



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

CTWS - NASDAQ - as of	2/27/17	\$56.26
Price Target		--
52-Week Range	\$40.80 -	\$58.32
Shares Outstanding (mm)		11.2
Market Cap. (\$mm)		\$632.4
1-Mo. Average Daily Volume		20,631
Institutional Ownership		47.9%
LT Debt/Total Capital	Q3'16	45.6%
ROE	TTM	11.0%
Book Value / Share	Q3'16	\$21.15
Price / Book Value		2.7x
Dividend Yield		2.0%
EBITDA Margin	FY'15	40.3%

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

		Prior	Current	Prior	Current
	2015A	2016E	2016E	2017E	2017E
1Q	\$0.28	--	\$0.28	A	--
2Q	\$0.78	--	\$0.89	A	--
3Q	\$0.79	--	\$0.85	A	--
4Q	\$0.20	\$0.09	\$0.10	--	--
Year	\$2.04	\$2.10	\$2.11	\$2.27	\$2.25
P/E	27.6x		26.7x		25.0x

### Revenue (\$MM)

		Prior	Current	Prior	Current
	2015A	2016E	2016E	2017E	2017E
1Q	\$20.0	--	\$21.6	A	--
2Q	\$26.6	--	\$26.1	A	--
3Q	\$28.4	--	\$29.5	A	--
4Q	\$20.9	\$22.0	\$22.2	--	--
Year	\$96.0	\$99.1	\$99.2	\$106.5	\$114.5

**Company Description:** *Connecticut Water Service, Inc. is the largest publicly traded water company based in New England. Through its wholly-owned public water utility subsidiaries, The Connecticut Water Company, The Maine Water Company and the Biddeford & Saco Water Company, CTWS provides drinking water to roughly 122,000 customers, or about 400,000 people in CT and ME.*

### Water Utilities

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February 28, 2017

## Connecticut Water Service, Inc.

CTWS — NASDAQ — Neutral-3

### CTWS Closes on Heritage Village Water Company.

#### Investment Highlights

- Yesterday evening, CTWS announced completion of the ~\$20.7MM purchase (stock + assumed debt) of Heritage Village Water Company. The transaction adds ~7,700 customers, including the CT Water's first wastewater operations.
- Announced in May 2016, the deal was delayed as the town of Southbury, CT evaluated the possibility of exercising a right of first refusal. Regulators in Connecticut approved the purchase in early December of last year.
- Due to timing uncertainties, Heritage Village was not previously reflected in our model, which we fully remedy at this time. With terms of the transaction unchanged, we still expect \$0.01-\$0.02 of EPS accretion this year is possible, although our 2017E EPS actually slides lower by \$0.02 on a more conservative tax outlook.
- Still pending is the planned acquisition of Avon Water, which is reflected in our model as closing on 4/1/17. We expect an update on Avon when CTWS releases Q4'16 results in mid-March; for consideration of ~\$33MM, this deal would add ~4,800 customers.
- We are initiating a 2018 EPS estimate of \$2.33, but expect this number to see revisions based on several major factors, including timing of Avon and year-1 results from the UCONN connection and Heritage Village.
- We are reiterating our Neutral rating. Completing the Heritage Village purchase is a material development, in our view, although at current valuations, we elect to wait for Q4 results before taking a more serious look at revising our rating.
- We expect CTWS to report Q4'16 results on or about Monday, March 13, 2017.

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

**SUITABILITY**

We assign CTWS a suitability rating of '3.' A complete description of our suitability scale is on page 5. We view the company as operating entrenched regulated utility monopoly franchises in two states, with a slightly above average risk/reward tied to a reliance upon, and growth potential within, the US Northeast. Connecticut Water Service, Inc.'s small-cap status and relatively low trading volume versus most Utility sector peers keep CTWS below our '2' rating; industry-appropriate leverage, a history of capital return and a seemingly amicable regulatory environment keep CTWS well above our most aggressive '4' rating.

**CONSIDERATIONS AND RISKS**

A portion of CTWS's growth strategy centers on acquisition, both major and tuck-in. Inability to gain regulatory approval for deals or effectively integrate purchases, and potential overpayment for assets could affect the stock price over various time horizons.

