

Janney Water Meter - December 2010

Outlook for Industrial, Municipal, Agricultural End-Markets Continues to Improve, While Construction Remains Challenged.

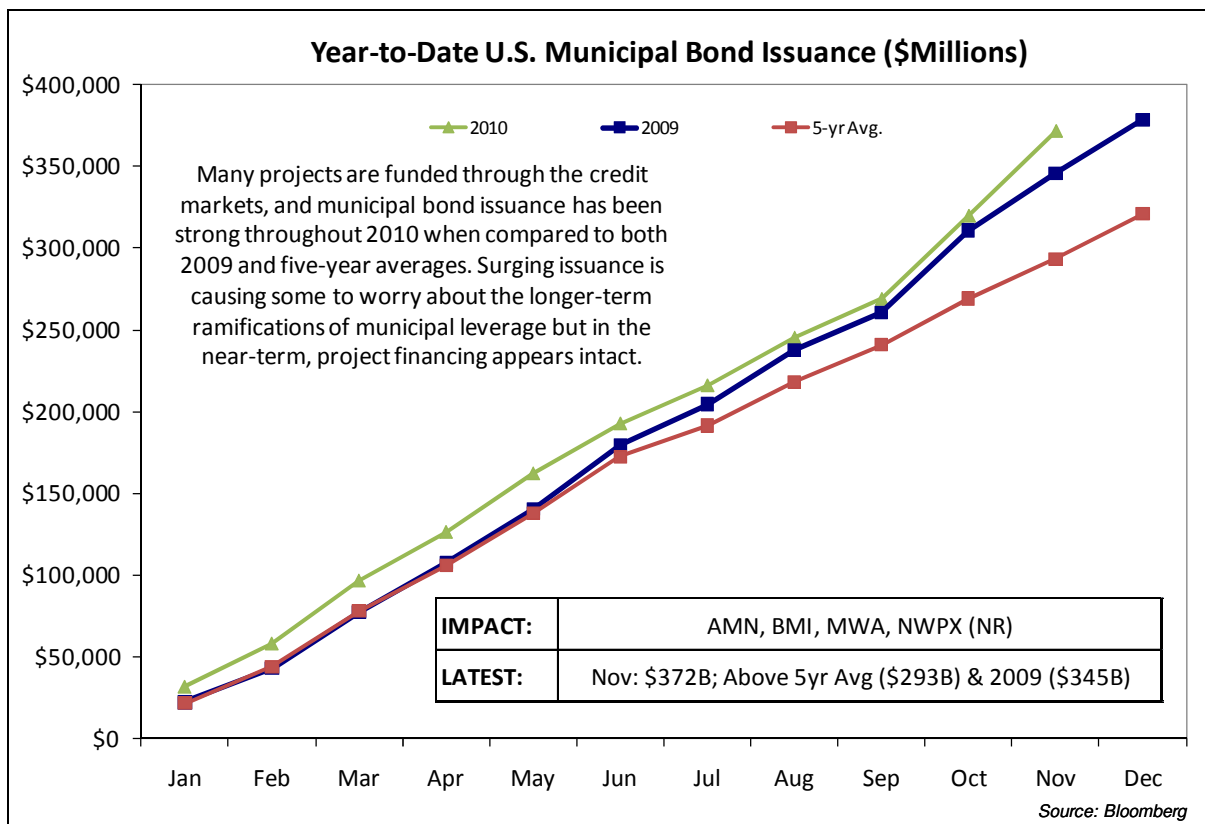
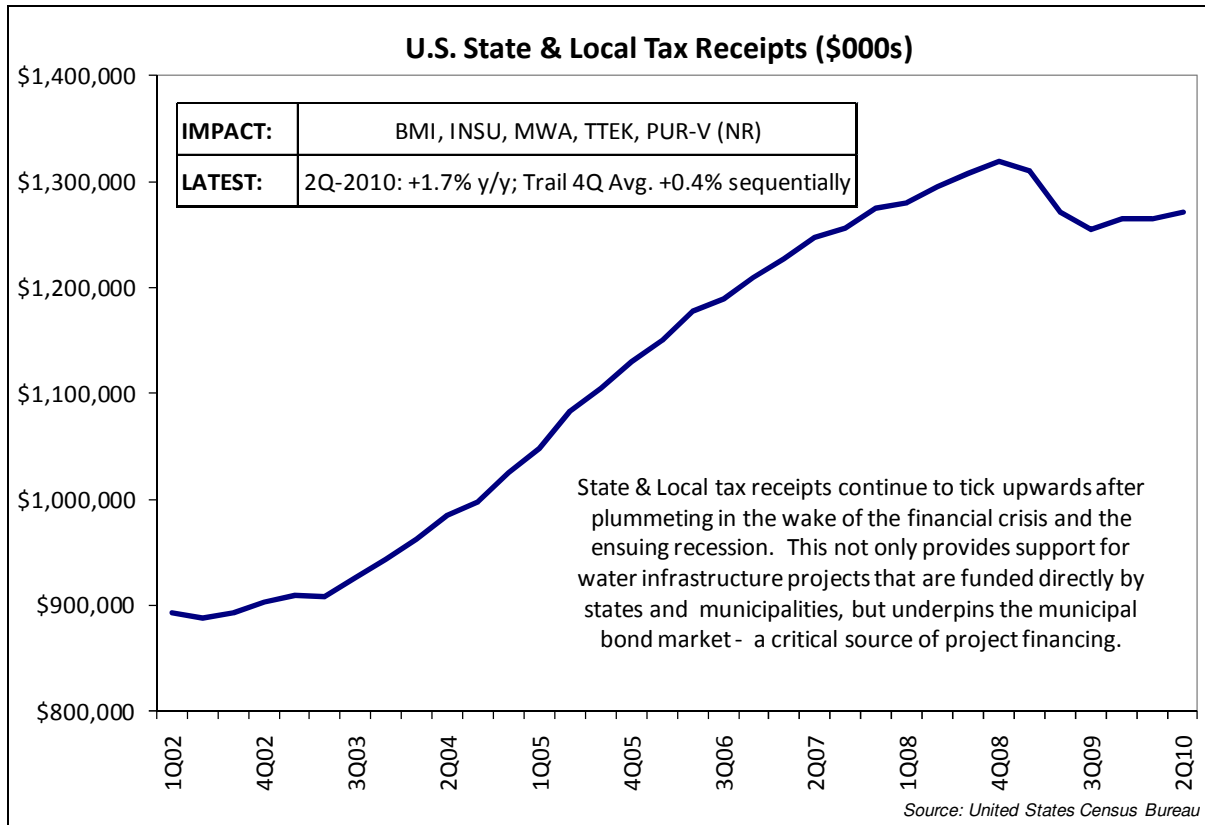
INVESTMENT CONCLUSION:

