



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

AWK - NYSE - as of	8/2/17	\$81.96
Price Target		\$105.00
52-Week Range	\$69.41 -	\$82.89
Shares Outstanding (mm)		14604.5
Market Cap. (\$mm)		\$14,501.2
1-Mo. Average Daily Volume		678,382
Institutional Ownership		84.9%
LT Debt / Total Cap	Q2'17	51.2%
ROE	TTM	9.0%
Book Value / Share	Q2'17	\$30.08
Price / Book Value		2.7x
Dividend Yield		2.0%
EBITDA Margin	FY'16	47.1%

EPS (Cont'd Ops) FY 12/31

		Prior	Current		Prior	Current
	2016A	2017E	2017E		2018E	2018E
1Q	\$0.46	--	\$0.52	A	--	--
2Q	\$0.77	--	\$0.73	A	--	--
3Q	\$1.05	\$1.12	\$1.12		--	--
4Q	\$0.57	\$0.61	\$0.61		--	--
Year	\$2.85	\$3.03	\$2.98		\$3.31	\$3.31
P/E	28.8x		27.5x			24.8x

*Adjusted for Special Items

Revenue (\$MM)

		Prior	Current		Prior	Current
	2016A	2017E	2017E		2018E	2018E
1Q	\$743	--	\$756	A	--	--
2Q	\$827	--	\$844	A	--	--
3Q	\$930	\$982	\$982		--	--
4Q	\$802	\$830	\$830		--	--
Year	\$3,302	\$3,428	\$3,412		\$3,600	\$3,593

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.*

Water Utilities

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August 3, 2017

American Water Works Co.

AWK – NYSE – Long-term Buy-1

Rare Miss from AWK in Q2'17, but Thesis Unchanged; Reiterating Long-term Buy Rating.

Investment Highlights

- AWK reported Q2'17 EPS of \$0.73 versus \$0.77 in Q2'17; results missed both consensus for \$0.79 and our slightly more conservative target of \$0.78. Net of a discrete tax item in NY, Q2 EPS were \$0.75.
- Revenue grew 2.1% to \$844MM in Q2, falling short of our estimate for \$860MM and consensus at \$867MM. Non-reg drove essentially all of the miss for us, although weather and M&A could have factored into the consensus miss. Wastewater sales were up 29% y/y (+\$8MM); the Scranton Sewer purchase should continue to boost in 2H'17.
- Operations & Maintenance (O&M) expense slid 0.6% in Q2'17, well under our +2.0% estimate; this was bolstered by reduced market-based activity, but is positive nonetheless for us given recent M&A. TTM regulated efficiency sits at 34.5%, down 70bps yr/yr; the 2021 goal remains 32.5%.
- The Shorelands (NJ) and Meadowbrook (CA) acquisitions (~16k customers) closed in early-Q2; Q3 closures have been slow thus far, but deals covering ~34k customer equivalents remain pending.
- General rate filings in PA (requesting net revenue of \$107.9MM) and MO (\$74.6MM) dominate the current regulatory calendar, and contribute to what we expect will be a reacceleration of growth in 2018.
- Management reiterated 2017 EPS guidance of \$2.98-\$3.08; our 2017 estimate slides to the low end, but our 2018E/19E EPS move +\$0.00/+\$0.02 to \$3.31/\$3.53.
- We are reiterating our LTB rating and 2 to 3-yr price target of \$105, which is ~30x our 2019E EPS. AWK shares have traded at this valuation in the past, and we believe they are likely to again given constructive industry parameters and AWK's growth outlook.

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

ADDITIONAL DISCUSSION—Q2 RECAP & FINAL THOUGHTS

Q2 is a bit of an anomalous quarter from our vantage point. A tough comp for the military services group happened to coincide with difficult weather for the regulated business and a lull in rate activity (ahead of the 2018 items noted in our bullet points). Additive to that, a discrete tax item due to a ruling in New York shaved a fairly clean \$0.02/share from consolidated EPS. We remind investors that AWK moved away from discussing ‘adjusted’ results (at least as far as profits go) as we emerged from the Freedom spill items, which we are fine with given investors’ decreasing interest in quarter-to-quarter results.

With this in mind, we not only reiterate our Long-term Buy rating and \$105 price target (2 to 3 year timeframe), but suggest that investors be aggressive if any weakness develops following these Q2 results. The long-term outlook for the water industry, and AWK’s leading position to be a consolidator, are unchanged for us, and we see the day-to-day narrative percolating as we work toward the closing months of 2018 and closer to major rate activity in the key states of MO and PA.

