



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

|                            |           |         |
|----------------------------|-----------|---------|
| YORW - NASDAQ - as of      | 3/7/17    | \$35.50 |
| Price Target               |           | \$27.00 |
| 52-Week Range              | \$26.54 - | \$39.85 |
| Shares Outstanding (mm)    |           | 12.8    |
| Market Cap. (\$mm)         |           | \$455.9 |
| 1-Mo. Average Daily Volume |           | 21,412  |
| Institutional Ownership    |           | 33.9%   |
| LT Debt/Total Capital      | Q4'16     | 42.6%   |
| ROE                        | TTM       | 10.6%   |
| Book Value / Share         | Q4'16     | \$8.87  |
| Price / Book Value         |           | 4.0x    |
| Dividend Yield             |           | 1.8%    |
| EBITDA Margin              | FY'16     | 61.6%   |

### EPS FY 12/31

|      |        | Prior  | Current | Prior  | Current |
|------|--------|--------|---------|--------|---------|
|      | 2016A  | 2017E  | 2017E   | 2018E  | 2018E   |
| 1Q   | \$0.19 | --     | \$0.19  | --     | --      |
| 2Q   | \$0.22 | --     | \$0.22  | --     | --      |
| 3Q   | \$0.28 | --     | \$0.28  | --     | --      |
| 4Q   | \$0.23 | --     | \$0.25  | --     | --      |
| Year | \$0.92 | \$1.03 | \$0.95  | \$1.13 | \$1.01  |
| P/E  | 38.6x  |        | 37.4x   |        | 35.1x   |

### Total Operating Revenue (\$MM)

|      |        | Prior  | Current | Prior  | Current |
|------|--------|--------|---------|--------|---------|
|      | 2016A  | 2017E  | 2017E   | 2018E  | 2018E   |
| 1Q   | \$11.3 | --     | \$11.5  | --     | --      |
| 2Q   | \$11.8 | --     | \$12.2  | --     | --      |
| 3Q   | \$12.6 | --     | \$13.0  | --     | --      |
| 4Q   | \$11.9 | --     | \$12.3  | --     | --      |
| Year | \$47.6 | \$50.1 | \$49.1  | \$52.3 | \$51.1  |

**Company Description:** *The York Water Company impounds, purifies, and distributes water within its franchise in York and Adams Counties in Pennsylvania. The company has its own distribution system that supplies water to several adjacent areas. York Water serves a population of approximately 187,000 and its average daily consumption is approximately 18.5 million gallons.*

### Water Utilities

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## The York Water Company

YORW – NASDAQ – Underperform-3

### Q4'16 Results for YORW; Reiterating Underperform Rating on Valuation.

#### Investment Highlights

- York reported Q4'16 EPS of \$0.23 versus \$0.27 in the year-ago period; we were looking for \$0.26, which was the only published estimate. FY'16 EPS slid 5.4% to \$0.92 due mostly to a higher effective tax rate.
- Revenue grew 2.3% in Q4 and 1.1% on the full year, respectively. Acquisitions should help accelerate 2017 revenue growth; surcharge activity for the core system should be a small contributor as well.
- York's FY 2016 effective tax rate was 31.3%, up from 27.5% in 2015. YORW continues to benefit from IRS Tangible Property Rules, although year-to-year qualifying spend will see some variation. We model tax at ~30% in 2017, which is in line with guidance.
- YORW guided to Cap Ex of \$22.8MM and \$15.6MM in 2017 and 2018, respectively, after underspending initial targets for 2016. Nonetheless, we view the potential escalation positively, as it bodes well for surcharges over the next couple of years.
- YORW closed the 1700 customer purchase of West York Borough sewer on February 27, but noted in its 10-K that consolidated revenue growth is likely to lag expense growth over the near-term.
- Combined O&M plus G&A were 36.1% of revenue in 2016, a trim of 30bps from 36.4% in 2015.
- Reflecting ripple effect from the Q4'16 miss and reduced expectations for West York accretion, our 2017E EPS falls \$0.08 to \$0.95. We still expect a slight pickup in growth during the out year, but our 2018E EPS falls in sympathy to \$1.01.
- We are reiterating our Underperform rating, but raise our price target to \$27; our target values YORW in line with its 5-yr average TTM P/E of ~27, based on our 2018 estimates.