While the outlook for the broad economy remains uncertain, oscillating from bullish to bearish on a daily (and sometimes hourly) basis, the key forward-looking indicators that we watch to gauge demand trends in the water infrastructure space continue to suggest that the recent rebound in sector fundamentals will be sustained and in some cases accelerate into 2011. Coming off of a very strong third quarter earnings season (most companies in the water space "beat" and "raised"), the key question facing investors is: were the strong third quarter results an anomalous blip, or were they the beginning of a sustained rebound? The data clearly indicate the latter. From municipal bond issuance, to municipal water pricing, to industrial demand proxies such as the ISM Index and agricultural indicators such as ag commodity prices, most of the demand gauges we track suggest that the recent earnings momentum enjoyed by most companies in the water space will not only be sustained in 2011, but in some cases will actually accelerate. Indeed, only residential and commercial construction remain weak among the data points we track, and even here there is clear evidence of stabilization (if not yet improvement). Overall, we remain decidedly positive on the water group, favoring companies with concentrate exposure to municipal (BMI-BUY), agricultural (LNN-BUY), and industrial (NLC-BUY) end-markets and applications.

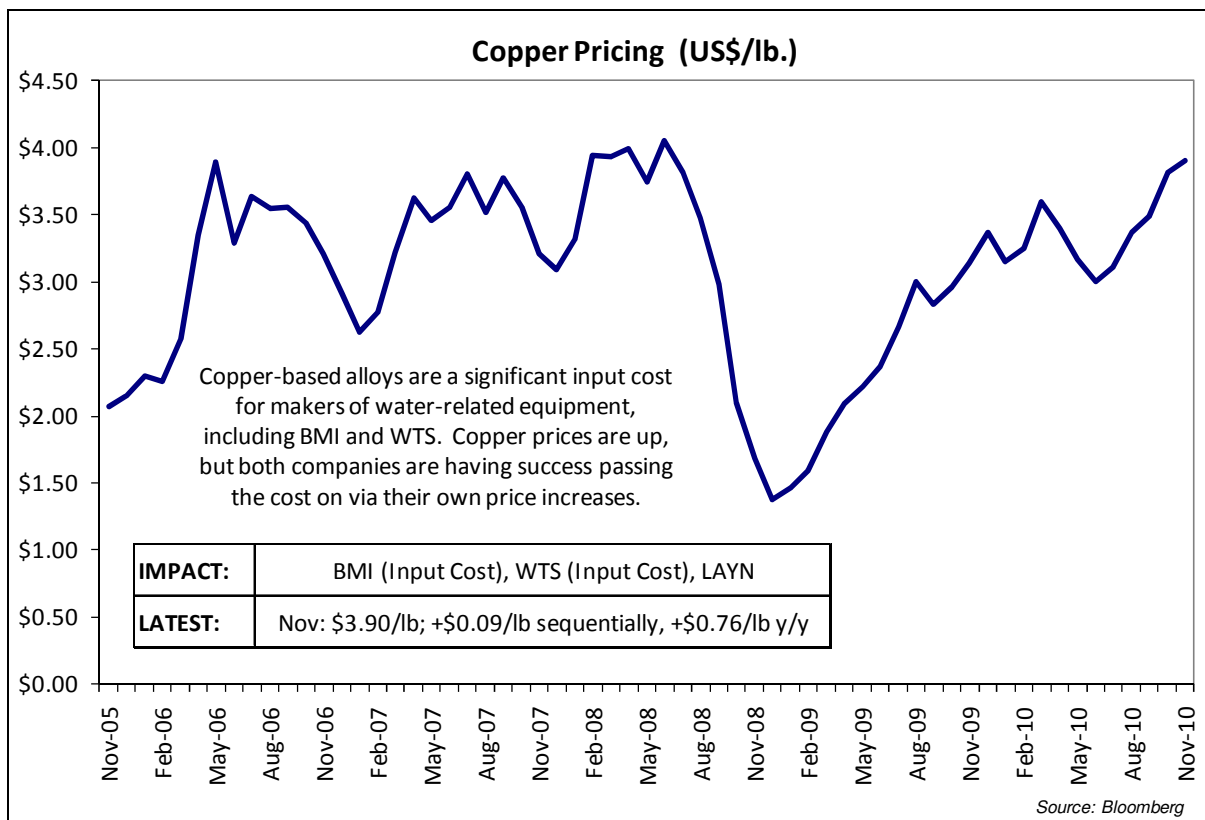
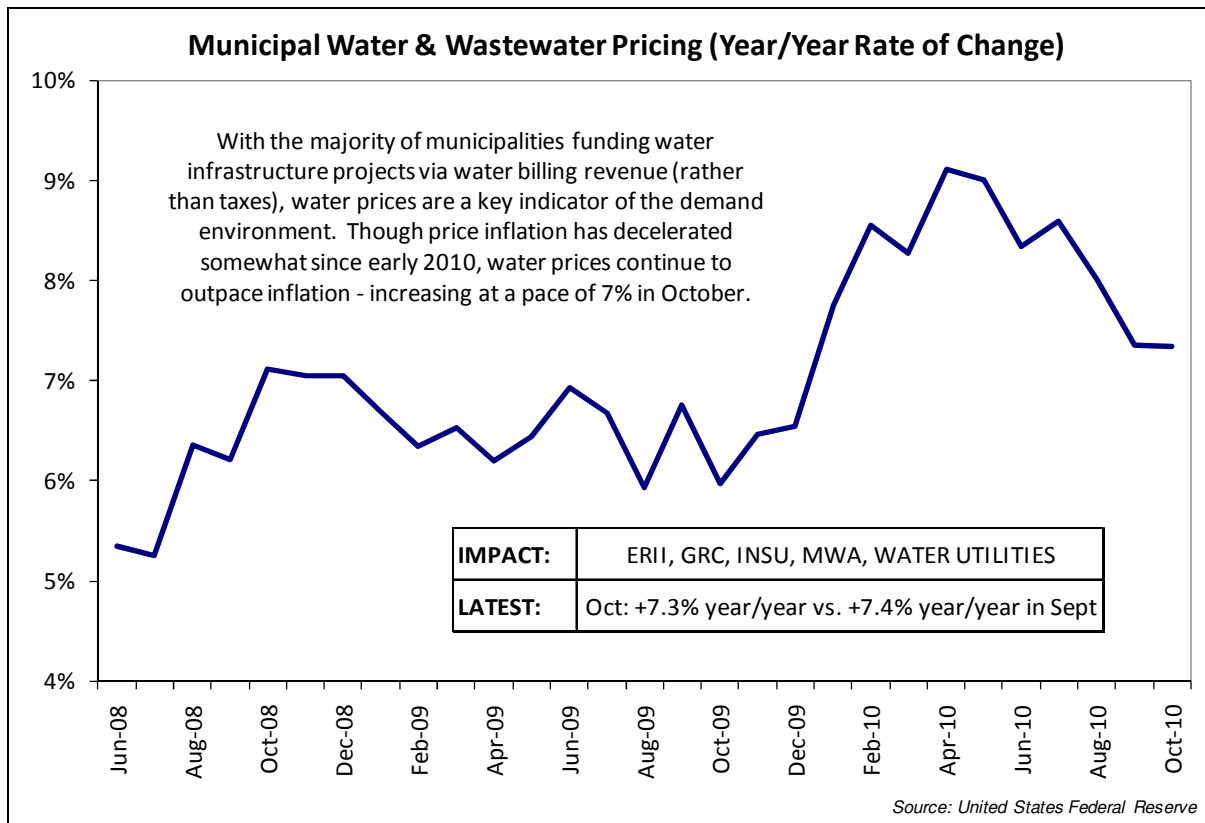
KEY POINTS:

- **Municipal: Muni issuance, water CPI trend higher.** While municipalities continue to suffer from financial distress and budgets are likely to contract in 2011, water authorities are in decidedly better shape. Year-to-date, \$372 billion in muni bonds have been issued, besting even 2009's \$345 billion. Meanwhile, water pricing rose 7% in October, continuing a trend of easily outpacing broad inflation. Coupled with our recent survey of municipal water authorities, many of which indicate that 2011 cap ex budgets will be higher than 2010 (O&M expenses are under pressure, however), this reinforces our view that demand in municipal channel will continue to improve.