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	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E	FY'19E
Operating Revenues	\$3,011,328	\$3,159,000	\$743,000	\$827,000	\$930,000	\$802,000	\$3,302,000	\$756,000	\$844,000	\$981,860	\$829,910	\$3,411,770	\$3,592,910	\$3,729,240
Operating Expenses														
O&M	1,349,864	1,404,000	348,000	351,000	432,000	373,000	1,504,000	337,000	349,000	374,430	380,160	1,440,590	1,473,980	1,504,470
D&A	424,084	440,000	116,000	115,000	119,000	120,000	470,000	124,000	126,000	127,930	128,660	506,590	535,530	561,390
General Taxes	236,732	243,000	66,000	64,000	65,000	63,000	258,000	68,000	63,000	67,750	64,730	263,480	283,490	294,220
(Gain) on Asset Sale	(1,928)	(3,000)	(100)	(2,000)	(5,000)	(2,000)	(10,000)		(2,000)	(200)	(300)	(2,500)	(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	227,000	308,000	411,950	256,660	1,203,610	1,301,610	1,370,860
%	33.3%	34.0%	28.7%	36.2%	34.3%	30.9%	32.7%	30.0%	36.5%	42.0%	30.9%	35.3%	36.2%	36.8%
Interest (Expense)/Income	(297,818)	(308,000)	(80,000)	(81,000)	(81,000)	(83,000)	(325,000)	(85,000)	(85,000)	(84,830)	(86,280)	(341,110)	(346,660)	(348,960)
Other (Expense)/Income	5,057	15,000	2,000	7,000	5,000	1,000	15,000	3,000	3,000	5,000	5,000	16,000	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	145,000	226,000	332,120	175,380	878,500	976,050	1,043,000
Provision for Income Taxes	279,973	306,000	54,000	88,000	95,000	65,000	302,000	52,000	95,000	130,855	65,768	343,623	380,827	406,952
%	39.4%	39.1%	39.7%	39.1%	39.1%	39.2%	39.2%	35.9%	42.0%	39.4%	37.5%	39.1%	39.0%	39.0%
Income (Loss) from Cont'd Ops	429,842	476,000	82,000	137,000	148,000	101,000	468,000	93,000	131,000	201,265	109,613	534,877	595,223	636,048
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	\$93,000	\$131,000	\$201,265	\$109,613	\$534,877	\$595,223	\$636,048
Diluted Avg Sh	179,806	180,000	179,000	178,000	178,000	178,000	179,000	179,000	179,000	179,561	179,622	179,338	179,783	180,027
GAAP EPS	\$ 2.35	\$ 2.64	\$ 0.46	\$ 0.77	\$ 0.83	\$ 0.57	\$ 2.63	\$ 0.52	\$ 0.73	\$ 1.12	\$ 0.61	\$ 2.98	\$ 3.31	\$ 3.53
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	\$ 0.52	\$ 0.73	\$ 1.12	\$ 0.61	\$ 2.98	\$ 3.31	\$ 3.53
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	\$ 1.905
Rate of Change Analysis:														
Revenues	4.6%	4.9%	6.4%	5.7%	3.8%	2.4%	4.5%	1.7%	2.1%	5.6%	3.5%	3.3%	5.3%	3.8%
Operating Income	5.7%	7.2%	4.3%	7.7%	-11.7%	6.9%	0.5%	6.5%	3.0%	29.1%	3.5%	11.4%	8.1%	5.3%
EPS--Cont'd Ops--Adj if Nec	10.7%	8.0%	3.2%	12.8%	9.3%	3.2%	7.9%	13.4%	-4.9%	6.4%	7.5%	4.7%	11.0%	6.7%
EBITDA	5.1%	6.1%	5.9%	6.9%	-8.3%	6.4%	1.9%	6.7%	4.9%	24.6%	5.2%	10.9%	7.5%	5.2%
O&M Expense	4.7%	4.0%	7.5%	4.3%	18.8%	-1.8%	7.1%	-3.2%	-0.6%	-13.3%	1.9%	-4.2%	2.3%	2.1%
Margin Analysis:														
O&M	44.8%	44.4%	46.8%	42.4%	46.5%	46.5%	45.5%	44.6%	41.4%	38.1%	45.8%	42.2%	41.0%	40.3%
D&A	14.1%	13.9%	15.6%	13.9%	12.8%	15.0%	14.2%	16.4%	14.9%	13.0%	15.5%	14.8%	14.9%	15.1%
General Tax	7.9%	7.7%	8.9%	7.7%	7.0%	7.9%	7.8%	9.0%	7.5%	6.9%	7.8%	7.7%	7.9%	7.9%
Operating Income	33.3%	34.0%	28.7%	36.2%	34.3%	30.9%	32.7%	30.0%	36.5%	42.0%	30.9%	35.3%	36.2%	36.8%
Tax rate	39.4%	39.1%	39.7%	39.1%	39.1%	39.2%	39.2%	35.9%	42.0%	39.4%	37.5%	39.1%	39.0%	39.0%
