



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

WTR - NYSE - as of	10/31/17	\$35.48
Price Target		\$30.00
52-Week Range	\$28.03 -	\$36.27
Shares Outstanding (mm)		177.7
Market Cap. (\$mm)		\$6,303.1
1-Mo. Average Daily Volume		481,872
Institutional Ownership		54.3%
LTD / Total Capital	Q3'17	50.2%
ROE--Adj	TTM	12.6%
Book Value / Share	Q3'17	\$10.88
Price / Book Value		3.3x
Dividend Yield		2.3%
LTM EBITDA Margin		57.1%

### EPS (continuing ops) FY 12/31

		Prior	Current		Prior	Current
	2016A	2017E	2017E	A	2018E	2018E
1Q	\$0.29	--	\$0.28	A	--	--
2Q	\$0.33	--	\$0.34	A	--	--
3Q	\$0.41	--	\$0.43	A	--	--
4Q	\$0.28	\$0.29	\$0.31	--	--	--
Year	\$1.32	\$1.34	\$1.35		\$1.40	\$1.40
P/E	26.9x		26.3x			25.3x

\*Adjusted for special items

### Revenue (\$MM)

		Prior	Current		Prior	Current
	2016A	2017E	2017E	A	2018E	2018E
1Q	\$193	--	\$188	A	--	--
2Q	\$204	--	\$203	A	--	--
3Q	\$227	--	\$215	A	--	--
4Q	\$197	\$197	\$200	--	--	--
Year	\$820	\$815	\$806		\$847	\$841

**Company Description:** Aqua America is a water and wastewater utility holding company with operating subsidiaries serving ~3MM people. WTR provides regulated service to customers in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana, Virginia. The company's history spans over 125 years.

### Water Utilities

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## Aqua America, Inc.

WTR – NYSE – Underperform-2

### Q3'17 Results from WTR; Reiterating Underperform.

#### Investment Highlights

- Aqua America reported Q3'17 EPS of \$0.43, up 4.0% from the year-ago period. Results met consensus, while coming in a penny ahead of our expectation. A lower effective tax rate and a couple of special expense items offset difficult weather.
- Revenue slid 5.1% to \$215.0MM in Q3; topline missed consensus for \$233.4MM and our target at \$227.0. Market-based divestitures were a drag of about \$3.4MM, but likely aided profitability; due mostly to Hurricane Harvey in TX, we expect weather concerns effectively drove the balance of the decline.
- As expected, Aqua PA implemented a DSIC surcharge as of 10/1/17, which keeps the subsidiary on pace to file a base rate case next year (with impact to 2019).
- Adding one over the past quarter, five muni deals representing ~14k customers and a purchase price of ~\$150MM are pending. Closings may stretch into 2018, which is consistent with our prior outlook.
- O&M expense fell 14.8% to \$68.0MM in Q3. We calculate \$5.4MM of the decline occurred outside of the regulated businesses and aside from the impact of market-based divestitures, and largely allowed WTR to meet consensus despite weather-related weakness.
- YTD Cap Ex at \$338MM versus \$270MM yr/yr bodes well for growth in our view, but we still site/calculate TTM ROE at 12.6% as somewhat of a limiting factor.
- Aqua reiterated EPS guidance for 2017 in the range of \$1.34 to \$1.39; our 2017E EPS rises a penny to \$1.35, while our 2018E EPS is unchanged at \$1.40. We are initiating a 2019 EPS estimate of \$1.46.
- We are reiterating our Underperform rating. M&A impact has been slow to escalate, in our view, and with ROE still compressing, we see negatively skewed near-term risk/reward at current valuations.

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

**ADDITIONAL DISCUSSION—MULTIPLE ITEMS**

As noted in our opening bullet points, we suggest that unexpected downside to Operations & Maintenance (O&M) expense in the quarter allowed WTR to meet EPS consensus. In response to our query on the conference call this morning about negative O&M expense outside of the regulated segment, management cited an insurance settlement and gains at a medical plan as potentially one-time items impacting the quarter; we estimate EPS impact to Q3'17 was +\$0.02 to +\$0.03. Having said that, timing is somewhat fortuitous, as we almost equivalently cite Hurricane Harvey as a negative special item from the quarter, that is unlikely to repeat next year. We could argue that adjusted Q3'17 EPS would be closer to \$0.40 or \$0.41, but see reported figures of \$0.43 as a reasonable comp for the year-ahead quarter.