- **Industrial: Demand outlook strong as ISM jumps.** While fears of an economic double-dip persist, key forward-looking indicators suggest that the recent rebound in the industrial economy has reached a sustainable base for future growth. After a brief dip in September, the ISM New Orders index jumped 7.2 points to 58.3 in October, indicating continued expansion in industrial output is likely. Continued improvement in the industrial economy is a significant positive driver for BUY-rated Nalco (NLC), a leader in industrial water management.
- **Ag: Surging corn prices set stage for strong 2011.** With unfavorable weather conditions in the Midwest leading to weak harvest output in the United States and the global supply/demand outlook also tight, agricultural commodity prices have risen substantially in recent weeks. Corn prices are a key demand indicator for the center pivot irrigation market, and closed November near \$6/bushel (up from roughly \$4/bushel a year ago). With center pivot systems not only a more water-efficient solution but also enabling substantial crop yield improvements, higher corn prices set the stage for a very strong 2011 selling season for BUY-rated Lindsay (LNN) and Neutral-rated Valmont (VMI).
- **Construction: ABI, Housing Starts bounce along.** One area where the data paint a less positive picture is on the demand outlook for water infrastructure for construction applications. Housing starts continue to bounce along the bottom of the trough, while the Architectural Billings Index suggests that the rebound in commercial construction is still a ways off. On the plus side, residential remodeling activity is brisk, while new construction seems to have clearly hit bottom. Overall, we believe the next inflection point in the construction markets will be a positive one.

