



## COMPANY UPDATE

### Key Metrics

AWK - NYSE - as of	4/12/17	\$78.82
Price Target		\$86.00
52-Week Range	\$68.09 -	\$85.24
Shares Outstanding (mm)		178.2
Market Cap. (\$mm)		\$14,046.9
1-Mo. Average Daily Volume		822,013
Institutional Ownership		84.9%
LT Debt / Total Cap	Q4'16	52.5%
ROE	TTM	9.9%
Book Value / Share	Q4'16	\$29.31
Price / Book Value		2.7x
Dividend Yield		1.9%
EBITDA Margin	FY'16	46.6%

### EPS (Cont'd Ops) FY 12/31

	Prior 2016A	Current 2017E	Prior 2017E	Prior 2018E	Current 2018E
1Q	\$0.46	\$0.49	\$0.49	--	--
2Q	\$0.77	\$0.79	\$0.79	--	--
3Q	\$1.05	\$1.14	\$1.14	--	--
4Q	\$0.57	\$0.61	\$0.61	--	--
Year	\$2.85	\$3.03	\$3.03	\$3.22	\$3.22
P/E	27.7x		26.0x		24.5x

\*Adjusted for Special Items

### Revenue (\$MM)

	Prior 2016A	Current 2017E	Prior 2017E	Prior 2018E	Current 2018E
1Q	\$743	\$774	\$774	--	--
2Q	\$827	\$863	\$863	--	--
3Q	\$930	\$988	\$988	--	--
4Q	\$802	\$830	\$830	--	--
Year	\$3,302	\$3,455	\$3,455	\$3,589	\$3,589

**Company Description:** *Founded in 1886, American Water is the largest investor-owned U.S. water and wastewater utility company. With headquarters in Voorhees, NJ, the company employs more than 7,000 professionals who provide drinking water, wastewater and other related services to approximately 15 million people in more than 30 states and parts of Canada*

## Water Utilities

Analyst: Spencer E. Joyce, CFA  
502.588.8402 // sjoyce@hilliard.com  
Institutional Sales Desk: George Moorin  
502.588.9141 // gmoorin@hilliard.com  
J.J.B. Hilliard, W.L. Lyons, LLC  
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## American Water Works Co.

AWK – NYSE – Long-term Buy-1

### Key Takeaways from April Non-Deal Roadshow.

#### Investment Highlights

- Over the course of April 11-12, we hosted institutional investor meetings in Minneapolis and Chicago for AWK. Our keynote company attendee was William Varley, SVP of Mid-West Operations.
- Key Takeaway #1: Utility-focused active managers seem to be under-positioned in AWK.** We believe a level of potential buying support exists from a roster of well-acquainted accounts that have trimmed positions across AWK's multi-year rally.
- Key Takeaway #2: In our view, investors more/less accepted AWK's efforts to de-emphasize the importance of the market-based businesses.** We expect this bodes well for sustaining valuations, but represents a risk to sentiment over the next few years.
- Key Takeaway #3: Incremental shifts in state-level legislation and regulatory outlooks continue to favor growth.** Oft-discussed was NJ 2834, which would raise compliance standards for muni-owned systems (hopefully compelling M&A). Fair value legislation seems to be working (albeit at a slow pace).
- Key Takeaway #4: AWK is not yet adjusting strategy in response to Trump Administration rhetoric or policy.** Although interested, the buy-side does not seem to be handicapping D.C. as a major part of the AWK investment decision making process.
- Our financial model is unchanged at this time. We are reiterating our LTB rating, and 2-yr price target of \$86, which is based on ~26x our 2018E EPS. We add a slight premium to reflect our expectation for growth into 2019, which falls within with our 2-yr horizon.
- This base multiple is ~10% below average peak multiples of the last few years, and remains justified, in our view, based on resilient growth prospects, and peer valuations.

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

**ADDITIONAL DISCUSSION—NON-DEAL ROADSHOW**

Our Key Takeaway #1 is perhaps our biggest surprise from this round of visits. Investors that have been familiar with AWK for years seemed under positioned (or at least willing to own more), which we partially attribute to ripple effects from AWK's 2016 addition to the S&P 500 and the rise of ESG-centric investing (Environmental, Social and corporate Governance). This adds to our argument that valuation is more/less sustainable at the 'higher' levels of the past couple of years.

