

**COMPANY UPDATE / TARGET CHANGE
ESTIMATE CHANGE**
Key Metrics

ARTNA - NASDAQ - as of 3/8/17	\$32.14
Price Target	\$37.00
52-Week Range	\$25.17 - \$35.00
Shares Outstanding (mm)	9.2
Market Cap. (\$mm)	\$294.2
1-Mo. Average Daily Volume	20,352
Institutional Ownership	43.7%
LT Debt/Total Capital	Q4'16 42.4%
ROE	TTM 9.6%
Book Value / Share	Q4'16 \$15.13
Price / Book Value	2.1x
Dividend Yield	2.8%
EBITDA Margin	FY'16 45.9%

EPS FY 12/31

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$0.31	--	\$0.32	--	--
2Q	\$0.33	--	\$0.38	--	--
3Q	\$0.48	--	\$0.44	--	--
4Q	\$0.30	--	\$0.35	--	--
Year	\$1.41	\$1.46	\$1.49	\$1.61	\$1.65
P/E	22.8x		21.6x		19.5x

Revenue (\$mm)

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$18.4	--	\$18.9	--	--
2Q	\$19.4	--	\$20.4	--	--
3Q	\$21.8	--	\$21.9	--	--
4Q	\$19.4	--	\$20.2	--	--
Year	\$79.1	\$81.4	\$81.4	\$85.3	\$85.3

Company Description: *Artesian Resources Corp., through its wholly owned subsidiary, Artesian Water Company, provides water service to approximately 85,000 metered customers, and has a customer base of ~275,000 residents in DE, MD, and PA. It sells water to residential, commercial, industrial, governmental, municipal, and utility customers, and also provides wastewater treatment services.*

Water Utilities

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Artesian Resources Corp.

ARTNA — NASDAQ — Long-term Buy-3

Beat in Q4 Caps Strong Year at ARTNA; Reiterating Long-term Buy and Raising Price Target by 6%.

Investment Highlights

- Artesian reported Q4'16 EPS of \$0.30 vs. \$0.20 in Q4'15, a number we view as an easy comparison. Our target of \$0.25/share was the only published estimate. FY 2016 EPS grew 12.5% to \$1.41, marking a third consecutive year of double digit gains.
- Total revenue grew 2.7% and 3.6% in Q4 and FY 2016, respectively; the quarter exceeded our \$19.3M estimate by \$0.1MM. As expected, revenue growth slowed last year, although DSIC surcharges and customer additions were steady contributors.
- Utility operating expenses slipped 1.4% in 2016, due in part to falling 9.0% in Q4. For a third year in a row, utility op ex growth lagged revenue, in a trend we believe could actually hold for a couple more years.
- We estimate customer growth at ~1.5% in 2016, the quickest rate since the Cecil Co., MD, acquisition drove 2.8% growth in 2011. Cap Ex exceeded \$28MM in 2016, a level not matched since 2008, which similarly bodes well for future growth.
- On 2/28, ARTNA disclosed a purchase of water assets in Delaware, with expansion plans to serve a 600 unit planned community. The system currently serves a healthcare center and a National Guard facility.
- We still expect a general rate case filing this spring, although we hope for some timing guidance in the 10-k. Nonetheless, even a ~1 yr delay would position new rates to impact within our investment time horizon.
- Largely keying on ripple effects from the beat in Q4'16, our 2017/2018 EPS estimates rise by \$0.03/\$0.04 to \$1.49/\$1.65.
- We are raising our 2-year price target by \$2 to \$37, at which ARTNA would fetch ~22x our 2018 EPS estimate, valuing the shares roughly in line with the company's own 5-year average trailing multiple.

**Note Important Disclosures on Pages 5-6
Note Analyst Certifications on Page 5**

ADDITIONAL DISCUSSION—FINAL THOUGHTS

Should ARTNA shares fail to react to what we view as a third consecutive strong year of execution, we are inclined to add to positions fairly aggressively. In our view, the company still has further room to trim (or contain growth of) expenses, and with consistent DSIC surcharges, Artesian should be able to concurrently add incremental revenue. This one-two punch feeds into a resilient outlook for us, which in our view, represents the most mis-priced story in the water space.