Although not specifically mentioned in Aqua's earnings press release, management spent several minutes (and slides) discussing the impact from Hurricane Harvey on today's conference call. The storm clearly had a meaningful impact on Q3 revenue and some corresponding variable production costs; having said that, we gauge that one-time response expenses were largely immaterial. Similarly, we expect hurricane impact to WTR was likely contained to Q3, and is unlikely to be a conversation around fourth quarter results.

We take a somewhat conservative initial position in rolling out our 2019 estimates, which is embodied in large part by an effective tax rate of 11.4% in 2019. An eventual general rate case in Pennsylvania will likely be one of the greatest points of sensitivity in our model (excluding any transformative M&A), although at this juncture we hold fairly high conviction that Aqua will have fresh base rates impact the year. Based from our projection for FY 2018 ROE of 11.7%, we expect further compression in 2019.

**SUITABILITY**

We assign WTR a suitability rating of '2.' A complete description of our suitability scale is on page 5. We view Aqua America as a strong operator in the water space, and flag consistent cash flow and earnings predictability due to entrenched regulated monopoly franchises. High sensitivity to a single state (PA) versus some larger utility peers is the primary factor that pushes WTR just below our most conservative '1' suitability rating. A strong history of returning capital to shareholders, low cyclicality and industry-appropriate leverage keep the company well above our more aggressive '3' rating.

**CONSIDERATIONS AND RISKS**

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

Significant Cap Ex are required to maintain infrastructure and expand rate base. Should WTR suffer from the lack of ability to secure appropriate funding to make investments, or if delays are incurred in completing projects, operating results could be negatively affected. Contamination of water could result in service interruptions or cause enforcement actions. Assets can be subject to condemnation through eminent domain. The company's non-reg businesses provide performance guarantees and have long-term contracts. Additionally, WTR is subject to all other risks that result from operating as a public company.

Our Suitability rating is 2 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

