

Remain Overweight Water Cyclical as Key Demand Channels Show Signs of Life.

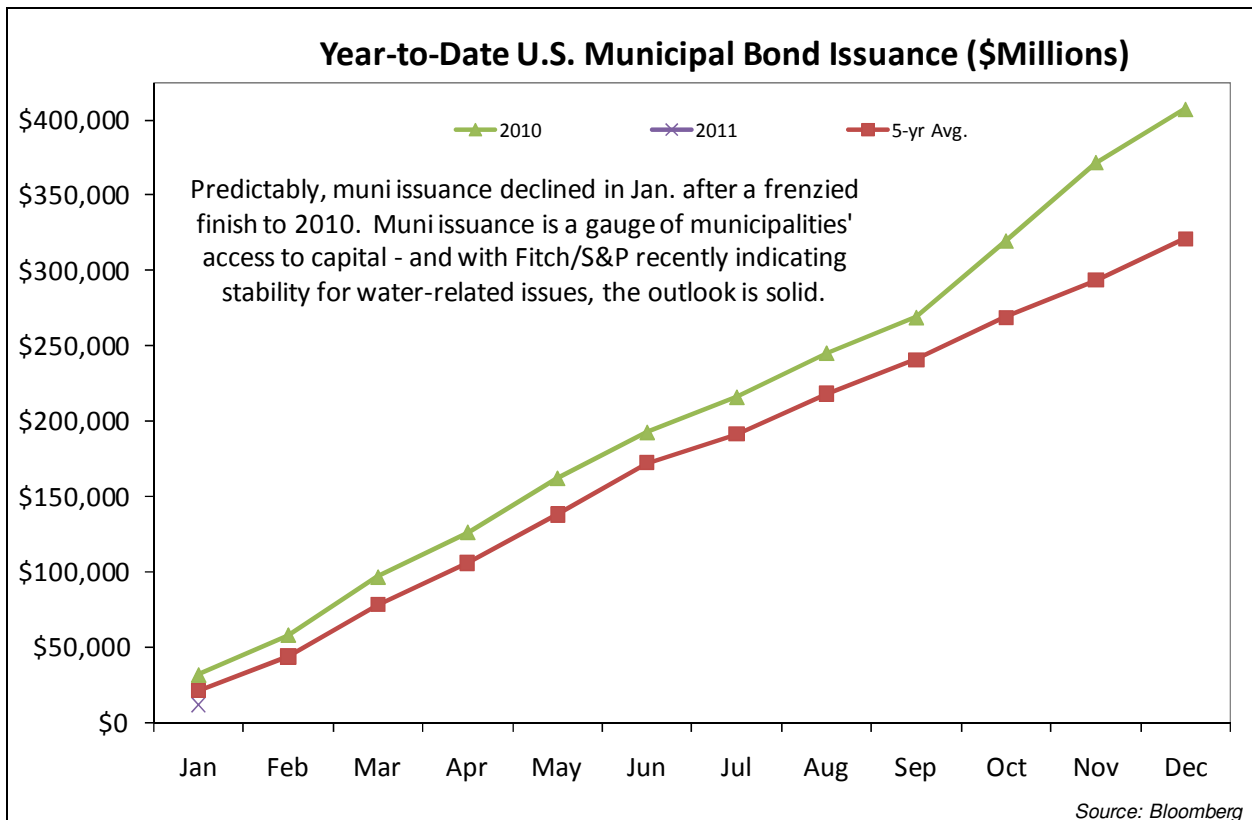
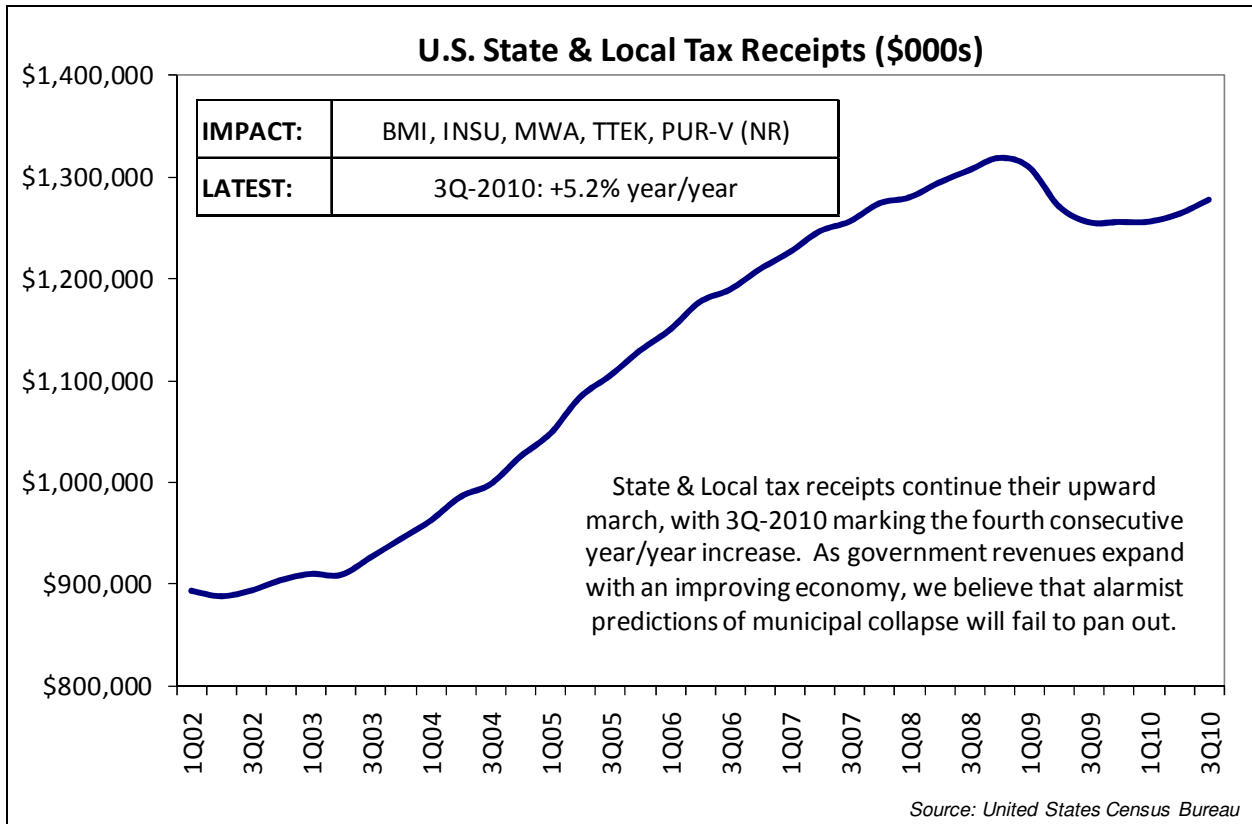
Janney Water Meter - February 2011

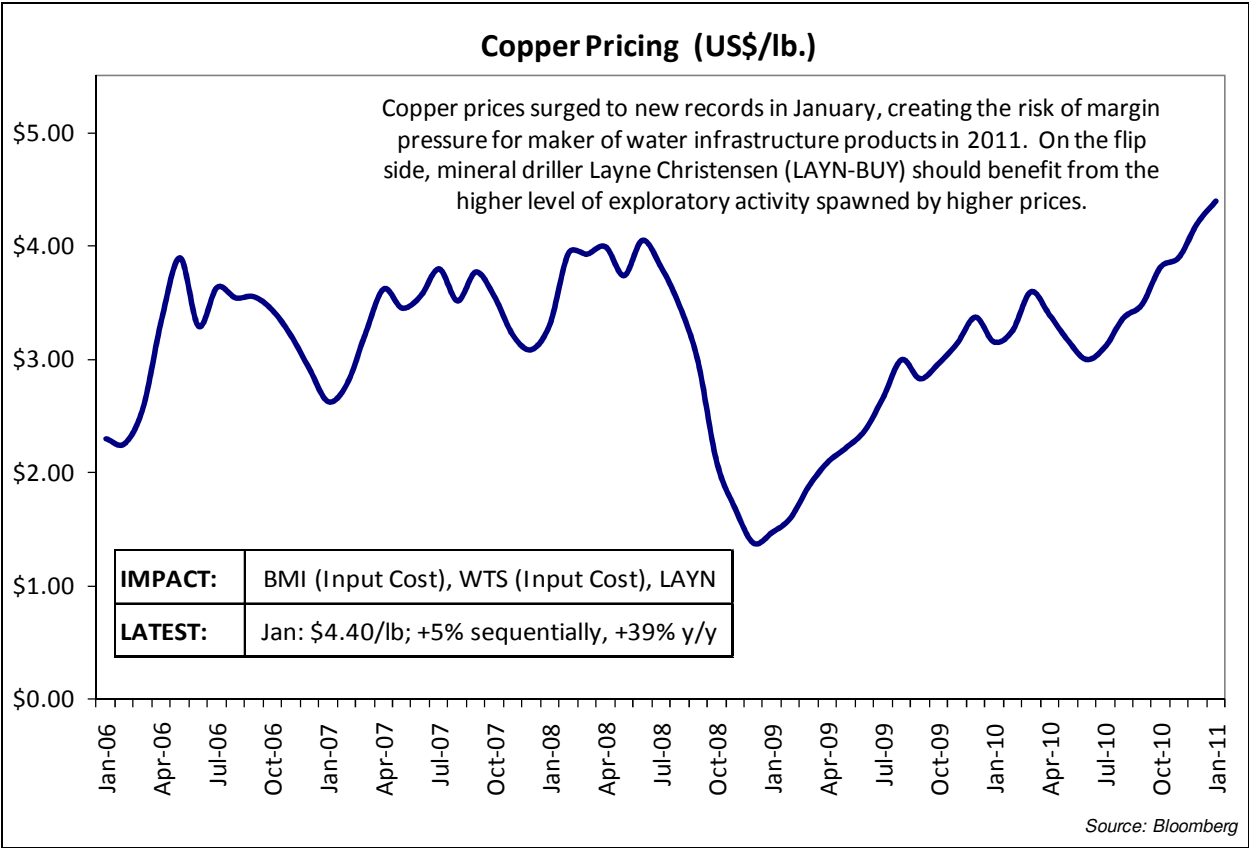
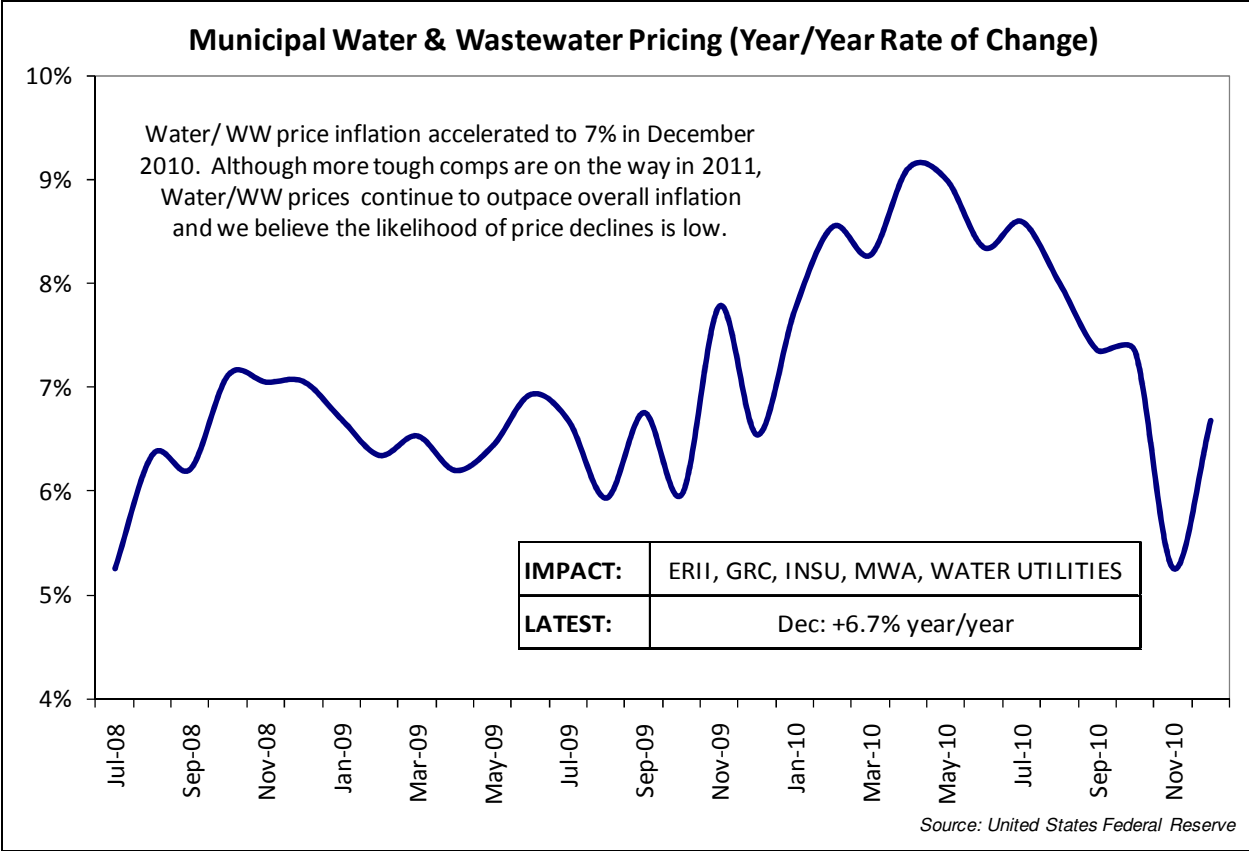
INVESTMENT CONCLUSION:

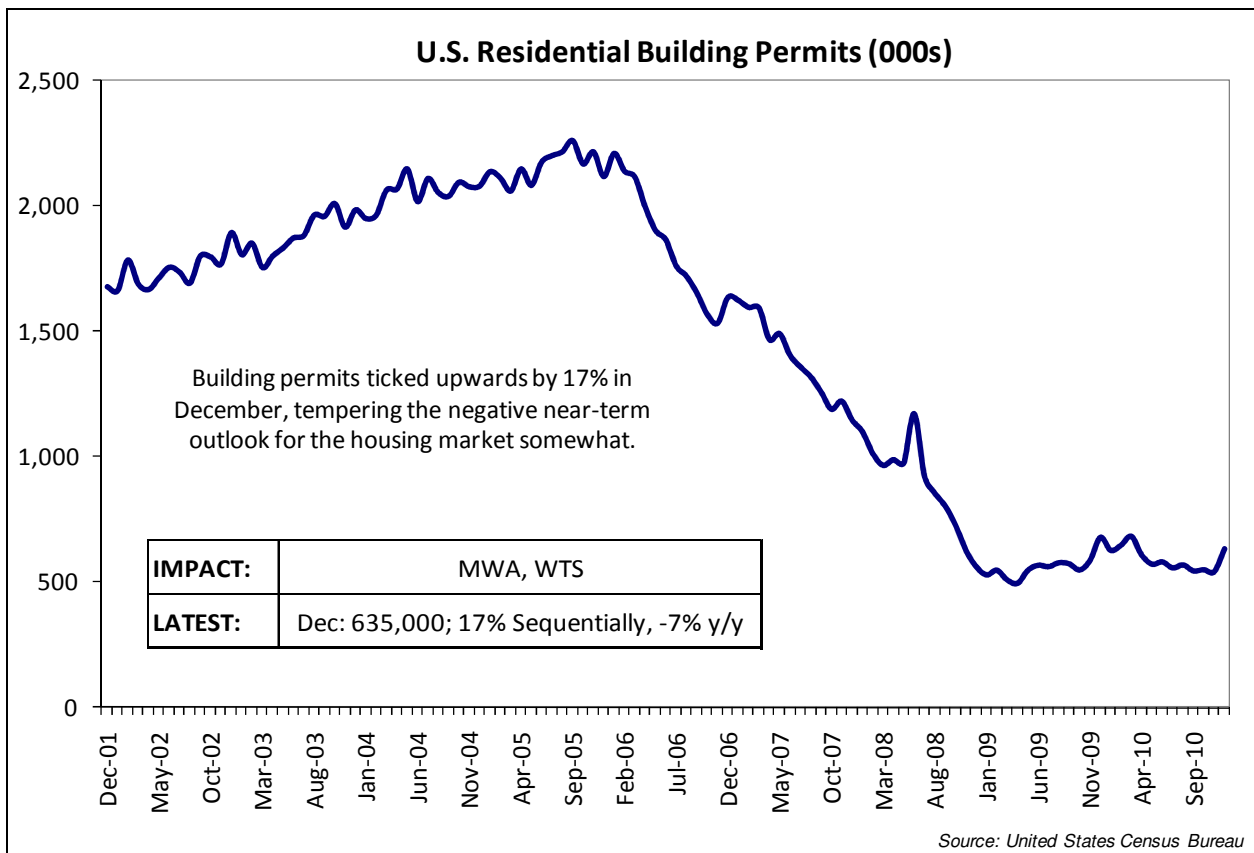
