



COMPANY UPDATE

Key Metrics

DGAS - NASDAQ (Price as of 2/17/17)	\$26.15
Price Target	NA
52-Week Range	\$31.29 - \$21.77
Shares Outstanding (mm)	7,119.0
Market Cap. (\$mm)	\$186.2
3-Mo. Average Daily Volume	11,809
Institutional Ownership	25.0%
Debt/Total Capital	40.0%
ROE (ttm)	8.4%
Book Value/Share	\$10.99
Price/Book Value	2.4x
Indicated Dividend / Yield	\$0.83 3.2%
Dividend Cycle	March, June, Sept., Dec.

EPS FY 6/30

	2015	2016	Prior 2017E	Curr. 2017E
1Q			--	--
2Q			--	--
3Q			--	--
4Q			--	--
Year	\$0.92	\$0.78	\$0.85	\$0.88
P/E	28.4x	33.5x		29.7x
Payout	87%	105%		94%

Note: Figures exclude non-recurring items

Revenue (\$mm)

	2015	2016	Prior 2017E	Curr. 2017E
1Q			--	--
2Q			--	--
3Q			--	--
4Q			--	--
Year	\$86	\$64		\$77

Company Description: Delta Natural Gas Company is engaged primarily in the distribution, transmission, storage and production of natural gas. Facilities are located in 23 predominantly rural counties in central and southeastern Kentucky. Delta serves approximately 36,000 residential, commercial, industrial, and transportation customers. The majority of Delta's customers are residential and commercial. Delta's retail sales are seasonal.

Delta Natural Gas Company

DGAS -- NASDAQ -- Neutral -- 2

Company to be acquired for \$30.50 per share in cash

Investment Highlights

- **On February 21, Delta Natural Gas announced it had entered into an agreement to merge with Peoples Gas for \$30.50 in cash per Delta share.** This represents a premium of 17% to Delta's closing share price on February 17, 2017, the last trading day prior to the announcement of the agreement. The total estimated value of the transaction is approximately \$218 million. Prior to the closing, the transaction is expected to have no impact on Delta's dividend. Delta's shareholders will continue to receive dividends at an annualized rate of \$0.83 per share until closing. Delta typically pays dividends on March 15, June 15, September 15 and December 15. Thus, as of now, we think it likely that Delta shareholders will receive three, and possibly four, dividends this calendar year.
- **Peoples, a privately held company, is the largest natural gas distributor in Pennsylvania.** It serves approximately 700,000 customers in Pennsylvania, West Virginia and Kentucky. The proposed acquisition will allow the company to significantly expand its presence in Kentucky beyond the 10 eastern Kentucky counties it currently serves.
- **The transaction is subject to standard closing conditions.** These include the approval of Delta shareholders, the approval of the Kentucky Public Service Commission and the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act. The transaction is expected to close by the end of 2017. We expect the proposed transaction will be approved.
- **We believe the proposed buyout price is a fair one for Delta shareholders.** The price of \$30.50 per share would represent a multiple of nearly 35x our current fiscal 2017 earnings estimate of \$0.88 per share. The transaction multiple would represent a premium to other recent natural gas distribution acquisition multiples.

**Note Important Disclosures on Pages 2 - 3.
Note Analyst Certification on Page 2.**

Rating

We maintain our Neutral rating on Delta. However, the stock is now trading based on the proposed acquisition rather than fundamentals. As we believe the transaction is likely to be completed, we remain comfortable with shareholders maintaining positions in the stock and collecting dividends until the deal closes late this year. However, we would not be opposed to taking profits for those wishing to utilize funds for other investment opportunities prior to the deal close. This is especially the case as it may take another ten months for the deal to complete. As of this writing, the stock's intraday price is \$30.20 per share, up 15.5% from the previous trading day's close. Assuming the deal transaction is completed and all four dividends are paid this year, this would provide a potential total return of about 3.7% from the current intraday market price.

Also, we note that this will be a taxable event for Delta shareholders as it is an all-cash transaction. As of now, it appears the transaction will take place this calendar year so it may prove to be a 2017 taxable event.

Finally, we believe the \$30.50 per share offer from Peoples Gas represents a fair one for Delta shareholders. While we believe DGAS is a strong company with a solid fundamental outlook, as we have noted in recent years, the company did not have any clear, consistent earnings drivers, in our view. We believe selling the company may represent the most effective way to maximize shareholder value given the lack of earnings growth prospects.

Suitability

We assign a 2 suitability rating to Delta Natural Gas Company. While the company manages a stable natural gas distribution business, the proposed acquisition by People Gas will now be the primary consideration in how the stock trades this year. While we believe the transaction will be approved, there is always the risk that the deal might not be finalized for some unseen reason. Were that to occur, Peoples Gas would pay Delta Natural Gas a \$4.3 million termination fee.

Additional information is available upon request.

Analyst Certification

I, David B. Burks, 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' customers owned at least 5% of the outstanding common stock of Delta Natural Gas Company as of February 17, 2017.

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

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 set back in the next 12 months.

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 revenue, volatility, low trading volume or a narrow customer or product base



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	33	27%	18%	82%
Hold/Neutral	76	62%	7%	93%
Sell	13	11%	0%	100%

As of 6 January 2017

Other Disclosures

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