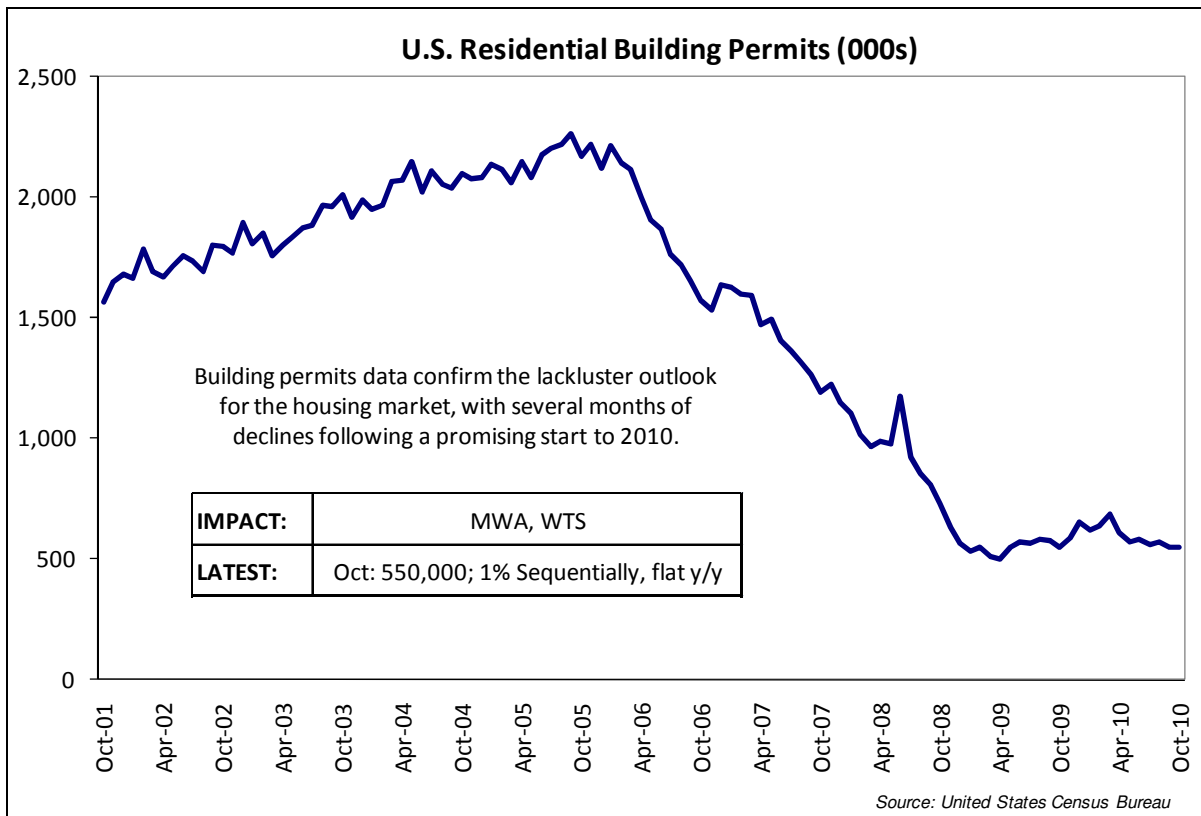
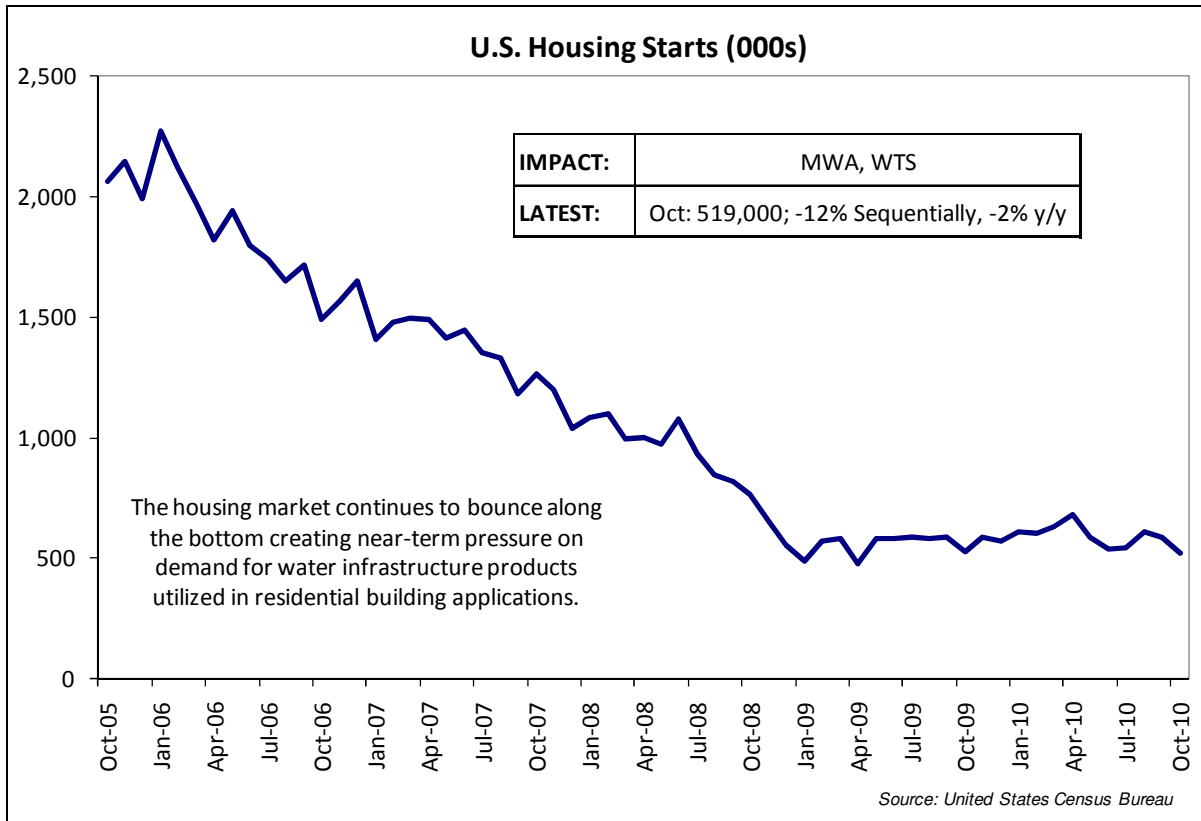
JANNEY WATER METER: MUNICIPAL INDICATORS