Our positive qualitative view of both the company and industry is intact. We believe AWK remains a strong core holding for water exposure, and expect the average regulatory focus across the US to center on improved service and systems for an elongated period of time, which is conducive to growth. [Note: a primary alternative here would be a regulatory focus on limiting returns] Much time was allocated to the M&A conversation, particularly the municipal opportunities because that is where the legislative action is, although we are comfortable that most investors realize the roll-up story is still a long-game effort.

To quantify our position on the market-based contribution, AWK guides non-reg to contribute about a fifth of consolidated EPS growth through the 2021 planning horizon ('2%' of the '7%-10%' CAGR pyramid). This is not huge in absolute terms, but it is material in setting American Water apart from potential peer gas and electric firms that could challenge (or surpass) a CAGR of 5%-8%. Having said that, we really like AWK's non-reg lines aside from Keystone, but were surprised that the buy-side was not more interested in the granular details of business development and execution.

**SUITABILITY**

We assign AWK a suitability rating of '1.' Recently added to the S&P 500 Index, we view American Water as a large-cap core holding in the Utility sector. We believe substantial regional diversification helps mitigate regulatory/environment/disaster risks, while exposing the firm to broad secular growth opportunities in water and wastewater infrastructure. Despite a relatively recent IPO (late-2000s), sector-appropriate leverage, long-tenured individual franchises and a predominantly regulated business mix keep AWK above our more aggressive '2' rating.

**CONSIDERATIONS AND RISKS**

We view all companies in the Water Utilities industry as being subject to significant regulatory and political risks. 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.

Continued growth in non-traditional water distribution, including the Keystone Clearwater purchase, could bring uncertainties associated with costs, liabilities, operational efficiencies and managerial expertise. Furthermore this could alter the market opinion toward fair valuation multiples and metrics.

Significant Cap Ex is required to maintain infrastructure and expand rate base. Should AWK lack the ability to secure funding, or if delays occur, results could be impacted. Water assets can be subject to condemnation through eminent domain. The company's non-regulated businesses provide guarantees and have long-term contracts. AWK is subject to all other risks that result from being a public company.