Earnings at Chester Realty Co. can be more difficult to predict than earnings at the regulated utility, and results hold the potential to distort the sustainable earnings run-rate for water activities. Oscillations at Chester could cause consolidated results to differ from our expectations and/or appear weak on a yr/yr basis.

Providing a public service, CTWS is subject to various eminent domain laws and statutes. Seizure of assets could result in permanent losses to stakeholders. Increasingly more complicated environmental restrictions could drive unforeseen fines and costs, which could push financial results below expectations.

Regulatory approval is necessary for the Connecticut Water Company and the Maine Water Company to grow earnings and generate an attractive return on investor capital. A deterioration of relationships at the germane CT and ME regulatory commissions could have a pronounced negative effect on the company.

CWTS' core utility is capital intensive; continued access to capital markets will be important for the company to pursue all prudent Cap Ex investments and acquisitions. Broad capital market disruptions could affect the company's ability to grow and execute its growth strategy.

As a small-cap with minimal trading volume, CTWS holds material liquidity risk. Forced entry/exit, and high position turnover are likely to reduce total return due to shallow market depth and wide bid/ask spreads.

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

*Additional information is available upon request.*

Connecticut Water Service															
Income Statements (000's)															
	FY'13	FY'14	Q1'15	Q2'15	Q3'15	Q4'15	FY'15	Q1'16	Q2'16	Q3'16	Q4'16E	FY'16E	FY'17E	FY'18E	
<b>Operating Revenues:</b>	\$ 91,481	\$ 94,020	\$ 20,030	\$ 26,624	\$ 28,444	\$ 20,943	\$ 96,041	\$ 21,552	\$ 26,055	\$ 29,477	\$ 22,150	\$ 99,230	\$ 114,460	\$ 119,140	
<b>Operating Expenses:</b>															
O&M	44,564	44,445	11,324	11,179	12,185	13,364	48,052	11,289	8,840	11,495	13,100	44,720	51,330	52,750	
Depreciation	10,792	11,784	3,136	3,161	3,228	3,346	12,871	3,398	3,359	3,449	3,690	13,900	15,590	16,790	
Other Tax	8,188	9,031	2,346	2,082	2,294	2,572	9,294	2,449	2,238	2,535	2,590	9,810	10,220	10,620	
Organizational Review Charge	-	-	-	-	-	-	-	-	-	-	-	0	0	0	
Total Operating Expenses	63,544	65,260	16,806	16,422	17,707	19,282	70,217	17,136	14,437	17,479	19,380	68,430	77,140	80,160	
<b>Utility Operating Income / (Loss)</b>	<b>27,937</b>	<b>28,760</b>	<b>3,224</b>	<b>10,202</b>	<b>10,737</b>	<b>1,661</b>	<b>25,824</b>	<b>4,416</b>	<b>11,618</b>	<b>11,998</b>	<b>2,770</b>	<b>30,800</b>	<b>37,320</b>	<b>38,980</b>	
%	30.5%	30.6%	16.1%	38.3%	37.7%	7.9%	26.9%	20.5%	44.6%	40.7%	12.5%	31.0%	32.6%	32.7%	
Income Tax Expense	5,944	3,596	(941)	453	1,283	(1,613)	(818)	393	589	1,219	277	2,480	3,730	3,120	
as % of Op Income	21.3%	12.5%	-29.2%	4.4%	11.9%	-97.1%	-3.2%	8.9%	5.1%	10.2%	10.0%	8.1%	10.0%	8.0%	
Other Utility Income, NoT	856	833	155	205	255	182	797	155	188	160	180	680	690	690	
Gain / (Loss) on Real Estate	(7)	50	-	-	351	(2)	349	-	-	2	-	-	-	-	
Non-Water Sales Earnings	1,483	1,471	369	375	296	354	1,394	395	406	181	400	1,380	1,450	1,520	
AFUDC	366	518	90	108	129	203	530	232	289	330	200	1,050	990	990	