SUITABILITY

We assign ARTNA a suitability rating of ‘3.’ A complete description of our suitability scale is on page 5. Artesian’s small-cap status, relatively low trading volume and a lack of regional diversification versus most Utility sector peers keep ARTNA below our ‘2’ suitability rating. Industry-appropriate leverage, tenured monopoly franchises and a seemingly amicable regulatory environment keep ARTNA well above our most aggressive ‘4’ rating.

CONSIDERATIONS AND RISKS

We view all companies in the Water Utilities industry as being subject to significant regulatory and political risk. Utility operations are heavily regulated; negative rate-making climates and/or new environmental restrictions may affect the company’s ability to earn a sufficient return on invested capital. Weather, natural disaster, and availability of water supplies could negatively impact sources of water, demand for water services, and a utility’s ability to supply water to customers. Risks associated with the collection, treatment, and disposal of wastewater could also impose significant costs.

Significant capital expenditures are required to maintain infrastructure and expand rate base. Should the company suffer from a lack of ability to secure appropriate funding to make investments, or if delays are incurred in completing projects, operating results could be negatively affected. Contamination of water could result in service interruptions or cause enforcement actions. Water assets can be subject to condemnation through eminent domain.

Artesian operates with limited geographical diversity. As such, the company’s operating results may be more sensitive to negative events that directly affect its regions of operations. Additionally, the company is subject to all other risks that result from operating as a publicly traded company.

Our Suitability rating is 3 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

Additional information is available upon request.

Artesian Resources Corp.