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

*Additional information is available upon request.*

American Water Works Co.													
Income Statement (\$000's)	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
<b>Operating Revenues</b>	<b>\$3,011,328</b>	<b>\$3,159,000</b>	\$743,000	\$827,000	\$930,000	\$802,000	<b>\$3,302,000</b>	\$774,350	\$863,340	\$987,580	\$830,030	<b>\$3,455,300</b>	<b>\$3,588,990</b>
<b>Operating Expenses</b>													
O&M	1,349,864	1,404,000	348,000	351,000	432,000	373,000	1,504,000	356,780	360,840	377,930	383,370	1,478,920	1,509,490
D&A	424,084	440,000	116,000	115,000	119,000	120,000	470,000	124,820	123,740	127,780	128,510	504,850	533,110
General Taxes	236,732	243,000	66,000	64,000	65,000	63,000	258,000	71,240	69,070	68,140	64,740	273,190	283,590
(Gain) on Asset Sale	(1,928)	(3,000)	(100)	(2,000)	(5,000)	(2,000)	(10,000)	(200)	(1,000)	(200)	(300)	(1,700)	(1,700)
Impairment Charge													
Operating Income (Loss)	1,002,576	1,075,000	213,100	299,000	319,000	248,000	1,080,000	221,710	310,690	413,930	253,710	1,200,040	1,264,500
%	33.3%	34.0%	28.7%	36.2%	34.3%	30.9%	32.7%	28.6%	36.0%	41.9%	30.6%	34.7%	35.2%
Interest (Expense)/Income	(297,818)	(308,000)	(80,000)	(81,000)	(81,000)	(83,000)	(325,000)	(83,160)	(83,410)	(83,240)	(84,690)	(334,500)	(340,150)
Other (Expense)/Income	5,057	15,000	2,000	7,000	5,000	1,000	15,000	4,700	6,400	5,000	5,000	21,100	21,100
Inc (loss) Cont'd Ops Before Tax	709,815	782,000	136,000	225,000	243,000	166,000	770,000	143,250	233,680	335,690	174,020	886,640	945,450
Provision for Income Taxes	279,973	306,000	54,000	88,000	95,000	65,000	302,000	56,441	92,070	132,262	65,258	346,030	368,996
%	39.4%	39.1%	39.7%	39.1%	39.1%	39.2%	39.2%	39.4%	39.4%	39.4%	37.5%	39.0%	39.0%
Income (Loss) from Cont'd Ops	429,842	476,000	82,000	137,000	148,000	101,000	468,000	86,810	141,610	203,428	108,763	540,610	576,454
Inc (Loss) from Disc Ops, net of tax	(6,733)												
Net Income (Loss)	\$423,109	\$476,000	\$82,000	\$137,000	\$148,000	\$101,000	\$468,000	\$86,810	\$141,610	\$203,428	\$108,763	\$540,610	\$576,454
Diluted Avg Sh	179,806	180,000	179,000	178,000	178,000	178,000	179,000	178,064	178,628	178,693	178,757	178,587	178,925
GAAP EPS	\$ 2.35	\$ 2.64	\$ 0.46	\$ 0.77	\$ 0.83	\$ 0.57	\$ 2.63	\$ 0.49	\$ 0.79	\$ 1.14	\$ 0.61	\$ 3.03	\$ 3.22
Inc (loss) frm disc'd ops, net/tax	\$ (0.04)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
EPS from Cont'd Ops--Adj if Nec	\$ 2.45	\$ 2.64	\$ 0.46	\$ 0.77	\$ 1.05	\$ 0.57	\$ 2.85	\$ 0.49	\$ 0.79	\$ 1.14	\$ 0.61	\$ 3.03	\$ 3.22
Dividend	\$ 1.210	\$ 1.330	\$ 0.340	\$ 0.375	\$ 0.375	\$ 0.375	\$ 1.465	\$ 0.375	\$ 0.415	\$ 0.415	\$ 0.415	\$ 1.620	\$ 1.765
<b>Rate of Change Analysis:</b>													
Revenues	4.6%	4.9%	6.4%	5.7%	3.8%	2.4%	4.5%	4.2%	4.4%	6.2%	3.5%	4.6%	3.9%
Operating Income	5.7%	7.2%	4.3%	7.7%	-11.7%	6.9%	0.5%	4.0%	3.9%	29.8%	2.3%	11.1%	5.4%
EPS--Cont'd Ops--Adj if Nec	10.7%	8.0%	3.2%	12.8%	9.3%	3.2%	7.9%	6.4%	3.0%	8.0%	7.2%	6.3%	6.4%
EBITDA	5.1%	6.1%	5.9%	6.9%	-8.3%	6.4%	1.9%	5.3%	5.2%	25.1%	4.3%	10.6%	5.4%
O&M Expense	4.7%	4.0%	7.5%	4.3%	18.8%	-1.8%	7.1%	2.5%	2.8%	-12.5%	2.8%	-1.7%	2.1%
<b>Margin Analysis:</b>													
O&M	44.8%	44.4%	46.8%	42.4%	46.5%	46.5%	45.5%	46.1%	41.8%	38.3%	46.2%	42.8%	42.1%
D&A	14.1%	13.9%	15.6%	13.9%	12.8%	15.0%	14.2%	16.1%	14.3%	12.9%	15.5%	14.6%	14.9%
General Tax	7.9%	7.7%	8.9%	7.7%	7.0%	7.9%	7.8%	9.2%	8.0%	6.9%	7.8%	7.9%	7.9%
Operating Income	33.3%	34.0%	28.7%	36.2%	34.3%	30.9%	32.7%	28.6%	36.0%	41.9%	30.6%	34.7%	35.2%
Tax rate	39.4%	39.1%	39.7%	39.1%	39.1%	39.2%	39.2%	39.4%	39.4%	39.4%	37.5%	39.0%	39.0%
					*\$0.22 after-tax charge for WW chemical spill settlement	Scranton, PA, WW closed 12/29		*McKsprt could close in Q1'17	*Shorlands closed April 3; 11k H2O cust; 500k share purch price		*Model 10/1 McKsprt close; 22k WW cust		
	*Adj EPS Guidance \$2.38-\$2.44	*EPS Guidance \$2.60-\$2.65					*Adj EPS Guidance \$2.81-\$2.86					*Adj EPS Guidance \$2.98-\$3.08	