*Additional information is available upon request.*

## Aqua America, Inc.

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>	<b>\$779,903</b>	<b>\$814,204</b>	\$192,607	\$203,876	\$226,593	\$196,799	<b>\$819,875</b>	\$187,787	\$203,418	\$215,008	\$199,550	<b>\$805,760</b>	<b>\$840,950</b>	<b>\$870,900</b>
<b>Operating Expenses</b>														
O & M	288,560	309,310	73,541	73,994	79,812	77,550	304,897	69,128	70,853	67,982	74,510	282,470	292,140	296,510
Depreciation	123,050	125,290	32,145	31,619	33,881	33,342	130,987	33,837	33,407	34,264	34,820	136,330	146,220	153,370
Amortization	3,480	3,447	450	528	389	654	2,021	189	127	42	660	1,020	1,020	1,020
Taxes other than Income	50,450	55,057	14,140	14,242	14,712	13,291	56,385	14,737	14,419	15,234	13,570	57,960	52,970	54,860
Operating Income	314,363	321,100	72,331	83,493	97,799	71,962	325,585	69,896	84,612	97,486	75,990	327,980	348,600	365,140
%	40.3%	39.4%	37.6%	41.0%	43.2%	36.6%	39.7%	37.2%	41.6%	45.3%	38.1%	40.7%	41.5%	41.9%
Other Expense / (Income):														
Interest, net	76,400	76,536	19,853	20,115	20,168	20,458	80,594	21,326	21,387	22,411	20,940	86,060	87,170	87,400
AFUDC	(5,130)	(6,219)	(2,308)	(1,871)	(2,267)	(2,369)	(8,815)	(3,193)	(3,463)	(3,914)	(3,500)	(14,070)	(14,070)	(14,070)
(Gain) on Asset Sale	0	(468)	(207)	(121)	(62)	12	(378)	(269)	(10)	(43)	(110)	(430)	(410)	(410)
(Gain) on Debt Extinguish	0	(678)												
Equity (Earnings) / Loss from JV	3,990	35,177	249	229	(1,621)	167	(976)	30	161	(593)	200	(200)	(200)	(200)
Income Before Tax	239,103	216,752	54,744	65,141	81,581	53,694	255,160	52,002	66,537	79,625	58,460	256,620	276,110	292,420
Income Tax	25,219	14,962	3,007	5,515	8,411	4,045	20,978	2,930	5,569	3,400	3,910	15,810	26,990	33,340
%	10.5%	6.9%	5.5%	8.5%	10.3%	7.5%	8.2%	5.6%	8.4%	4.3%	6.7%	6.2%	9.8%	11.4%
Net Income--Cont'd Ops	213,884	201,790	51,737	59,626	73,170	49,649	234,182	49,072	60,968	76,225	54,550	240,810	249,120	259,080
Net Income Avail to Common	\$233,239	\$201,790	\$51,737	\$59,626	\$73,170	\$49,649	\$234,182	\$49,072	\$60,968	\$76,225	\$54,550	\$240,820	\$249,130	\$259,080
EPS Disc Ops	\$0.11													
EPS Continuing Ops	\$1.20	\$1.14	\$0.29	\$0.33	\$0.41	\$0.28	\$1.32	\$0.28	\$0.34	\$0.43	\$0.31	\$1.35	\$1.40	\$1.46
<b>EPS--Cont'd Ops; Ex-NonRecur</b>	<b>\$1.20</b>	<b>\$1.26</b>	<b>\$0.29</b>	<b>\$0.33</b>	<b>\$0.41</b>	<b>\$0.28</b>	<b>\$1.32</b>	<b>\$0.28</b>	<b>\$0.34</b>	<b>\$0.43</b>	<b>\$0.31</b>	<b>\$1.35</b>	<b>\$1.40</b>	<b>\$1.46</b>
Diluted Avg Shares	177,763	177,763	177,819	178,084	177,817	177,880	177,846	177,969	178,045	178,124	178,151	178,072	178,218	178,008
Dividend	\$0.634	\$0.686	\$0.178	\$0.178	\$0.1913	\$0.1913	\$0.739	\$0.1913	\$0.1913	\$0.2047	\$0.2047	\$0.7920	\$0.8394	\$0.8800
<b>Rate of Change Analysis:</b>														
Revenues	2.4%	4.4%	1.2%	-0.9%	2.5%	-0.1%	0.7%	-2.5%	-0.2%	-5.1%	1.4%	-1.7%	4.4%	3.6%
Op Income	4.2%	2.1%	1.6%	4.0%	2.9%	-3.6%	1.4%	-3.4%	1.3%	-0.3%	5.6%	0.7%	6.3%	4.7%
EPS--Cont'd Ops; Ex-Items	4.8%	4.5%	6.6%	3.8%	8.3%	-0.7%	4.8%	-5.2%	2.3%	4.0%	9.7%	2.7%	3.4%	4.1%
EBITDA	3.6%	2.0%	2.4%	3.0%	3.3%	-1.2%	1.9%	-1.0%	2.2%	-0.2%	5.2%	1.5%	6.6%	4.8%
O&M Expense	1.8%	7.2%	0.5%	-7.2%	1.6%	-0.4%	-1.4%	-6.0%	-4.2%	-14.8%	-3.9%	-7.4%	3.4%	1.5%
<b>Margin Analysis:</b>														
O&M	37.0%	38.0%	38.2%	36.3%	35.2%	39.4%	37.2%	36.8%	34.8%	31.6%	37.3%	35.1%	34.7%	34.0%
Taxes other than Income	6.5%	6.8%	7.3%	7.0%	6.5%	6.8%	6.9%	7.8%	7.1%	7.1%	6.8%	7.2%	6.3%	6.3%
Op Income	40.3%	39.4%	37.6%	41.0%	43.2%	36.6%	39.7%	37.2%	41.6%	45.3%	38.1%	40.7%	41.5%	41.9%
Net Income	27.4%	24.8%	26.9%	29.2%	32.3%	25.2%	28.6%	26.1%	30.0%	35.5%	27.3%	29.9%	29.6%	29.7%
Tax Rate	10.5%	6.9%	5.5%	8.5%	10.3%	7.5%	8.2%	5.6%	8.4%	4.3%	6.7%	6.2%	9.8%	11.4%
							*FY 2016 EPS guide \$1.30-\$1.35					*FY 2017 EPS guide \$1.34-\$1.39		