Other Income / (Expense)	(292)	(202)	(7)	(104)	(54)	(49)	(214)	(32)	(283)	(136)	(50)	(500)	(250)	(250)	
<b>EBI</b>	<b>24,399</b>	<b>27,834</b>	<b>4,772</b>	<b>10,333</b>	<b>10,431</b>	<b>3,962</b>	<b>29,498</b>	<b>4,773</b>	<b>11,629</b>	<b>11,316</b>	<b>3,223</b>	<b>30,930</b>	<b>36,470</b>	<b>38,810</b>	
LTD Interest	7,200	7,023	1,774	1,763	1,754	1,796	7,087	1,736	1,830	2,064	2,110	7,740	9,570	10,660	
Other Debt/Interest Expense	(1,070)	(508)	(105)	(105)	(105)	(35)	(350)	(111)	(144)	(283)	-	(540,000)	-	-	
<b>Net Income</b>	<b>18,269</b>	<b>21,319</b>	<b>3,103</b>	<b>8,675</b>	<b>8,782</b>	<b>2,201</b>	<b>22,761</b>	<b>3,148</b>	<b>9,943</b>	<b>9,535</b>	<b>1,113</b>	<b>23,730</b>	<b>26,900</b>	<b>28,150</b>	
Preferred Stk Div	38	38	9	10	10	9	38	9	10	10	9	38	38	38	
<b>Net Income--Common Stock</b>	<b>\$18,231</b>	<b>\$21,281</b>	<b>\$3,094</b>	<b>\$8,665</b>	<b>\$8,772</b>	<b>\$2,192</b>	<b>\$22,723</b>	<b>\$3,139</b>	<b>\$9,933</b>	<b>\$9,525</b>	<b>\$1,104</b>	<b>\$23,692</b>	<b>\$26,862</b>	<b>\$28,112</b>	
Diluted Avg Shares	10,996	11,091	11,144	11,157	11,171	11,120	11,164	11,211	11,223	11,233	11,239	11,227	11,869	12,065	
GAAP EPS			\$ 0.28	\$ 0.78	\$ 0.79	\$ 0.20	\$ 2.04	\$ 0.28	\$ 0.89	\$ 0.85	\$ 0.10	\$ 2.11	\$ 2.25	\$ 2.33	
EPS from Cont'd Ops	\$ 1.66	\$ 1.92	\$ 0.28	\$ 0.78	\$ 0.79	\$ 0.20	\$ 2.04	\$ 0.28	\$ 0.89	\$ 0.85	\$ 0.10	\$ 2.11	\$ 2.25	\$ 2.33	
EPS from Water Activities	\$ 1.53	\$ 1.79	\$ 0.24	\$ 0.74	\$ 0.76	\$ 0.17	\$ 1.91	\$ 0.24	\$ 0.85	\$ 0.83	\$ 0.06	\$ 1.99	\$ 2.13	\$ 2.20	
EPS from Services & Rentals	\$ 0.13	\$ 0.13	\$ 0.03	\$ 0.03	\$ 0.03	\$ 0.03	\$ 0.13	\$ 0.04	\$ 0.04	\$ 0.02	\$ 0.04	\$ 0.12	\$ 0.12	\$ 0.13	
EPS from Real Estate	\$ (0.00)	\$ 0.00	\$ -	\$ -	\$ 0.03	\$ (0.00)	\$ 0.03	\$ -	\$ -	\$ 0.00	\$ -	\$ -	\$ -	\$ -	
rounding error	\$ (0.00)	\$ (0.00)					\$ (0.03)								
Dividends Declared	\$ 0.9800	\$ 1.0100	\$ 0.2575	\$ 0.2575	\$ 0.2675	\$ 0.2675	\$ 1.0500	\$ 0.2675	\$ 0.2825	\$ 0.2825	\$ 0.2825	\$ 1.1150	\$ 1.1750	\$ 1.1750	
<b>Rate of Change Analysis:</b>															
Revenue	9.1%	2.8%	-1.1%	4.6%	3.2%	0.9%	2.1%	7.6%	-2.1%	3.6%	5.8%	3.3%	15.3%	4.1%	
O&M Expense	10.5%	-0.3%	6.2%	6.4%	12.1%	7.7%	8.1%	-0.3%	-20.9%	-5.7%	-2.0%	-6.9%	14.8%	2.8%	
Utility Op Income	7.3%	2.9%	-26.7%	0.8%	-7.2%	-38.0%	-10.2%	37.0%	13.9%	11.7%	66.8%	19.3%	21.2%	4.4%	
EPS--Cont'd Ops	8.5%	15.7%	3.2%	15.1%	3.3%	-8.1%	6.2%	0.9%	14.0%	8.0%	-50.2%	3.7%	6.7%	3.5%	
EBITDA	8.3%	5.5%	-12.2%	2.8%	-3.0%	-25.2%	-6.1%	22.4%	13.1%	10.2%	31.4%	15.7%	18.4%	5.4%	
<b>Margin Analysis:</b>															
O&M / Revenue	48.7%	47.3%	56.5%	42.0%	42.8%	63.8%	50.0%	52.4%	33.9%	39.0%	59.1%	45.1%	44.8%	44.3%	
Operating Margin	30.5%	30.6%	16.1%	38.3%	37.7%	7.9%	26.9%	20.5%	44.6%	40.7%	12.5%	31.0%	32.6%	32.7%	
Net Profit Margin--Common Stk	19.9%	22.6%	15.4%	32.5%	30.8%	10.5%	23.7%	14.6%	38.1%	32.3%	5.0%	23.9%	23.5%	23.6%	
			*Impact from BSWC rate case--net \$1MM ex-refunds *\$0.09 ME tax catch-up bene					*(\$1.0M) O&M chg on equity re-account; reversed in Q2		\$2.6MM O&M benefit from equity re-account		*Potential impact from Msfield/Storrs	*FY Effective out-of-period adj, net \$1.6MM O&M bene	*Exp FY of Ms filed/Storrs pipe *Expect Q1 Close Heritage Village	