					*\$0.22 after-tax charge for WV chemical spill settlement	Scranton, PA, WW closed 12/29			*Shorlands closed April 3; 11k H2O cust; 500k share purch price		*Model 10/1 McKspirt 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	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E	FY'19E
Cash	\$23,080	\$45,000	\$66,000	\$52,000	\$46,000	\$75,000	\$75,000	\$78,000	\$64,000	\$41,030	\$69,990	\$69,990	\$60,590	\$80,100
A/R	267,053	255,000	220,000	240,000	302,000	269,000	269,000	250,000	288,000	318,840	278,360	278,360	291,320	300,760
Unbilled Utility Rev	220,538	267,000	247,000	286,000	285,000	263,000	263,000	227,000	236,000	300,890	272,150	272,150	284,820	294,050
Other Current Assets	150,698	90,000	105,000	113,000	168,000	177,000	177,000	212,000	220,000	176,400	185,850	185,850	195,140	204,900
Total CAs	661,369	657,000	638,000	691,000	801,000	784,000	784,000	767,000	808,000	837,160	806,350	806,350	831,870	879,810
Net PP&E	13,029,296	13,933,000	14,098,000	14,317,000	14,559,000	14,992,000	14,992,000	15,128,000	15,391,000	15,609,320	15,855,160	15,855,160	16,644,630	17,408,240
Goodwill	1,208,043	1,302,000	1,313,000	1,313,000	1,313,000	1,345,000	1,345,000	1,345,000	1,373,000	1,394,250	1,468,750	1,468,750	1,493,750	1,518,750
Other LT Assets	1,232,248	1,349,000	1,368,000	1,385,000	1,298,000	1,361,000	1,361,000	1,370,000	1,394,000	1,427,800	1,497,100	1,497,100	1,646,810	1,811,490
Total Assets	\$16,130,956	\$17,241,000	\$17,417,000	\$17,706,000	\$17,971,000	\$18,482,000	\$18,482,000	\$18,610,000	\$18,966,000	\$19,268,530	\$19,627,360	\$19,627,360	\$20,617,060	\$21,618,290
ST Debt	449,959	628,000	839,000	950,000	951,000	849,000	849,000	980,000	1,117,000	717,000	967,000	967,000	1,167,000	1,377,000
CP of LTD	61,132	54,000	54,000	54,000	53,000	574,000	574,000	574,000	686,000	572,000	310,000	310,000	310,000	249,000
A/P	285,800	126,000	116,000	146,000	135,000	154,000	154,000	108,000	134,000	142,530	159,360	159,360	166,780	172,190
Other	444,107	725,000	605,000	590,000	789,000	815,000	815,000	756,000	724,000	828,450	855,750	855,750	898,540	943,470
Total CLs	1,240,998	1,533,000	1,614,000	1,740,000	1,928,000	2,392,000	2,392,000	2,418,000	2,661,000	2,259,980	2,292,110	2,292,110	2,542,320	2,741,660
LTD	5,448,245	5,874,000	5,850,000	5,861,000	5,853,000	5,759,000	5,759,000	5,744,000	5,659,000	6,073,000	6,335,000	6,335,000	6,105,000	6,605,000
Deferred Income Tax	2,120,739	2,310,000	2,358,000	2,430,000	2,524,000	2,596,000	2,596,000	2,629,000	2,723,000	2,812,000	2,871,000	2,871,000	3,156,000	3,441,000
Other	2,405,383	2,475,000	2,513,000	2,522,000	2,428,000	2,517,000	2,517,000	2,532,000	2,539,000	2,549,400	2,642,850	2,642,850	2,774,990	2,913,740
Common Shareholders' Equity	4,915,591	5,049,000	5,082,000	5,153,000	5,238,000	5,218,000	5,218,000	5,287,000	5,384,000	5,574,150	5,486,400	5,486,400	6,038,750	5,916,890
Total Liabilities & SE	\$16,130,956	\$17,241,000	\$17,417,000	\$17,706,000	\$17,971,000	\$18,482,000	\$18,482,000	\$18,610,000	\$18,966,000	\$19,268,530	\$19,627,360	\$19,627,360	\$20,617,060	\$21,618,290
Summary Cash Flow (\$000's)														
	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E	FY'19E
Net Income	\$423,109	\$476,000	\$82,000	\$137,000	\$148,000	\$101,000	\$468,000	\$93,000	\$131,000	\$201,260	\$109,610	\$534,880	\$595,220	\$636,050