Source: Company reports and Hilliard Lyons estimates

## Aqua America, Inc.

Balance Sheet Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17p	Q4'17E	FY'17E	FY'18E	FY'19E
Cash	\$4,138	\$3,229	\$3,981	\$4,923	\$3,712	\$3,763	\$3,763	\$4,425	\$7,811	\$15,000	\$6,640	\$6,640	\$100	\$6,360
A/R	96,999	99,146	91,761	99,718	109,986	97,394	97,394	89,409	98,890	112,190	99,340	99,340	101,330	103,360
Other	51,385	25,995	26,991	27,791	27,703	27,493	27,493	28,629	31,390	11,152	28,040	28,040	28,600	29,170
Total Current Assets	152,522	128,370	122,733	132,432	141,401	128,650	128,650	122,463	138,091	138,342	134,020	134,020	130,030	138,890
Net PP&E	4,401,990	4,688,925	4,752,881	4,823,487	4,901,486	5,001,615	5,001,615	5,057,826	5,159,151	5,276,474	5,395,990	5,395,990	5,663,750	5,924,360
Regulatory Assets	725,591	830,118	859,830	887,135	911,455	948,647	948,647	974,853	1,003,808	1,043,810	1,043,810	1,043,810	1,045,810	1,045,810
Goodwill	31,184	33,866	42,304	42,234	41,921	42,208	42,208	42,266	42,266	42,270	42,270	42,270	42,370	42,370
Other	95,465	59,759	37,695	37,551	39,762	37,871	37,871	38,187	40,383	44,485	38,630	38,630	39,400	40,190
Total Assets	5,406,752	5,741,038	5,815,443	5,922,839	6,036,025	6,158,991	6,158,991	6,235,595	6,383,699	6,545,381	6,654,720	6,654,720	6,921,360	7,191,620
CP of LTD	58,615	35,593	29,096	38,212	83,777	150,671	150,671	119,296	143,567	13,238	54,051	54,051	94,797	1,200,812
Loans Payable	18,398	16,721	28,041	26,239	47,990	6,535	6,535	27,732	67,456	92,456	177,456	177,456	170,556	305,556
A/P	63,035	56,452	33,971	40,651	44,073	59,872	59,872	50,185	46,376	45,840	62,270	62,270	64,760	67,350
Other	85,287	84,433	83,235	74,118	76,158	84,458	84,458	80,387	75,148	101,416	86,150	86,150	87,870	89,630
Total Current Liab	225,335	193,199	174,343	179,220	251,998	301,536	301,536	277,600	332,547	252,950	379,927	379,927	417,983	1,663,348
LTD	1,560,655	1,743,612	1,744,108	1,775,874	1,726,493	1,737,605	1,737,605	1,797,511	1,822,581	1,952,473	1,917,097	1,917,097	2,001,351	895,336
Shareholders' Equity	1,655,383	1,725,930	1,760,707	1,791,163	1,832,200	1,850,668	1,850,668	1,867,227	1,896,530	1,938,265	2,115,610	2,115,610	2,281,600	2,435,000
Total Liab & SE	5,406,752	5,741,038	5,815,443	5,922,839	6,036,025	6,158,991	6,158,991	6,235,595	6,383,699	6,545,381	6,654,720	6,654,720	6,921,360	7,191,620
Cash Flow Analysis	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--Cont'd Ops	\$213,884	\$201,790	\$51,737	\$59,626	\$73,170	\$49,649	\$234,182	\$49,072	\$60,968	\$76,225	\$54,550	\$240,810	\$249,120	\$259,080
D&A	126,535	128,737	32,595	32,147	31,377	36,889	133,008	34,026	33,534	34,306	35,480	137,346	147,240	154,390
Deferred Income Tax	31,477	16,506	1,436	3,615	10,294	1,905	17,250	2,681	3,618	10,000	10,000	26,300	40,000	40,000
(Inc) / Dec in Working Cap	(25,333)	15,806	(17,290)	(11,194)	(4,718)	36,901	3,699	(6,909)	(21,290)	32,670	(2,874)	1,597	(220)	3,630
Operating CF	346,563	362,839	68,478	84,194	110,123	125,344	388,139	78,870	76,830	153,201	97,156	406,053	436,140	457,100