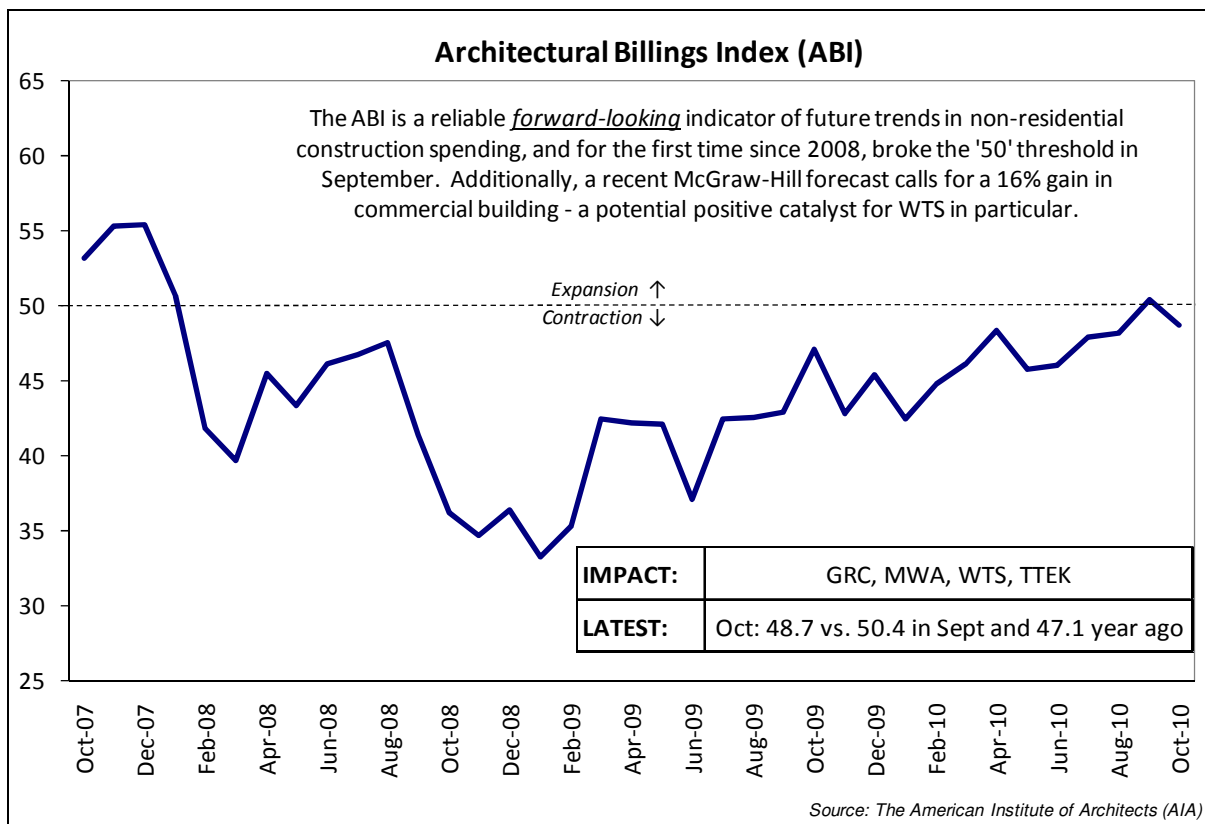
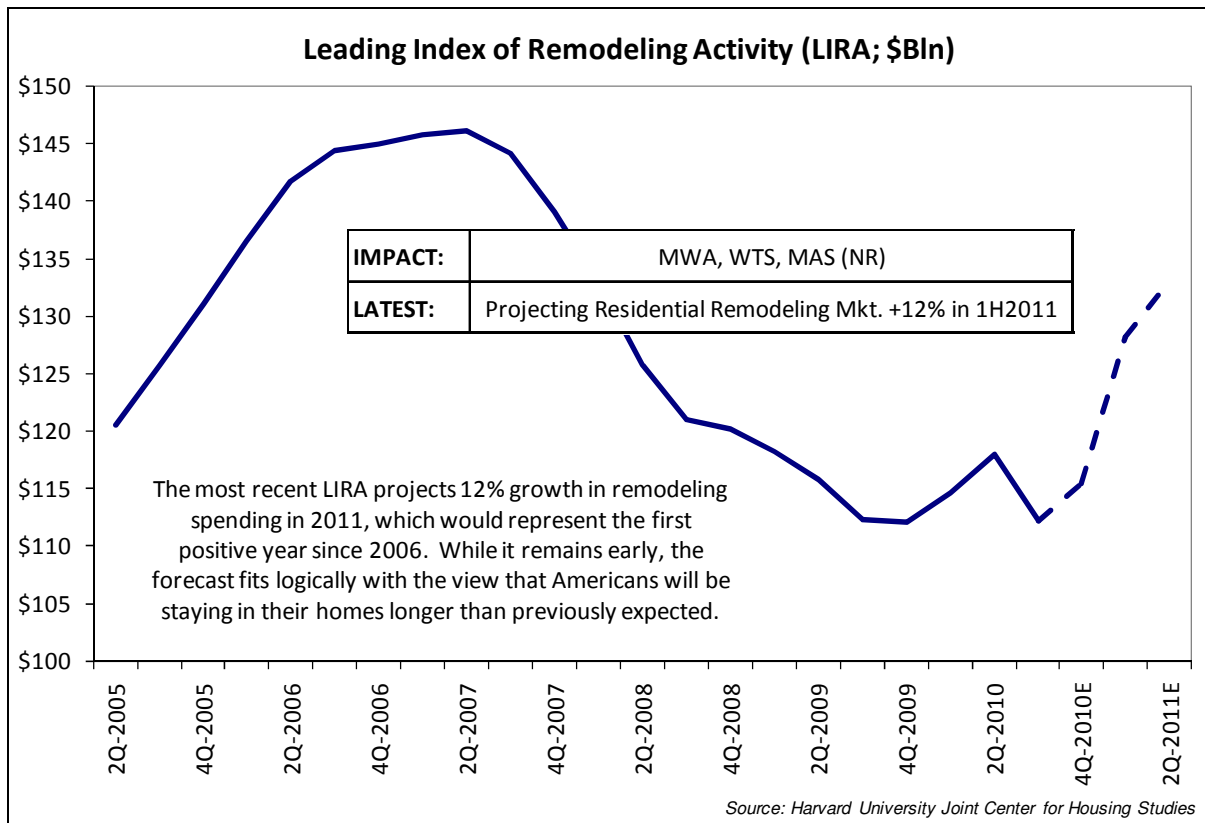
JANNEY WATER METER: PRICING INDICATORS