Summary Balance Sheet	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16p	FY'16p	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Cash	\$243	\$209	\$511	\$223	\$244	\$500	\$500	\$180	\$3,270	\$4,170	\$930	\$930	\$680
A/R	5,065	6,350	5,809	7,885	7,849	6,580	6,580	5,950	8,290	7,890	6,820	6,820	7,050
Other CAs	11,340	7,885	5,770	5,879	7,786	7,555	7,555	5,890	6,000	7,940	7,710	7,710	7,860
Total Current Assets	16,648	14,444	12,090	13,987	15,879	14,635	14,635	12,020	17,560	20,000	15,460	15,460	15,590
Net PP&E	393,793	405,606	407,173	413,642	419,952	425,502	425,502	427,570	433,210	438,830	443,870	443,870	463,240
Other	11,772	11,576	11,543	11,329	11,108	10,839	10,839	11,770	11,560	11,330	11,060	11,060	11,280
Total Assets	422,213	431,626	\$430,806	\$438,958	\$446,939	\$450,976	450,976	\$451,360	\$462,330	\$470,160	\$470,390	470,390	490,110
LOC	18,491	10,487	6,466	4,818	4,008	8,010	8,010	28,420	34,420	34,420	37,420	37,420	17,420
A/P	3,783	4,914	3,052	3,633	4,402	5,090	5,090	3,130	3,820	4,420	5,280	5,280	5,450
Accrued Exp	1,513	1,254	1,501	2,205	2,570	1,030	1,030	1,280	2,000	2,370	800	800	570
Other CLs	6,405	6,563	6,419	6,796	9,913	5,198	5,198	6,550	6,930	10,110	5,300	5,300	5,410
Total Current Liabilities	30,192	23,218	17,438	17,452	20,893	19,328	19,328	39,380	47,170	51,320	48,800	48,800	28,850
LTD	104,954	103,647	103,259	102,992	102,599	102,331	102,331	83,240	82,950	82,670	82,390	82,390	105,260
Def Income Tax	57,043	62,156	63,518	64,711	66,449	62,780	62,780	64,150	65,360	67,110	63,410	63,410	64,040
Net CIAC	92,429	99,847	102,842	108,118	110,868	112,106	112,106	112,860	113,610	114,360	115,110	115,110	118,110
Other	11,990	10,427	10,212	10,297	10,253	15,408	15,408	10,420	10,500	10,460	15,720	15,720	16,030
Shareholders' Equity	125,605	132,331	133,537	135,388	135,877	139,023	139,023	141,310	142,740	144,240	144,960	144,960	157,820
Total Liab & SE	\$422,213	\$431,626	\$430,806	\$438,958	\$446,939	\$450,976	\$450,976	\$451,360	\$462,330	\$470,160	\$470,390	\$470,390	\$490,110
Summary Cash Flow	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16E	FY'16E	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Net Income	\$9,506	\$11,305	\$2,830	\$3,041	\$4,360	\$2,723	\$12,954	\$2,940	\$3,540	\$4,100	\$3,250	\$13,830	\$15,450
D&A	8,673	8,837	2,315	2,249	2,270	2,353	9,188	2,430	2,360	2,380	2,460	9,630	10,040
Deferred Tax	7,255	5,097	543	1,188	1,733	2,000	5,460	750	750	750	750	3,000	3,000
(Inc) / Dec in Wrk Cap	(7,103)	3,200	897	(523)	2,380	(4,067)	(1,313)	1,940	(640)	2,600	(4,230)	(330)	730
Operating Cash Flow	18,331	28,439	6,585	5,955	10,743	3,009	26,289	8,060	6,010	9,830	2,230	26,130	29,220
Cap Ex	(23,730)	(20,694)	(4,270)	(7,780)	(7,954)	(8,196)	(28,200)	(4,500)	(8,000)	(8,000)	(7,500)	(28,000)	(29,410)
Dividends	(7,523)	(7,811)	(2,010)	(2,042)	(2,047)	(2,100)	(8,200)	(2,100)	(2,140)	(2,150)	(2,190)	(8,580)	(8,940)
Free Cash Flow	(12,922)	(66)	305	(3,867)	742	(7,287)	(10,111)	1,460	(4,130)	(320)	(7,460)	(10,450)	(9,130)
Net Adv and CIAC	3,808	5,829	3,214	4,495	2,156	1,250	11,120	1,000	1,000	1,000	1,000	4,000	4,000
LTD Proceeds	689	-	-	-	-	-	-	35,400	-	-	-	35,400	25,000
LTD (Repay)	(1,132)	(1,263)	(379)	(263)	(383)	(280)	(1,310)	(35,680)	(280)	(280)	(280)	(36,520)	(26,120)
Net LOC Borrow / (Repay)	8,159	(8,004)	(4,021)	(1,648)	(4,106)	4,000	(5,780)	(3,000)	6,000	-	3,000	6,000	4,000
Stock Issued	1,651	3,049	386	830	225	500	1,940	500	500	500	500	2,000	2,000
Net Cash Flow	253	(455)	(495)	(453)	(1,366)	(1,817)	(4,141)	(320)	3,090	900	(3,240)	430	(250)
EBITDA	\$ 31,094	\$ 34,203	\$ 8,120	\$ 8,941	\$ 10,713	\$ 8,564	\$ 36,338	\$ 8,340	\$ 9,650	\$ 10,620	\$ 9,100	\$ 37,710	\$ 40,370
EV / TTM EBITDA	9.9x	10.4x	10.3x	12.1x	10.4x	10.9x	10.9x	10.4x	10.1x	10.1x	10.1x	10.1x	10.1x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Book Value	\$ 14.04	\$ 14.55	\$ 14.63	\$ 14.79	\$ 14.81	\$ 15.13	\$ 15.13	\$ 15.34	\$ 15.44	\$ 15.56	\$ 15.59	\$ 15.59	\$ 16.77
Price / Book	1.6x	1.9x	1.9x	2.3x	1.9x	2.1x	2.1x	2.1x	2.1x	2.1x	2.1x	2.1x	1.9x
LTD / Total Cap	45.5%	43.9%	43.6%	43.2%	43.0%	42.4%	42.4%	37.1%	36.8%	36.4%	36.2%	36.2%	40.0%
ROE (TTM)	7.7%	8.8%	9.0%	8.7%	9.1%	9.6%	9.6%	9.5%	9.8%	9.5%	9.7%	9.7%	10.1%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

I, Spencer E. Joyce, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.		
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	35	29%	14%	86%
Hold/Neutral	71	59%	6%	94%
Sell	15	12%	7%	93%

As of 8 March 2017

Other Disclosures

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