Cap ex	(328,605)	(364,689)	(72,984)	(95,603)	(101,432)	(112,977)	(382,996)	(94,562)	(113,910)	(129,228)	(130,000)	(467,700)	(395,000)	(400,000)
JV Investment	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	(112,106)	(121,248)	(31,513)	(31,558)	(33,923)	(33,929)	(130,923)	(33,945)	(33,975)	(36,462)	(36,467)	(140,849)	(149,597)	(156,645)
Release (Addition) of Const Funds	-	47	-	-	-	-	-	-	-	-	-	-	-	-
Free Cash Flow	(94,148)	(123,051)	(36,019)	(42,967)	(25,232)	(21,562)	(125,780)	(49,637)	(71,055)	(12,489)	(69,311)	(202,496)	(108,457)	(99,545)
FCF/Share														
Acquisitions	(14,616)	(28,989)	(4,461)	(1,165)	-	(3,797)	(9,423)	(220)	(5,545)	(5,000)	(25,000)	(35,770)	(20,000)	(15,000)
Divestitures	558	648	2,853	3,586	106	1,201	7,746	639	463	-	-	-	-	-
Proceeds from LT Debt	317,699	560,544	96,314	72,983	64,991	269,298	503,586	117,879	104,901	500	105,000	328,280	179,000	0
Repayments of LT Debt	(253,192)	(400,407)	(80,341)	(32,309)	(68,709)	(191,728)	(373,087)	(89,666)	(55,833)	(500)	(105,000)	(251,000)	(54,000)	0
Net Proceeds (Repayments) ST Debt	(18,342)	(1,677)	11,320	(1,802)	21,751	(41,455)	(10,186)	21,197	39,724	25,000	85,000	170,920	(6,900)	135,000
Net Change in Cash Overdraft	(322)	(739)	(17,250)	1,912	2,752	4,510	(8,076)	(2,403)	(10,213)	-	-	(12,620)	(14,192)	(14,192)
Repurchase of Common Stock	(15,756)	(25,247)	(2,827)	(32)	(46)	(123)	(3,028)	(2,053)	(40)	(3,548)	(3,548)	(9,189)	(14,192)	(14,192)
Net Cash Flow--Cont'd Ops	(70,823)	(10,701)	(27,263)	1,297	(613)	13,979	(12,600)	(2,368)	3,547	8,463	(8,359)	166	(6,549)	6,263
CF--Disc Ops	48,634	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Cash Flow	(22,189)	(10,701)	(27,263)	1,297	(613)	13,979	(12,600)	(2,368)	3,547	8,463	(8,359)	166	(6,549)	6,263
EBITDA	440,893	449,837	104,926	115,640	132,069	105,958	458,593	103,922	118,146	131,792	111,470	465,330	495,840	519,530
EBITDA margin	56.5%	55.2%	54.5%	56.7%	58.3%	53.8%	55.9%	55.3%	58.1%	61.3%	55.9%	57.8%	59.0%	59.7%
EV / TTM EBITDA	14.4x	15.7x	16.4x	17.9x	15.7x	15.8x	15.8x	16.7x	17.1x	18.0x	17.8x	17.8x	17.0x	16.2x
Selected Financial Statistics	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
Book Value	\$9.32	\$9.74	\$9.90	\$10.06	\$10.30	\$10.40	\$10.40	\$10.49	\$10.65	\$10.88	\$11.88	\$11.88	\$12.80	\$13.69
Tangible BV	\$9.14	\$9.55	\$9.66	\$9.82	\$10.07	\$10.16	\$10.16	\$10.25	\$10.41	\$10.64	\$11.64	\$11.64	\$12.56	\$13.45
Cap Ex / Depreciation	2.6x	2.8x	2.2x	3.0x	3.2x	3.1x	2.9x	2.8x	3.4x	3.8x	3.7x	3.4x	2.7x	2.6x
Price / Book	2.9x	3.1x	3.2x	3.5x	3.0x	2.9x	2.9x	3.1x	3.1x	3.3x	3.0x	3.0x	2.8x	2.6x
Total Net Debt/ Total Capital	49.7%	50.9%	50.5%	50.6%	50.3%	50.5%	50.5%	51.0%	51.6%	51.3%	50.3%	50.3%	49.8%	49.6%
LT Debt/Total Capital	48.5%	50.3%	49.8%	49.8%	48.5%	48.4%	48.4%	49.0%	49.0%	50.2%	47.5%	47.5%	46.7%	26.9%
ROE (TTM)--adj for Q4'15 JV chg	13.5%	13.1%	13.2%	13.1%	13.3%	13.1%	13.1%	12.7%	12.6%	12.6%	12.5%	12.5%	11.7%	11.3%