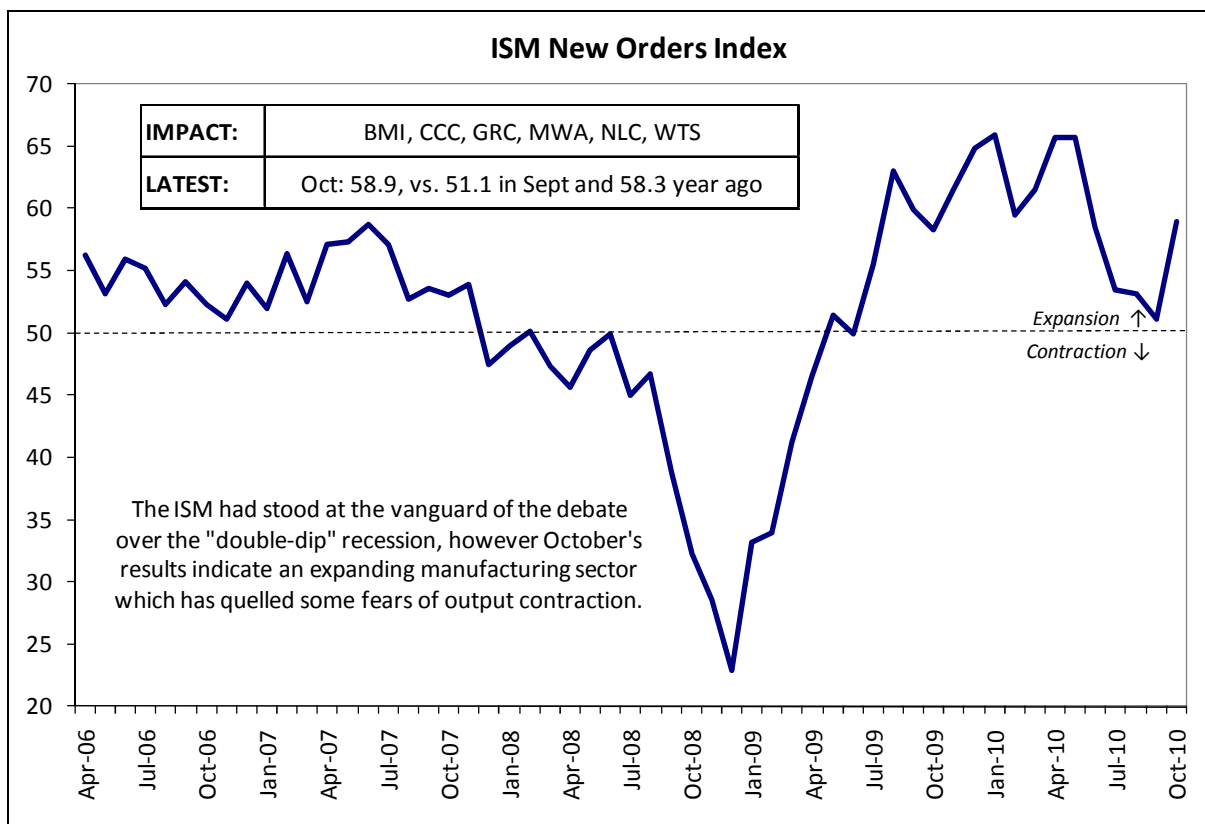
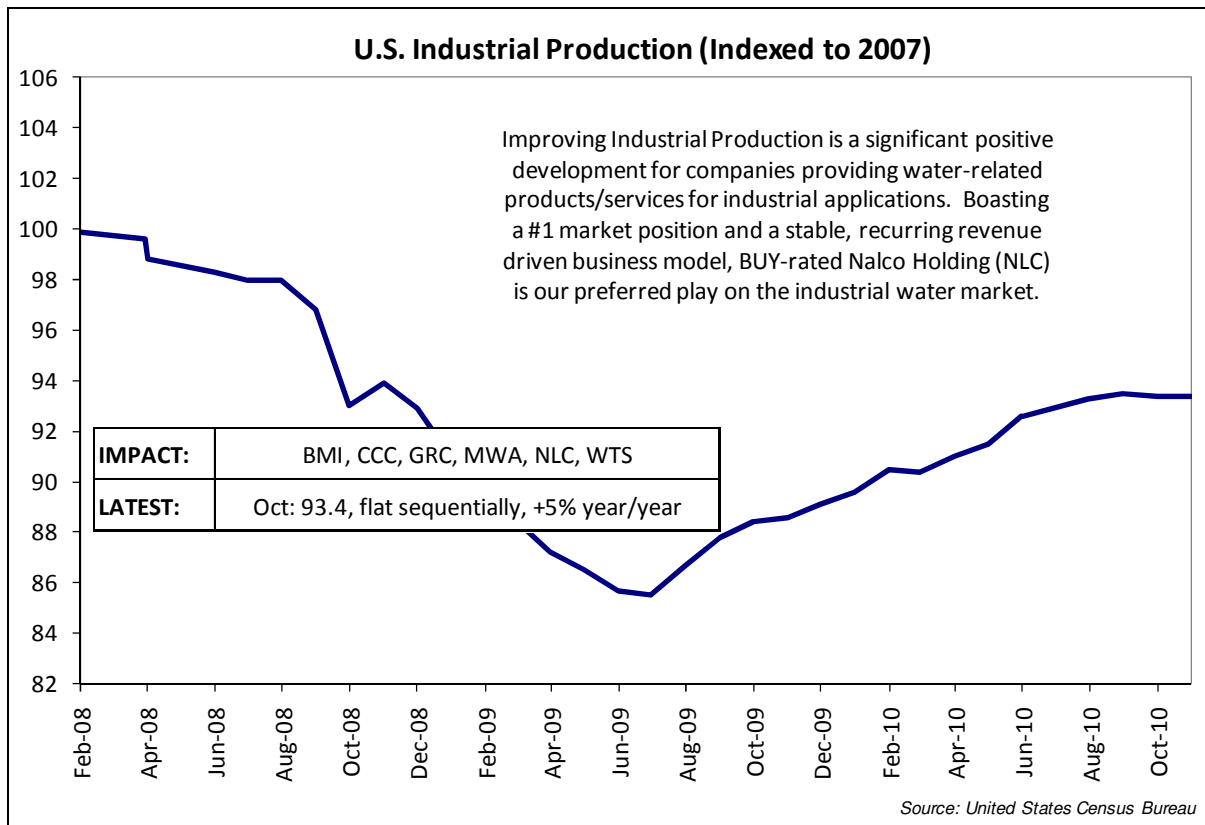
JANNEY WATER METER: RESIDENTIAL DEMAND INDICATORS