Source: Company reports and Hilliard Lyons estimates

American Water Works Co.													
Summary Balance Sheet (\$000's)	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
Cash	\$23,080	\$45,000	\$66,000	\$52,000	\$46,000	\$75,000	\$75,000	\$35,570	\$27,280	\$18,490	\$46,810	\$46,810	(\$5,280)
A/R	267,053	255,000	220,000	240,000	302,000	269,000	269,000	229,280	250,550	320,700	278,400	278,400	287,180
Unbilled Utility Rev	220,538	267,000	247,000	286,000	285,000	263,000	263,000	257,420	298,570	302,650	272,190	272,190	280,780
Other Current Assets	150,698	90,000	105,000	113,000	168,000	177,000	177,000	110,250	118,650	176,400	185,850	185,850	195,140
Total CAs	661,369	657,000	638,000	691,000	801,000	784,000	784,000	632,520	695,050	818,240	783,250	783,250	757,820
Net PP&E	13,029,296	13,933,000	14,098,000	14,317,000	14,559,000	14,992,000	14,992,000	15,169,680	15,373,440	15,591,910	15,837,900	15,837,900	16,629,790
Goodwill	1,208,043	1,302,000	1,313,000	1,313,000	1,313,000	1,345,000	1,345,000	1,347,500	1,350,000	1,371,250	1,445,750	1,445,750	1,470,750
Other LT Assets	1,232,248	1,349,000	1,368,000	1,385,000	1,298,000	1,361,000	1,361,000	1,504,800	1,523,500	1,427,800	1,497,100	1,497,100	1,646,810
<b>Total Assets</b>	<b>\$16,130,956</b>	<b>\$17,241,000</b>	<b>\$17,417,000</b>	<b>\$17,706,000</b>	<b>\$17,971,000</b>	<b>\$18,482,000</b>	<b>\$18,482,000</b>	<b>\$18,654,500</b>	<b>\$18,941,990</b>	<b>\$19,209,200</b>	<b>\$19,564,000</b>	<b>\$19,564,000</b>	<b>\$20,505,170</b>
ST Debt	449,959	628,000	839,000	950,000	951,000	849,000	849,000	914,000	1,014,000	614,000	864,000	864,000	1,044,000
CP of LTD	61,132	54,000	54,000	54,000	53,000	574,000	574,000	572,000	572,000	310,000	310,000	310,000	310,000
A/P	285,800	126,000	116,000	146,000	135,000	154,000	154,000	120,890	152,420	143,360	159,380	159,380	164,410
Other	444,107	725,000	605,000	590,000	789,000	815,000	815,000	635,250	619,500	828,450	855,750	855,750	898,540
Total CLs	1,240,998	1,533,000	1,614,000	1,740,000	1,928,000	2,392,000	2,392,000	2,242,140	2,357,920	2,157,810	2,189,130	2,189,130	2,416,950
LTD	5,448,245	5,874,000	5,850,000	5,861,000	5,853,000	5,759,000	5,759,000	5,761,000	5,761,000	6,061,000	6,323,000	6,323,000	6,032,000
Deferred Income Tax	2,120,739	2,310,000	2,358,000	2,430,000	2,524,000	2,596,000	2,596,000	2,648,000	2,730,000	2,819,000	2,878,000	2,878,000	3,160,000
Other	2,405,383	2,475,000	2,513,000	2,522,000	2,428,000	2,517,000	2,517,000	2,638,650	2,648,100	2,549,400	2,642,850	2,642,850	2,774,990
Common Shareholders' Equity	4,915,591	5,049,000	5,082,000	5,153,000	5,238,000	5,218,000	5,218,000	5,364,710	5,444,970	5,621,990	5,531,020	5,531,020	6,121,230
<b>Total Liabilities &amp; SE</b>	<b>\$16,130,956</b>	<b>\$17,241,000</b>	<b>\$17,417,000</b>	<b>\$17,706,000</b>	<b>\$17,971,000</b>	<b>\$18,482,000</b>	<b>\$18,482,000</b>	<b>\$18,654,500</b>	<b>\$18,941,990</b>	<b>\$19,209,200</b>	<b>\$19,564,000</b>	<b>\$19,564,000</b>	<b>\$20,505,170</b>
Summary Cash Flow (\$000's)	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