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

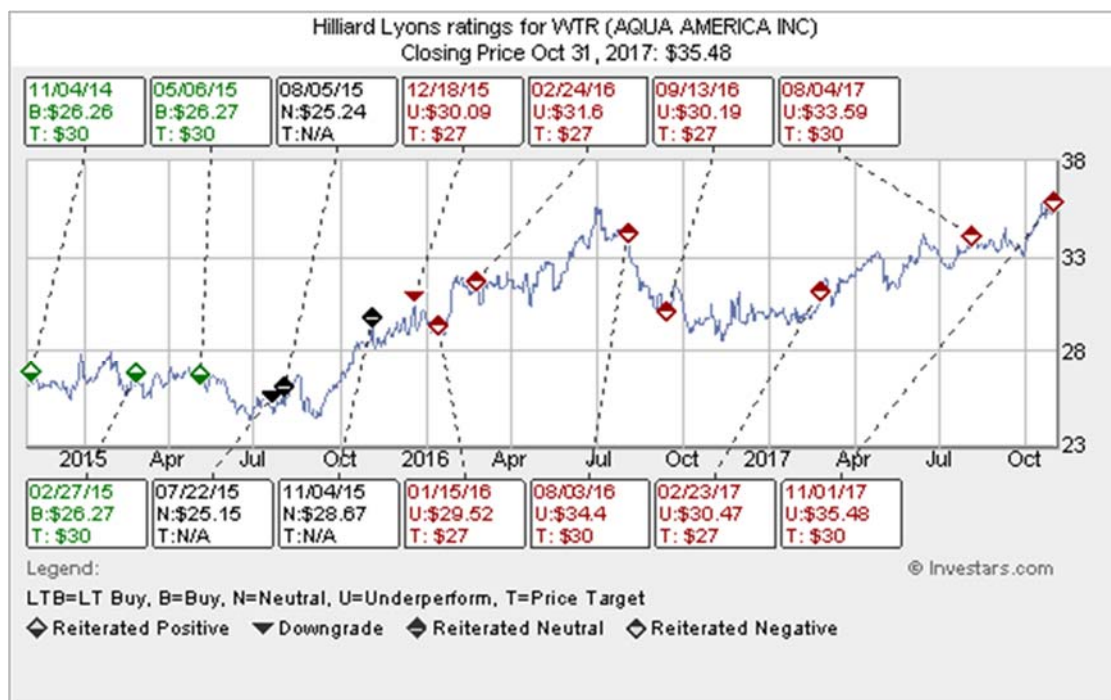
### **Investment Ratings**

**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	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 2017

### Other Disclosures

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