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

**SUITABILITY**

We assign YORW a suitability rating of '3.' A complete description of our suitability scale is on page 5. York's small-cap status, relatively low trading volume and a lack of regional diversification keep YORW below our '2' suitability rating. A long history of capital return, industry-appropriate leverage, and tenured monopoly franchises keep York well above our more aggressive '4' 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 YORW'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/or the utility's ability to supply water to customers. Risks associated with the collection, treatment, and disposal of wastewater could also impose significant costs.

Significant capital expenditures are required to maintain infrastructure and expand rate base. Should the company 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. Water assets can be subject to condemnation through eminent domain.

York Water operates with limited geographic diversity. As such, the company's operating results may be more sensitive to negative events that directly affect its regions of operations. Additionally, the company is subject to all other risks that result from operating as a publicly traded company.

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

*Additional information is available upon request.*



## The York Water Company

| Summary Balance Sheet         | FY'14     | FY'15     | Q1'16     | Q2'16     | Q3'16     | Q4'16     | FY'16     | Q1'17E    | Q2'17E    | Q3'17E    | Q4'17E    | FY'17E    | FY'18E    |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Cash                          | \$1,488   | \$2,879   | \$3,217   | \$5,009   | \$6,199   | \$4,209   | \$4,209   | \$1,480   | \$1,070   | \$290     | \$800     | \$800     | \$2,230   |
| A/R                           | 3,991     | 3,535     | 3,583     | 3,814     | 4,404     | 4,296     | 4,296     | 3,650     | 3,890     | 4,490     | 4,380     | 4,380     | 4,470     |
| Unbilled Rev                  | 2,377     | 2,614     | 2,510     | 2,444     | 2,369     | 2,429     | 2,429     | 2,560     | 2,490     | 2,420     | 2,480     | 2,480     | 2,530     |
| Other CAs                     | 3,377     | 2,764     | 2,249     | 1,746     | 1,869     | 1,686     | 1,686     | 2,262     | 2,540     | 2,288     | 2,271     | 2,271     | 2,363     |
| Total Current Assets          | 11,233    | 11,792    | 11,559    | 13,013    | 14,841    | 12,620    | 12,620    | 9,952     | 9,990     | 9,488     | 9,931     | 9,931     | 11,593    |
| Net PP&E                      | 253,194   | 261,420   | 261,881   | 263,682   | 265,411   | 270,907   | 270,907   | 274,220   | 278,590   | 282,880   | 286,150   | 286,150   | 292,110   |
| Deferred Reg Assets           | 32,614    | 32,996    | 33,278    | 33,368    | 34,015    | 33,027    | 33,027    | 33,360    | 33,690    | 34,030    | 34,370    | 34,370    | 35,760    |
| Other                         | 7,298     | 7,283     | 4,500     | 3,976     | 3,878     | 3,940     | 3,940     | 4,590     | 4,060     | 3,960     | 4,020     | 4,020     | 4,100     |
| Total Assets                  | \$304,339 | \$313,491 | \$311,218 | \$314,039 | \$318,145 | \$320,494 | \$320,494 | \$322,122 | \$326,330 | \$330,358 | \$334,471 | \$334,471 | \$343,563 |
| CP of LTD                     | 43        | 44        | 44        | 44        | 54        | 44        | 44        | 40        | 40        | 40        | 40        | 40        | 40        |
