



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

CTWS - NASDAQ - as of	11/9/17	\$62.19
Price Target		--
52-Week Range	\$49.23 -	\$64.15
Shares Outstanding (mm)		12.1
Market Cap. (\$mm)		\$750.5
1-Mo. Average Daily Volume		34,711
Institutional Ownership		48.0%
LT Debt/Total Capital	Q3'17	46.4%
ROE	TTM	9.3%
Book Value / Share	Q3'17	\$24.45
Price / Book Value		2.5x
Dividend Yield		1.9%
EBITDA Margin	TTM	44.1%

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

	2016A	Prior 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$0.28	--	\$0.36	A --	--
2Q	\$0.89	--	\$0.73	A --	--
3Q	\$0.85	--	\$0.89	A --	--
4Q	\$0.07	\$0.17	\$0.07	--	--
Year	\$2.08	\$2.22	\$2.05	\$2.20	\$2.04
P/E	29.9x		30.3x		30.5x

### Revenue (\$MM)

	2016A	Prior 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$21.6	--	\$22.5	A --	--
2Q	\$26.1	--	\$27.9	A --	--
3Q	\$29.5	--	\$31.8	A --	--
4Q	\$21.6	\$24.3	\$23.0	--	--
Year	\$98.7	\$109.4	\$105.2	\$114.6	\$109.7

**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 129,000 customers in 79 communities across CT and ME.*

### Water Utilities

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## Connecticut Water Service, Inc.

CTWS — NASDAQ — Neutral-3

### Somewhat Disappointing Q3'17 Results for CTWS in Light of M&A; Reiterating Neutral Rating.

#### Investment Highlights

- CTWS reported Q3'17 EPS of \$0.89 versus \$0.85 in Q3'16, results missed our expectation for \$0.97, which was one of only two published estimates. Operating income was up in the quarter, but offset by 7.2% greater shares outstanding; lower taxes aided EPS.
- Operating revenues grew 7.9% in Q3, reflecting incremental surcharges in CT (WICA) and ME (WISC), along with full quarters from the Heritage Village and AVON purchases' ~12,500 customers.
- Revenues from the above mentioned acquisitions were about \$2.4MM in the quarter, slightly below our model. We note this is the first quarter of financial impact for AVON, having closed July 1.
- Maine Water's general rate case for the Biddeford and Saco division, requesting \$1.6MM in additional revenue, is scheduled for impact 12/1; cumulative WICA surcharges in CT stand just under 10%.
- CTWS' tax rate (as a % of op income) was 1.9% in Q3'17, down from 10.2% in Q3'16; although carrying substantial period to period uncertainty, we believe utilization of IRS tangible property rules remains a strong complementary theme at CTWS.
- EPS from services & rentals were \$0.02 in Q3'17, down from \$0.04 in the year-ago period.
- Our 2017E EPS falls to \$2.05, reflecting the Q3 miss and the delay of a \$0.07 gain on sale from Q4'17 to Q2'18. Our core operating assumptions for 2018/2019 skew lower based on Q3'17 results, and a higher effective tax rate in 2018 versus 2017 coupled with higher shares outstanding limits our expectations for growth in the out year.
- We reiterate our Neutral rating pending an entry point.

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

**ADDITIONAL DISCUSSION—FORWARD OUTLOOK**

In our view, Q3'17 was an adequate period operationally. With that said, results below our expectations for the seasonally important period, in what seems like a clean quarter, drive subdued expectations for us moving forward, particularly for 2018. We acknowledge that some lingering expense items inherent in the first quarter of operating both the Heritage Village and AVON purchases could fall away next year, but we nonetheless see tax comparisons and a higher share count as meaningful headwinds next year. We remain comparatively optimistic toward 2019, where we believe optimization of, and accretion from, the noted purchases is more reasonable, but this theme carries relatively high uncertainty for us. As such, at current valuations, we elect to reiterate our Neutral rating.

**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. At current, the company is in the process of integrating two separate large transactions (AVON and Heritage Village), both of which hold some of these noted risks.