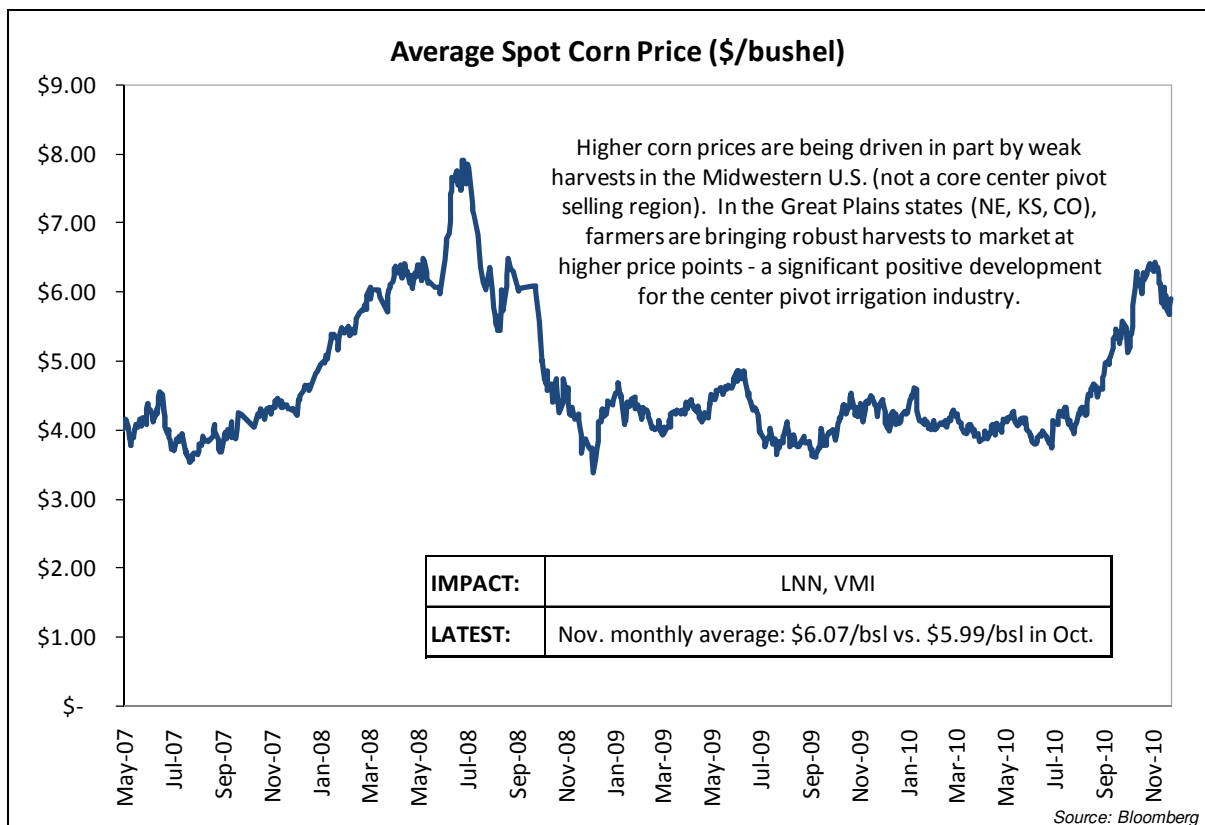
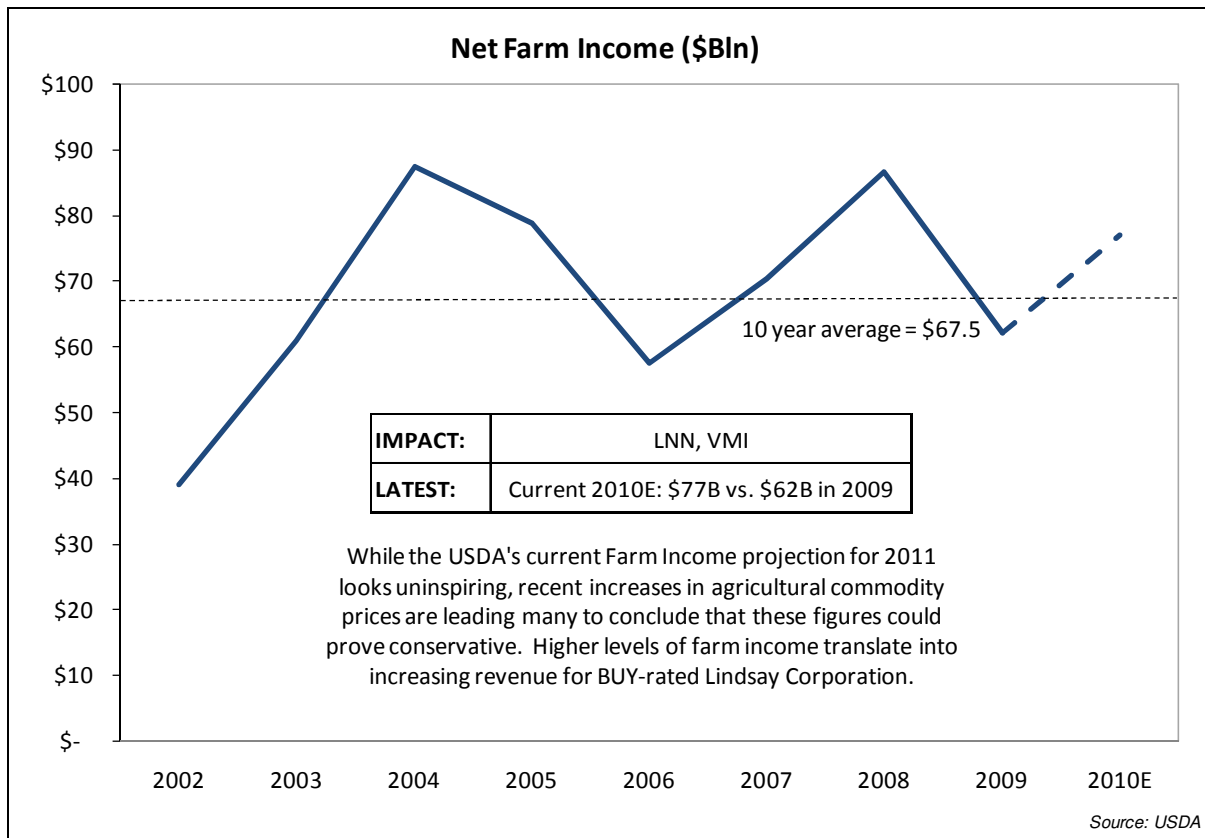
JANNEY WATER METER: REMODELING/NON-REZ DEMAND INDICATORS



JANNEY WATER METER: INDUSTRIAL DEMAND INDICATORS



JANNEY WATER METER: AGRICULTURAL DEMAND INDICATORS



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BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Janney Montgomery Scott Ratings Distribution as of 09/30/2010

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [B]	195	54	20	10
NEUTRAL [N]	157	43	10	6
SELL [S]	10	3	1	10

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

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