| ST Borrowings                 | 0         | 0         |           |           |           |           | 0         | 0         | 3,000     | 3,500     | 3,500     | 3,500     | 1,500     |
| A/P                           | 1,589     | 1,772     | 1,947     | 1,609     | 1,647     | 3,669     | 3,669     | 1,990     | 1,640     | 1,680     | 3,740     | 3,740     | 3,810     |
| Other CLs                     | 4,298     | 4,381     | 4,552     | 4,361     | 4,503     | 4,471     | 4,471     | 5,170     | 4,884     | 5,304     | 4,887     | 4,887     | 5,085     |
| Total Current Liabilities     | 5,930     | 6,197     | 6,543     | 6,014     | 6,204     | 8,184     | 8,184     | 7,200     | 9,564     | 10,524    | 12,167    | 12,167    | 10,435    |
| LTD                           | 84,842    | 87,261    | 84,543    | 84,569    | 84,584    | 84,609    | 84,609    | 98,510    | 98,510    | 98,510    | 98,510    | 98,510    | 98,510    |
| Deferred Income Tax           | 46,024    | 50,495    | 50,783    | 51,357    | 52,815    | 54,169    | 54,169    | 55,150    | 56,270    | 57,350    | 58,120    | 58,120    | 62,300    |
| CIAC                          | 31,052    | 34,930    | 35,107    | 35,104    | 35,245    | 36,654    | 36,654    | 30,650    | 30,916    | 28,080    | 31,196    | 31,196    | 32,460    |
| Other                         | 31,928    | 25,538    | 23,948    | 25,018    | 25,678    | 22,817    | 22,817    | 23,050    | 23,280    | 23,510    | 23,750    | 23,750    | 24,710    |
| Shareholders' Equity          | 104,563   | 109,070   | 110,294   | 111,977   | 113,619   | 114,061   | 114,061   | 107,562   | 107,790   | 112,384   | 110,728   | 110,728   | 115,148   |
| Total Liab & SE               | \$304,339 | \$313,491 | \$311,218 | \$314,039 | \$318,145 | \$320,494 | \$320,494 | \$322,122 | \$326,330 | \$330,358 | \$334,471 | \$334,471 | \$343,563 |
| Summary Cash Flow             | FY'14     | FY'15     | Q1'16     | Q2'16     | Q3'16     | Q4'16     | FY'16     | Q1'17E    | Q2'17E    | Q3'17E    | Q4'17E    | FY'17E    | FY'18E    |
| Net Income                    | \$11,484  | \$12,489  | \$2,486   | \$2,847   | \$3,571   | \$2,942   | \$11,846  | \$2,491   | \$2,872   | \$3,639   | \$3,259   | \$12,260  | \$12,970  |
| D&A                           | 5,932     | 6,151     | 1,627     | 1,555     | 1,614     | 1,626     | 6,422     | 1,690     | 1,630     | 1,710     | 1,730     | 6,760     | 7,040     |
| Deferred Tax                  | 4,753     | 2,270     | 244       | 363       | 443       | 596       | 1,646     | 980       | 1,120     | 1,080     | 770       | 3,950     | 4,180     |
| (Inc) / Dec in Wrk Cap        | (3,991)   | 1,098     | 917       | (191)     | (458)     | 2,221     | 2,489     | (970)     | (1,110)   | 190       | 1,690     | (200)     | 90        |
| Operating CF                  | 18,178    | 22,008    | 5,274     | 4,574     | 5,170     | 7,385     | 22,403    | 4,191     | 4,512     | 6,619     | 7,449     | 22,770    | 24,280    |
| Cap Ex                        | (14,139)  | (13,844)  | (1,921)   | (3,088)   | (3,293)   | (4,856)   | (13,158)  | (5,000)   | (6,000)   | (6,000)   | (5,000)   | (22,000)  | (13,000)  |
| Acquisitions                  | (369)     | (352)     | (5)       | (24)      | -         | (21)      | (50)      | (75)      | (75)      | (75)      | (75)      | (300)     | (300)     |