Source: Company reports and Hilliard Lyons estimates

Connecticut Water Service														
Balance Sheet Analysis														
	FY'13	FY'14	Q1'15	Q2'15	Q3'15	Q4'15	FY'15	Q1'16	Q2'16	Q3'16	Q4'16E	FY'16E	FY'17E	FY'18E
Cash & Equivalents	\$18,371	\$2,475	\$2,344	\$3,065	\$2,186	\$731	\$731	\$1,540	\$1,143	\$1,158	\$1,130	\$1,130	\$770	\$2,360
A/R	12,340	11,971	11,424	11,457	12,975	11,012	11,012	9,744	11,573	13,819	12,210	12,210	13,520	14,000
Accrued Unbilled Rev	7,624	8,283	7,362	9,400	10,115	8,259	8,259	8,119	9,074	10,150	8,790	8,790	9,930	10,180
Other Current Assets	8,561	13,439	15,022	11,782	13,982	7,027	7,027	9,940	9,151	11,371	9,870	9,870	8,270	6,670
Total Current Assets	46,896	36,168	36,152	35,704	39,258	27,029	27,029	29,343	30,941	36,498	32,000	32,000	32,490	33,210
Net Utility Plant	471,876	506,939	507,902	515,367	528,962	546,284	546,284	554,509	568,406	583,789	596,720	596,720	664,690	707,740
Goodwill	31,685	31,685	31,685	30,427	30,427	30,427	30,427	30,427	30,427	30,427	30,430	30,430	58,430	58,430
Other LT Assets	80,354	96,397	98,143	112,303	111,794	112,778	112,778	109,822	115,467	119,112	125,070	125,070	135,300	146,370
Total Assets	\$630,811	\$671,189	\$673,882	\$693,801	\$710,441	\$716,518	\$716,518	\$724,101	\$745,241	\$769,826	\$784,220	\$784,220	\$890,910	\$945,750
CP of LTD	4,121	2,457	2,464	2,469	2,597	2,842	2,842	2,850	2,862	2,883	2,000	2,000	2,250	80
Bank Loans Payable	-	1,991	5,422	3,718	11,442	16,085	16,085	29,472	11,200	21,837	31,840	31,840	36,840	40,840
A/P and Accrued Exp	10,846	10,019	7,222	9,164	9,744	11,882	11,882	8,499	11,577	11,652	11,630	11,630	13,710	13,760
Other	7,762	9,155	9,974	9,554	8,464	6,130	6,130	5,490	4,634	5,007	5,030	5,030	5,150	5,270
Total Current Liabilities	22,729	23,622	25,082	24,905	32,247	36,939	36,939	46,311	30,273	41,379	50,500	50,500	57,950	59,950
LTD	175,042	176,601	177,689	177,302	176,679	177,654	177,654	171,102	200,861	200,155	201,300	201,300	233,390	259,140
Common Shareholders' equity	197,753	209,451	210,266	216,186	223,024	209,451	209,451	225,834	230,439	237,620	235,068	235,068	295,138	315,058
Total Liab & SE	\$630,811	\$671,189	\$673,882	\$693,801	\$710,441	\$716,518	\$716,518	\$724,101	\$745,241	\$769,826	\$784,220	\$784,220	\$890,910	\$945,750
Book Value	\$ 17.93	\$ 18.84	\$ 18.87	\$ 19.38	\$ 19.96	\$ 18.84	\$ 18.84	\$ 20.14	\$ 20.53	\$ 21.15	\$ 20.92	\$ 20.94	\$ 24.87	\$ 26.11
Price / Book	2.0x	1.9x	1.9x	1.8x	1.8x	2.0x	2.0x	2.2x	2.7x	2.4x	2.7x	2.7x	2.3x	2.2x
Net Indebtedness / Total Cap	44.7%	45.9%	46.5%	45.4%	45.7%	48.2%	48.2%	47.1%	48.0%	48.4%	49.8%	49.8%	47.9%	48.5%