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'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
<b>Operating Revenues:</b>	\$ 94,020	\$ 96,041	\$ 21,552	\$ 26,055	\$ 29,477	\$ 21,583	\$ 98,667	\$ 22,463	\$ 27,902	\$ 31,797	\$ 22,990	\$ 105,150	\$ 109,700	\$ 115,650
<b>Operating Expenses:</b>														
O&M	44,445	48,052	11,289	8,840	11,495	12,567	44,191	11,236	11,626	12,133	13,320	48,320	49,340	50,330
Depreciation	11,784	12,871	3,398	3,359	3,449	3,699	13,905	3,692	3,984	4,283	4,330	16,290	17,920	19,000
Other Tax	9,031	9,294	2,449	2,238	2,535	2,574	9,796	2,605	2,477	2,822	2,670	10,570	10,980	11,380
Organizational Review Charge	-	-	-	-	-	-	-	-	-	0	-	0	0	0
Total Operating Expenses	65,260	70,217	17,136	14,437	17,479	18,840	67,892	17,533	18,087	19,238	20,320	75,180	78,240	80,710
<b>Utility Operating Income / (Loss)</b>	<b>28,760</b>	<b>25,824</b>	4,416	11,618	11,998	2,743	<b>30,775</b>	4,930	9,815	12,559	2,670	<b>29,970</b>	<b>31,460</b>	<b>34,940</b>
%	30.6%	26.9%	20.5%	44.6%	40.7%	12.7%	31.2%	21.9%	35.2%	39.5%	11.6%	28.5%	28.7%	30.2%
Income Tax Expense	3,596	(818)	393	589	1,219	369	2,570	(190)	(624)	235	294	(290)	940	1,400
as % of Op Income	12.5%	-3.2%	8.9%	5.1%	10.2%	13.5%	8.4%	-3.9%	-6.4%	1.9%	11.0%	-1.0%	3.0%	4.0%
Other Utility Income, NoT	833	797	155	188	160	241	744	165	190	264	240	860	860	860
Gain / (Loss) on Real Estate	50	349	-	-	2	(56)	(54)	33	-	-	-	30	890	480
Non-Water Sales Earnings	1,471	1,394	395	406	181	237	1,219	258	332	252	240	1,080	1,130	1,180
A/FUDC	518	530	232	289	330	347	1,198	336	231	101	180	850	1,130	1,130
Other Income / (Expense)	(202)	(214)	(32)	(283)	(136)	(558)	(1,009)	(9)	(744)	187	(50)	(620)	(200)	(200)
<b>EBI</b>	<b>27,834</b>	<b>29,498</b>	4,773	11,629	11,316	2,585	<b>30,303</b>	5,903	10,448	13,128	2,986	<b>32,460</b>	<b>34,330</b>	<b>36,990</b>
LTD Interest	7,023	7,087	1,736	1,830	2,064	2,084	7,714	2,061	2,106	2,230	2,350	8,750	10,040	11,010
Other Debt/Interest Expense	(508)	(350)	(111)	(144)	(283)	(260)	(798)	(226)	(76)	182	(260)	(380)	(390)	(390)
<b>Net Income</b>	<b>21,319</b>	<b>22,761</b>	3,148	9,943	9,535	761	<b>23,387</b>	4,068	8,418	10,716	896	<b>24,090</b>	<b>24,680</b>	<b>26,370</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>\$21,281</b>	<b>\$22,723</b>	\$3,139	\$9,933	\$9,525	\$752	<b>\$23,349</b>	\$4,059	\$8,408	10,706	\$887	<b>\$24,052</b>	<b>\$24,642</b>	<b>\$26,332</b>
Diluted Avg Shares	11,091	11,164	11,211	11,223	11,233	11,240	11,228	11,365	11,568	12,041	12,046	11,755	12,058	12,077
GAAP EPS			\$ 0.28	\$ 0.89	\$ 0.85	\$ 0.07		\$ 0.36	\$ 0.73	\$ 0.89				
EPS from Cont'd Ops	\$ 1.92	\$ 2.04	\$ 0.28	\$ 0.89	\$ 0.85	\$ 0.07	\$ 2.08	\$ 0.36	\$ 0.73	\$ 0.89	\$ 0.07	\$ 2.05	\$ 2.04	\$ 2.18
EPS from Water Activities	\$ 1.79	\$ 1.91	\$ 0.24	\$ 0.85	\$ 0.83	\$ 0.05	\$ 1.97	\$ 0.33	\$ 0.70	\$ 0.87	\$ 0.05	\$ 1.95	\$ 1.88	\$ 2.04
EPS from Services & Rentals	\$ 0.13	\$ 0.13	\$ 0.04	\$ 0.04	\$ 0.02	\$ 0.02	\$ 0.11	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.02	\$ 0.09	\$ 0.09	\$ 0.10
EPS from Real Estate	\$ 0.00	\$ 0.03	\$ -	\$ -	\$ 0.00	\$ (0.00)	\$ (0.00)	\$ 0.00	\$ -	\$ -	\$ -	\$ 0.00	\$ 0.07	\$ 0.04
rounding error	\$ (0.00)	\$ (0.03)					\$ 0.00							
Dividends Declared	\$ 1.0100	\$ 1.0500	\$ 0.2675	\$ 0.2825	\$ 0.2825	\$ 0.2825	\$ 1.1150	\$ 0.2825	\$ 0.2975	\$ 0.2975	\$ 0.2975	\$ 1.1750	\$ 1.2350	\$ 1.2950
<b>Rate of Change Analysis:</b>														
Revenue	2.8%	2.1%	7.6%	-2.1%	3.6%	3.1%	2.7%	4.2%	7.1%	7.9%	6.5%	6.6%	4.3%	5.4%
O&M Expense	-0.3%	8.1%	-0.3%	-20.9%	-5.7%	-6.0%	-8.0%	-0.5%	31.5%	5.6%	6.0%	9.3%	2.1%	2.0%
Utility Op Income	2.9%	-10.2%	37.0%	13.9%	11.7%	65.1%	19.2%	11.6%	-15.5%	4.7%	-2.7%	-2.6%	5.0%	11.1%
EPS--Cont'd Ops	15.7%	6.2%	0.9%	14.0%	8.0%	-66.1%	2.1%	27.6%	-17.9%	4.9%	10.1%	-1.6%	-0.2%	6.7%
EBITDA	5.5%	-6.1%	22.4%	13.1%	10.2%	11.7%	13.5%	10.4%	-9.3%	9.4%	6.1%	2.7%	6.9%	9.3%
<b>Margin Analysis:</b>														
O&M / Revenue	47.3%	50.0%	52.4%	33.9%	39.0%	58.2%	44.8%	50.0%	41.7%	38.2%	57.9%	46.0%	45.0%	43.5%
Operating Margin	30.6%	26.9%	20.5%	44.6%	40.7%	12.7%	31.2%	21.9%	35.2%	39.5%	11.6%	28.5%	28.7%	30.2%
Net Profit Margin--Common Stk	22.6%	23.7%	14.6%	38.1%	32.3%	3.5%	23.7%	18.1%	30.1%	33.7%	3.9%	22.9%	22.5%	22.8%
			(\$1.0M) O&M chg on equity re-account; reversed in Q2	\$2.6MM O&M benefit from equity re-account	*Initial impact from Msfield/Storrs		*FY Effective out-of-period adj, net \$1.6MM O&M bene	*Heritage Village Closed 2/27--\$20MM EV		*Avon closed effective July 1; ~\$40MM EV		*Exp FY of Msfield/Storrs pipe & service	*Exp FYs of AVON and HVWC **\$0.07 bene from land sale	