D&A	424,084	440,000	116,000	115,000	119,000	120,000	470,000	124,000	126,000	127,930	128,660	506,590	535,530	561,390
Deferred Tax	255,573	296,000	52,000	82,000	89,000	59,000	282,000	64,000	73,000	89,000	59,000	285,000	285,000	285,000
(Inc) / Dec in Wrk Cap	23,992	(52,618)	(90,000)	(52,000)	72,000	(109,000)	(179,000)	(85,000)	(61,000)	58,360	230	12,590	23,150	0
Operating CF	1,126,758	1,159,382	160,000	282,000	428,000	171,000	1,041,000	196,000	269,000	476,550	297,500	1,339,060	1,438,900	1,482,440
Cap Ex	(956,119)	(1,160,000)	(284,000)	(313,000)	(331,000)	(383,000)	(1,311,000)	(270,000)	(332,000)	(325,000)	(300,000)	(1,227,000)	(1,300,000)	(1,300,000)
Acquisitions	(8,935)	(197,000)	(22,000)	(2,000)	(5,000)	(175,000)	(204,000)	(2,000)	(7,000)	(5,000)	(149,000)	(163,000)	(50,000)	(50,000)
Asset/Securities Sales	13,841	5,000	(1,000)	3,000	3,000	4,000	9,000	-	4,000	-	-	4,000,000	-	-
Dividends	(216,354)	(239,000)	(61,000)	(66,000)	(67,000)	(67,000)	(261,000)	(67,000)	(74,000)	(74,520)	(74,540)	(290,060)	(317,300)	(342,930)
Free Cash Flow	(40,809)	(431,618)	(208,000)	(96,000)	28,000	(450,000)	(726,000)	(143,000)	(140,000)	72,030	(226,040)	(337,000)	(228,400)	(210,490)
Adv & Contribs for Construct	26,295	26,000	7,000	11,000	(2,000)	-	16,000	7,000	5,000	-	-	12,000	-	-
LTD Proceeds	500,497	565,000	-	2,000	-	551,000	553,000	-	20,000	800,000	-	820,000	290,000	-
LTD (Repaid)	(238,371)	(130,000)	(11,000)	(2,000)	(7,000)	(124,000)	(144,000)	(4,000)	(2,000)	(500,000)	-	(506,000)	(291,000)	-
ST Debt Drawn (Repaid)	(180,348)	180,000	211,000	110,000	1,000	(101,000)	221,000	131,000	137,000	(400,000)	250,000	118,000	200,000	210,000
Anti-Dilutive Repurch	-	(126,000)	(62,000)	(3,000)	-	-	(65,000)	(54,000)	-	-	-	-	-	-
Stock Issued	20,913	39,000	10,000	8,000	4,000	4,000	26,000	10,000	6,000	5,000	5,000	26,000	20,000	20,000
Net Cash Flow	88,177	122,382	(53,000)	30,000	24,000	(120,000)	(119,000)	(53,000)	26,000	(22,970)	28,960	133,000	(9,400)	19,510
EBITDA	1,424,732	1,512,000	329,000	412,000	433,000	366,000	1,540,000	351,000	432,000	539,680	385,020	1,707,700	1,835,440	1,930,550
EBITDA margin--period	47.3%	47.9%	44.3%	49.8%	46.6%	45.6%	46.6%	46.4%	51.2%	55.0%	46.4%	50.1%	51.1%	51.8%
EV / TTM EBITDA	10.5x	11.0x	11.8x	13.4x	12.6x	12.1x	12.1x	12.5x	12.4x	12.3x	12.3x	12.3x	11.3x	11.0x
Selected Financial Statistics														
	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E	FY'19E
Book Value	\$ 27.29	\$ 28.05	\$ 28.39	\$ 28.95	\$ 29.43	\$ 29.31	\$ 29.31	\$ 29.54	\$ 30.08	\$ 31.04	\$ 30.54	\$ 30.54	\$ 33.57	\$ 32.85
Tangible BV	\$ 20.58	\$ 20.82	\$ 21.06	\$ 21.57	\$ 22.05	\$ 21.76	\$ 21.76	\$ 22.02	\$ 22.41	\$ 23.28	\$ 22.37	\$ 22.37	\$ 25.27	\$ 24.42
Price / Book	2.0x	2.1x	2.4x	2.9x	2.5x	2.5x	2.5x	2.6x	2.6x	2.6x	2.7x	2.7x	2.4x	2.5x
LT Debt / Total Capital	52.6%	53.8%	53.5%	53.2%	52.8%	52.5%	52.5%	52.1%	51.2%	52.1%	53.6%	53.6%	50.3%	52.7%
Net Total Debt / Total Capital	54.7%	56.3%	56.8%	56.9%	56.5%	57.7%	57.7%	57.7%	57.9%	56.8%	57.9%	57.9%	55.5%	57.9%
ROE (TTM)--Adj for Freedom Spill	8.7%	9.5%	9.4%	9.6%	9.8%	9.9%	9.9%	10.0%	9.0%	9.9%	9.9%	9.9%	10.4%	10.8%

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	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017

Other Disclosures

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