LTD / Total Cap	46.9%	45.7%	45.7%	45.0%	44.1%	45.8%	45.8%	43.0%	46.5%	46.0%	46.0%	46.0%	44.1%	45.1%
ROE (TTM)—Common Stk	9.6%	10.4%	10.4%	10.8%	10.7%	10.6%	10.6%	10.5%	10.9%	11.0%	10.4%	10.4%	9.9%	9.2%
Cash Flow Analysis														
	FY'13	FY'14	Q1'15	Q2'15	Q3'15	Q4'15	FY'15	Q1'16	Q2'16	Q3'16	Q4'16E	FY'16E	FY'17E	FY'18E
Net Income	\$18,231	\$21,281	\$3,094	\$8,665	\$8,772	\$2,192	\$22,723	\$3,139	\$9,933	\$9,525	\$1,100	\$23,690	\$26,860	\$28,110
D & A	11,140	12,457	3,356	3,328	3,431	2,783	12,898	3,641	3,687	3,622	3,070	14,020	15,730	16,950
AFUDC	(366)	(518)	(90)	(108)	(129)	(203)	(530)	(232)	(289)	(330)	200	(650)	990	990
(Gain) / Loss on Sale of Prop	7	(50)	-	-	(351)	2	(349)	-	-	(2)	-	-	-	-
(Increase) Decrease in Wrkg. Cap.	382	(4,602)	(2,093)	2,691	(4,943)	10,578	6,233	(5,528)	227	(5,094)	4,471	(5,924)	1,820	1,060
Operating CF	29,394	28,568	4,267	14,576	6,780	15,352	40,975	1,020	13,558	7,721	8,841	31,136	45,400	47,110
Cap Ex	(33,303)	(45,668)	(6,523)	(7,715)	(16,022)	(17,765)	(48,025)	(11,753)	(16,225)	(19,492)	(16,000)	(63,470)	(55,000)	(60,000)
(Acquisitions) / Divestitures	95	243	-	-	6	8	14	-	-	-	-	0	(22,260)	0
Release of Restricted Cash	5,457	5,779	-	-	-	(846)	(846)	649	-	197	-	850	0	0
Dividends—Common Stk	(10,796)	(11,226)	(2,878)	(2,884)	(2,994)	(2,997)	(11,753)	(3,005)	(3,180)	(3,183)	(3,170)	(12,540)	(13,950)	(14,180)
Free Cash Flow	(9,153)	(22,304)	(5,134)	3,977	(12,230)	(6,248)	(19,635)	(13,089)	(5,847)	(14,757)	(10,329)	(44,024)	(45,810)	(27,070)
LTD Proceeds	14,550	4,500	-	1,630	219	2,503	4,352	-	30,000	19,930	-	49,930	26,970	27,250
LTD (Repayments)	(15,870)	(4,114)	(661)	(282)	(376)	(1,157)	(2,476)	(762)	(259)	(20,587)	-	(21,610)	(3,510)	(3,790)
Interim Bank Loan Proceed / (Repay)	(1,660)	1,991	3,431	(1,704)	7,724	4,643	14,094	13,387	(18,272)	10,637	10,000	15,750	5,000	4,000
Common Stk Issued + Option Exercise	1,854	1,697	366	387	381	402	1,536	425	427	380	300	1,530	17,000	1,200
Net CF	(10,279)	(18,230)	(1,998)	4,008	(4,282)	143	(2,129)	(39)	6,049	(4,397)	(29)	1,576	(350)	1,590
Cap Ex / Depreciation	3.0x	3.7x	1.9x	2.3x	4.7x	6.4x	3.7x	3.2x	4.4x	5.4x	5.2x	4.5x	3.5x	3.5x
EBITDA	39,077	41,217	6,580	13,530	14,168	4,444	38,722	8,057	15,305	15,620	5,840	44,820	53,050	55,930
EBITDA margin	42.7%	43.8%	32.9%	50.8%	49.8%	21.2%	40.3%	37.4%	58.7%	53.0%	26.4%	45.2%	46.3%	46.9%
EBITDA/share	\$3.55	\$3.72	\$0.59	\$1.21	\$1.27	\$0.40	\$3.47	\$0.72	\$1.36	\$1.39	\$0.52	\$3.99	\$4.47	\$4.64
EV / TTM EBITDA	14.1x	14.0x	14.4x	13.7x	14.5x	15.5x	15.5x	16.8x	19.8x	17.5x	18.6x	18.6x	17.0x	16.7x