Source: Company reports and Hilliard Lyons estimates

## Connecticut Water Service

Balance Sheet Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Cash & Equivalents	\$2,475	\$731	\$1,540	\$1,143	\$1,158	\$1,564	\$1,564	\$2,955	\$2,694	\$8,274	\$5,190	\$5,190	\$6,780	\$6,830
A/R	11,971	11,012	9,744	11,573	13,819	13,024	13,024	11,648	12,875	15,642	12,980	12,980	13,830	14,360
Accrued Unbilled Rev	8,283	8,259	8,119	9,074	10,150	8,171	8,171	8,000	9,153	9,906	8,880	8,880	9,060	9,610
Other Current Assets	13,439	7,027	9,940	9,151	11,371	6,605	6,605	8,505	8,511	13,327	11,830	11,830	10,230	8,630
Total Current Assets	36,168	27,029	29,343	30,941	36,498	29,364	29,364	31,108	33,233	47,149	38,880	38,880	39,900	39,430
Net Utility Plant	506,939	546,284	554,509	568,406	583,789	601,396	601,396	636,610	647,688	683,738	691,140	691,140	734,380	776,610
Goodwill	31,685	30,427	30,427	30,427	30,427	30,427	30,427	43,045	43,045	66,979	66,980	66,980	66,980	66,980
Other LT Assets	96,397	112,778	109,822	115,467	119,112	123,315	123,315	127,786	131,050	141,510	148,590	148,590	160,760	173,910
Total Assets	\$671,189	\$716,518	\$724,101	\$745,241	\$769,826	\$784,502	\$784,502	\$838,549	\$855,016	\$939,376	\$945,590	\$945,590	\$1,002,020	\$1,056,930
CP of LTD	2,457	2,842	2,850	2,862	2,883	4,859	4,859	5,185	5,196	7,950	2,250	2,250	80	8,000
Bank Loans Payable	1,991	16,085	29,472	11,200	21,837	32,953	32,953	35,089	43,632	18,547	20,550	20,550	38,550	53,550
A/P and Accrued Exp	10,019	11,882	8,499	11,577	11,652	13,116	13,116	8,412	9,640	8,585	13,510	13,510	14,150	14,810
Other	9,155	6,130	5,490	4,634	5,007	4,197	4,197	5,152	4,140	4,753	4,780	4,780	4,860	4,940
Total Current Liabilities	23,622	36,939	46,311	30,273	41,379	55,125	55,125	53,838	62,608	39,835	41,090	41,090	57,640	81,300
LTD	176,601	177,654	171,102	200,861	200,155	197,047	197,047	205,589	205,351	255,193	256,680	256,680	271,350	275,960
Common Shareholders' equity	209,451	223,977	225,834	230,439	237,620	236,028	236,028	254,325	260,048	294,405	295,798	295,798	312,878	331,248
Total Liab & SE	\$671,189	\$716,518	\$724,101	\$745,241	\$769,826	\$784,502	\$784,502	\$838,549	\$855,016	\$939,376	\$945,590	\$945,590	\$1,002,020	\$1,056,930
Book Value	\$ 18.84	\$ 20.14	\$ 20.14	\$ 20.53	\$ 21.15	\$ 21.00	\$ 21.00	\$ 22.38	\$ 22.48	\$ 24.45	\$ 24.56	\$ 25.16	\$ 25.95	\$ 27.43
Price / Book	1.9x	1.9x	2.2x	2.7x	2.4x	2.7x	2.7x	2.4x	2.5x	2.5x	2.5x	2.5x	2.4x	2.3x
Net Indebtedness / Total Cap	45.9%	46.6%	47.1%	48.0%	48.4%	49.6%	49.6%	48.8%	49.1%	48.1%	48.0%	48.0%	49.2%	49.9%
