existing businesses and proved correct.	New Promoter (can't say)
Capex/ Sales	Less than 1. (GOOD SIGN)	Less than 1. (GOOD SIGN)
Capital allocation in existing or new business	Existing Businesses (Investment in MAVAG, capex in Glass Lined Equipments)	No new capex in the recent past

7. Porter's 5 forces



Bargaining Power of Suppliers:

- The main raw material used for making glass- lined equipment and non-glass lined equipment is Steel.
- It constitutes 40-50% of Sales.
- The company has seen variability in the Operating Profit with a lag effect with the **fluctuation in prices of Steel**. Generally, the raw material is procured before 4-6 months.
- There are many steel producers in the country, but the prices are dictated by global demand and supply, therefore not allowing the Glass- Lined Equipments manufacturers to have any say in the prices much.

Bargaining Power of Buyers:

- According to the Management, they are able to pass on the fluctuation in the prices of raw materials to their customers. However, this is not completely true. There has been variability in the Gross Profit Margins as the steel prices fluctuated.
- **Selling and Distribution Expense:** Swiss Glascoat Equipments Ltd. incurs 3-4% as a proportion of Sales every year whereas GMM Pfaunder's incurs less than half a percent every year. However, this doesn't come from Advertisements, but from freight costs. Since GMM Pfaunder is a bigger supplier, it is able to save costs on transports relatively.
- **Credit Period cycle:** The industry is a Capital Goods Industry; therefore, it is expected that the cycle would be longer. The Cash Conversion Cycle for Swiss Glascoat Equipments Ltd. is 127.22 days whereas 70.22 days for GMM Pfaunder.
- There are **no bad debts** for the listed companies in this industry.
- **Customer switching cost:** There is moderate to high customer stickiness as the Equipment required is generally tailored-made and not standardized. Moreover, there are years of client relationships the company shares.
- There are no discounts given to the customers.
- Market size is expected to grow at 20-25% CAGR for the next 3 years, given the demand cycle from the Pharma, Agro and Specialty chemicals. After the incremental demand tapers out, sustainability can be expected from the Brownfield Expansion and recurring demand.

Threat of Substitutes:

- The Glass- Lined Equipment is itself substituting steel reactors and vessels. Currently, there is no other substitute for Glass- Lined Equipment available.

Threat of New Entrants:

- The industry is dominated by players, with "years of experience" and the small producers generally get acquired by any MNC or bigger Equipment producer.
- They also have established customer networks across industries.
- The Glass lining work is done with utmost precision, therefore skilled manpower is required which also acts as a threat to the new entrants.
- Capex for business: Moderate to High

Competition among existing players:

- Location of manufacturing plant plays an important role as transportation cost can bring down the Operating margins.
- Gmm Pfaunder has an EBIT margin from the Glass- lined Equipment segment of 20.1%, while Swiss Glascoat has of 8.6%. This can be expected to improve from Swiss Glascoat, from the synergies realized with the help of new Promoter company HLE Engineers in the years to come.
- Growth in Capex Vs. Growth in Sales:

GMM Pfaunder:

	2018	2017	2016	2015
Growth in Sales	32.54	68.74	-12.55	29.39

Purchase of Fixed Assets	23.38	14.31	13.61	7.42
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The ratio of growth in Sales is generally higher than the growth of Capital Expenditure, which is a good sign for GMM Pfadler Ltd.

Swiss Glascoat Equipments Ltd:

	2018	2017	2016	2015
Growth in Sales	9.27	-11.16	4.93	12.03
Purchase of Fixed Assets	1.3	6.41	3.02	5.10

The ratio of growth in Sales is generally higher than the growth of Capital Expenditure, which is a good sign for Swiss Glascoat Equipments Ltd as well.

- The Industry is dominated by **Organized players**.
- The two listed companies, GMM Pfadler and Swiss Glascoat have a market share of 50% and 20% respectively.
- **Technology advantage:** The companies can save costs on Electricity by bringing in Natural Gas Furnaces or producing their own electricity through renewable sources like Wind and Solar. At the same time, companies can improve the quality by improving the quality of manpower. Both GMM Pfadler and Swiss Glascoat have a strong promoter group (Pfadler and HLE Engineering) thus providing them technological aid.
- Competition from outside India, is not much as the plant has to be set up in India for entering into the market, because of logistics cost.

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