Source: Company reports and Hilliard Lyons estimates

### **Analyst Certifications**

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

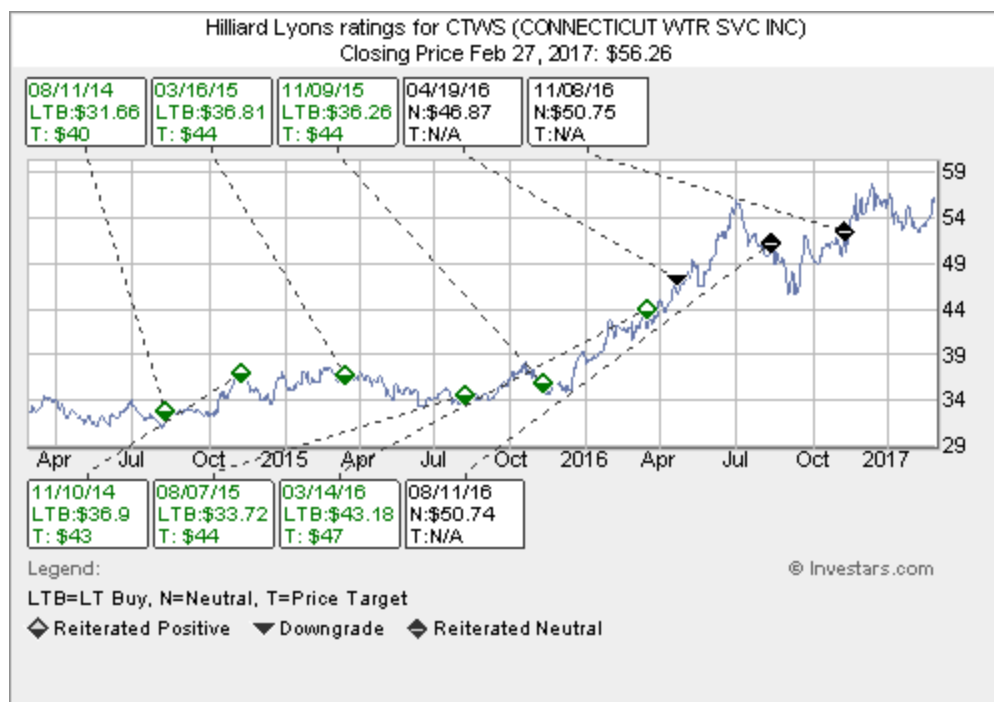
### **Investment Ratings**

**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.



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

**Other Disclosures**

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