LTD / Total Cap	45.7%	44.1%	43.0%	46.5%	45.6%	45.4%	45.4%	44.6%	44.1%	46.4%	46.4%	46.4%	46.4%	45.4%
ROE (TTM)—Common Stk	10.4%	10.5%	10.4%	10.7%	10.9%	10.1%	10.1%	10.2%	9.3%	9.3%	9.0%	9.0%	8.1%	8.2%
Cash Flow Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Net Income	\$21,281	\$22,723	\$3,139	\$9,933	\$9,525	\$752	\$23,349	\$4,059	\$8,408	\$10,706	\$890	\$24,050	\$24,640	\$26,330
D & A	12,457	12,898	3,641	3,687	3,622	2,223	13,173	3,963	4,064	4,525	2,600	15,150	16,760	17,770
AFUDC	(518)	(530)	(232)	(289)	(330)	(347)	(1,198)	(336)	(230)	(102)	180	(490)	1,130	1,130
(Gain) / Loss on Sale of Prop	(50)	(349)	-	-	(2)	56	54	33	-	(66,000)	-	(30,000)	890,000	480,000
(Increase)/Decrease in Wrkg. Cap.	(4,602)	6,233	(5,528)	227	(5,094)	8,194	(2,201)	(4,102)	(2,170)	(8,778)	9,657	(5,393)	1,350	1,250
Operating CF	28,568	40,975	1,020	13,558	7,721	10,878	33,177	3,617	10,072	6,285	13,327	33,287	44,770	46,960
Cap Ex	(45,668)	(48,025)	(11,753)	(16,874)	(18,843)	(19,219)	(66,689)	(10,163)	(14,275)	(12,548)	(10,000)	(46,990)	(60,000)	(60,000)
(Acquisitions) / Divestitures	243	14	-	-	-	9	9	1,548	-	(5,679,000)	-	(4,130)	0	0
Release of Restricted Cash	5,779	(846)	649	-	197	-	846	-	-	-	-	0	0	0
Dividends—Common Stk	(11,226)	(11,753)	(3,005)	(3,180)	(3,183)	(3,184)	(12,552)	(3,274)	(3,450)	(3,600)	(3,580)	(13,900)	(14,900)	(15,640)
Free Cash Flow	(22,304)	(19,635)	(13,089)	(6,496)	(14,108)	(11,516)	(45,209)	(8,272)	(7,653)	(15,542)	(253)	(31,733)	(30,130)	(28,680)
LTD Proceeds	4,500	4,352	-	30,000	19,930	-	49,930	5,000	-	50,000	(1,965)	53,040	17,250	15,000
LTD (Repayments)	(4,114)	(2,476)	(762)	(259)	(20,587)	(1,164)	(22,772)	(808)	(296)	(762)	(3,171)	(5,040)	(4,710)	(2,460)
Interim Bank Loan Proceed / (Repay)	1,991	14,094	13,387	(18,272)	10,637	11,116	16,868	2,136	8,543	(27,585)	2,000	(14,910)	18,000	15,000
Common Stk Issued + Option Exercise	1,697	1,536	425	427	380	378	1,610	339	353	352	300	1,340	1,200	1,200
Net CF	(18,230)	(2,129)	(39)	5,400	(3,748)	(1,186)	427	(1,605)	947	6,463	(3,089)	2,697	1,610	60
Cap Ex / Depreciation	3.7x	3.7x	3.2x	4.6x	5.2x	8.6x	5.1x	2.6x	3.5x	2.8x	3.8x	3.1x	3.6x	3.4x
EBITDA	41,217	38,722	8,057	15,305	15,620	4,966	43,948	8,893	13,879	17,084	5,270	45,120	48,220	52,710
EBITDA margin	43.8%	40.3%	37.4%	58.7%	53.0%	23.0%	44.5%	39.6%	49.7%	53.7%	22.9%	42.9%	44.0%	45.6%
EBITDA/share	\$3.72	\$3.47	\$0.72	\$1.36	\$1.39	\$0.44	\$3.91	\$0.78	\$1.20	\$1.42	\$0.44	\$3.84	\$4.00	\$4.36
EV / TTM EBITDA	14.0x	15.5x	16.8x	19.8x	17.5x	18.7x	18.7x	18.0x	19.5x	22.2x	22.2x	21.8x	21.1x	19.4x