Net Income	\$423,109	\$476,000	\$82,000	\$137,000	\$148,000	\$101,000	\$468,000	\$86,810	\$141,610	\$203,430	\$108,760	\$540,610	\$576,450
D&A	424,084	440,000	116,000	115,000	119,000	120,000	470,000	124,820	123,740	127,780	128,510	504,850	533,110
Deferred Tax	255,573	296,000	52,000	82,000	89,000	59,000	282,000	52,000	82,000	89,000	59,000	282,000	282,000
(Inc) / Dec in Wrk Cap	23,992	(52,618)	(90,000)	(52,000)	72,000	(109,000)	(179,000)	(1,290)	(56,510)	70,160	230	12,590	23,150
Operating CF	1,126,758	1,159,382	160,000	282,000	428,000	171,000	1,041,000	262,340	290,840	490,370	296,500	1,340,050	1,414,710
Cap Ex	(956,119)	(1,160,000)	(284,000)	(313,000)	(331,000)	(383,000)	(1,311,000)	(300,000)	(325,000)	(325,000)	(300,000)	(1,250,000)	(1,300,000)
Acquisitions	(8,935)	(197,000)	(22,000)	(2,000)	(5,000)	(175,000)	(204,000)	(5,000)	(5,000)	(5,000)	(149,000)	(164,000)	(50,000)
Asset/Securities Sales	13,841	5,000	(1,000)	3,000	3,000	4,000	9,000	-	-	-	-	-	-
Dividends	(216,354)	(239,000)	(61,000)	(66,000)	(67,000)	(67,000)	(261,000)	(66,770)	(74,130)	(74,160)	(74,180)	(289,240)	(315,800)
Free Cash Flow	(40,809)	(431,618)	(208,000)	(96,000)	28,000	(450,000)	(726,000)	(109,430)	(113,290)	86,210	(226,680)	(363,190)	(251,090)
Adv & Contrbs for Construct	26,295	26,000	7,000	11,000	(2,000)	-	16,000	-	-	-	-	-	-
LTD Proceeds	500,497	565,000	-	2,000	-	551,000	553,000	-	-	800,000	-	800,000	290,000
LTD (Repaid)	(238,371)	(130,000)	(11,000)	(2,000)	(7,000)	(124,000)	(144,000)	-	-	(500,000)	-	(500,000)	(291,000)
ST Debt Drawn (Repaid)	(180,348)	180,000	211,000	110,000	1,000	(101,000)	221,000	65,000	100,000	(400,000)	250,000	15,000	180,000
Anti-Dilutive Repurch	-	(126,000)	(62,000)	(3,000)	-	-	(65,000)	-	-	-	-	-	-
Stock Issued	20,913	39,000	10,000	8,000	4,000	4,000	26,000	5,000	5,000	5,000	5,000	20,000	20,000
Net Cash Flow	88,177	122,382	(53,000)	30,000	24,000	(120,000)	(119,000)	(39,430)	(8,290)	(8,790)	28,320	(28,190)	(52,090)
EBITDA	1,424,732	1,512,000	329,000	412,000	433,000	366,000	1,540,000	346,330	433,430	541,510	381,920	1,703,190	1,795,910
EBITDA margin--period	47.3%	47.9%	44.3%	49.8%	46.6%	45.6%	46.6%	44.7%	50.2%	54.8%	46.0%	49.3%	50.0%
EV / TTM EBITDA	10.5x	11.0x	11.8x	13.4x	12.6x	12.1x	12.1x	12.6x	12.4x	11.8x	11.9x	11.9x	11.1x
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	\$ 27.29	\$ 28.05	\$ 28.39	\$ 28.95	\$ 29.43	\$ 29.31	\$ 29.31	\$ 30.13	\$ 30.48	\$ 31.46	\$ 30.94	\$ 30.94	\$ 34.19
Tangible BV	\$ 20.58	\$ 20.82	\$ 21.06	\$ 21.57	\$ 22.05	\$ 21.76	\$ 21.76	\$ 22.56	\$ 22.92	\$ 23.79	\$ 22.85	\$ 22.85	\$ 25.98
Price / Book	2.0x	2.1x	2.4x	2.9x	2.5x	2.5x	2.5x	2.6x	2.6x	2.5x	2.5x	2.5x	2.3x
LT Debt / Total Capital	52.6%	53.8%	53.5%	53.2%	52.8%	52.5%	52.5%	51.8%	51.4%	51.9%	53.3%	53.3%	49.6%
Net Total Debt / Total Capital	54.7%	56.3%	56.8%	56.9%	56.5%	57.7%	57.7%	57.3%	57.3%	56.3%	57.4%	57.4%	54.7%
ROE (TTM)--Adj for Freedom Spill	8.7%	9.5%	9.4%	9.6%	9.8%	9.9%	9.9%	9.8%	9.8%	9.9%	9.9%	9.9%	9.9%

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	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

**Other Disclosures**

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