| Dividends                     | (7,402)   | (7,682)   | (1,980)   | (1,987)   | (1,993)   | (1,996)   | (7,956)   | (2,060)   | (2,060)   | (2,060)   | (2,100)   | (8,280)   | (8,440)   |
| Free Cash Flow                | (3,732)   | 130       | 1,368     | (525)     | (116)     | 512       | 1,239     | (2,944)   | (3,623)   | (1,516)   | 274       | (7,810)   | 2,540     |
| Cust Adv & CIAC               | 638       | 1,117     | 255       | 637       | 828       | 49        | 1,769     | 220       | 220       | 250       | 250       | 940       | 940       |
| LTD Proceeds                  | 14,880    | 14,301    | -         | -         | -         | -         | -         | -         | 0         | 0         | -         | 0         | 0         |
| LTD (Repay)                   | (14,923)  | (11,886)  | (11)      | (11)      | (11)      | (20)      | (53)      | (10)      | (10)      | (10)      | (10)      | (40)      | (40)      |
| Net LOC Borrow / (Repay)      | -         | -         | -         | -         | -         | -         | -         | -         | 3,000     | 500       | -         | 3,500     | (2,000)   |
| Stock Issued, Net             | (5,692)   | (2,546)   | 733       | 835       | 71        | (465)     | 1,174     | 0         | 0         | 0         | 0         | -         | -         |
| Net Cash Flow                 | (8,829)   | 1,116     | 2,345     | 936       | 772       | 76        | 4,129     | (2,734)   | (413)     | (776)     | 514       | (3,410)   | 1,440     |
| EBITDA                        | 28,009    | 28,812    | 6,841     | 7,250     | 8,028     | 7,191     | 29,310    | 6,940     | 7,470     | 8,270     | 7,500     | 30,180    | 31,470    |
| EBITDA Margin                 | 61.0%     | 61.2%     | 60.7%     | 61.3%     | 63.7%     | 60.5%     | 61.6%     | 60.1%     | 61.2%     | 63.6%     | 60.8%     | 61.5%     | 61.6%     |
| EV / TTM EBITDA               | 13.5x     | 14.0x     | 16.3x     | 16.9x     | 15.8x     | 19.5x     | 19.5x     | 18.8x     | 18.7x     | 18.6x     | 18.4x     | 18.4x     | 17.6x     |
| Selected Financial Statistics | FY'14     | FY'15     | Q1'16     | Q2'16     | Q3'16     | Q4'16     | FY'16     | Q1'17E    | Q2'17E    | Q3'17E    | Q4'17E    | FY'17E    | FY'17E    |
| Book Value                    | \$8.23    | \$8.51    | \$8.58    | \$8.71    | \$8.83    | \$8.87    | \$8.87    | \$8.36    | \$8.38    | \$8.74    | \$8.61    | \$8.61    | \$8.95    |
| Price / Book                  | 2.8x      | 2.9x      | 3.6x      | 3.7x      | 3.4x      | 4.3x      | 4.3x      | 4.2x      | 4.2x      | 4.1x      | 4.1x      | 4.1x      | 4.0x      |
| LTD / Total Cap               | 44.8%     | 44.4%     | 43.4%     | 43.0%     | 42.7%     | 42.6%     | 42.6%     | 47.8%     | 47.8%     | 46.7%     | 47.1%     | 47.1%     | 46.1%     |
| ROE (TTM)                     | 11.1%     | 11.7%     | 11.5%     | 11.3%     | 11.2%     | 10.6%     | 10.6%     | 10.6%     | 10.7%     | 10.8%     | 11.1%     | 11.1%     | 11.5%     |
| ROA (TTM)                     | 4.0%      | 4.1%      | 4.0%      | 4.0%      | 4.0%      | 3.8%      | 3.8%      | 3.7%      | 3.7%      | 3.7%      | 3.8%      | 3.8%      | 3.8%      |

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                  | 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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