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

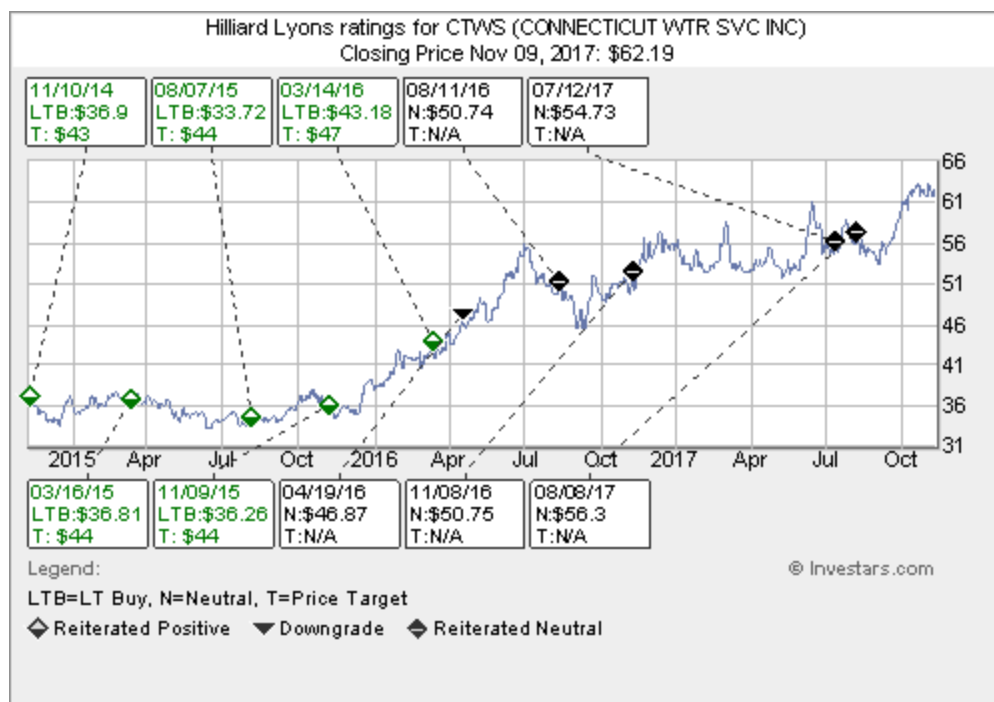
### **Investment Ratings**

**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.



Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.		
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 2017

**Other Disclosures**

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