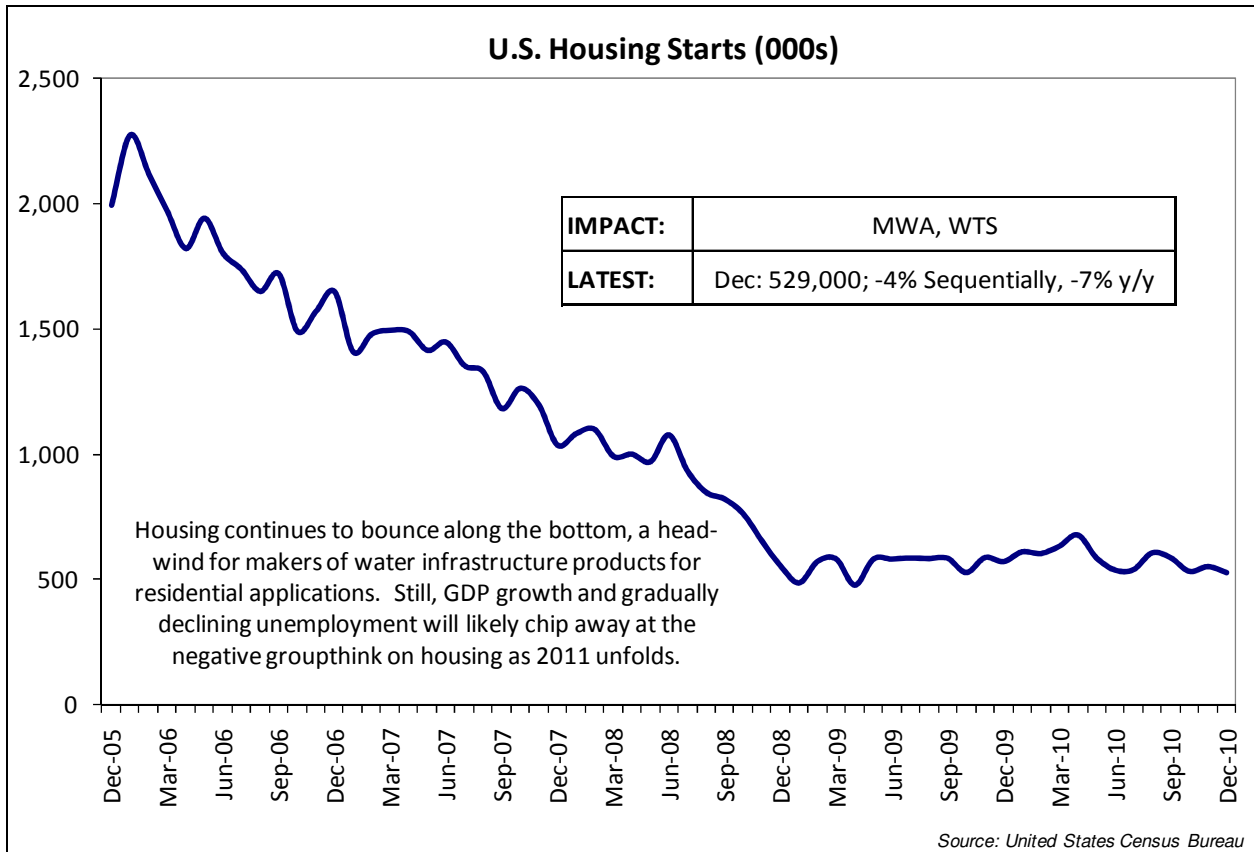
While the long-term "secular" themes driving growth in the water sector are real, the reality is that in the short/intermediate-term, fundamentals for most water equipment/technology companies have a high degree of correlation with the industrial economy broadly and with discrete cyclical sub-sectors more specifically. As a result, successful stock picking in the water space is predicated in large part on an ability to gauge differences in the cyclical directions of these key verticals and invest accordingly. Based on our current read of key forward-looking indicators, we believe that many of the key end-markets for water equipment/technology will experience an accelerating upward trajectory in 2011, and that the irrigation, industrial water treatment, and municipal demand channels have the most positive outlooks for 2011. As a result, we continue to favor the more cyclical sub-sectors over less cyclical, lower-beta water utility names, and believe investors should focus on companies levered to these key verticals. In the municipal channel, BUY-rated Badger Meter (BMI) and Mueller Water (MWA) offer concentrated exposure, while in the industrial water area, BUY-rated Nalco Holding (NLC) is our preferred play. In irrigation, although we expect strong growth in 2011, Neutral-rated Lindsay Corporation (LNN) and Valmont (VMI) are already discounting much of the good news, in our view.

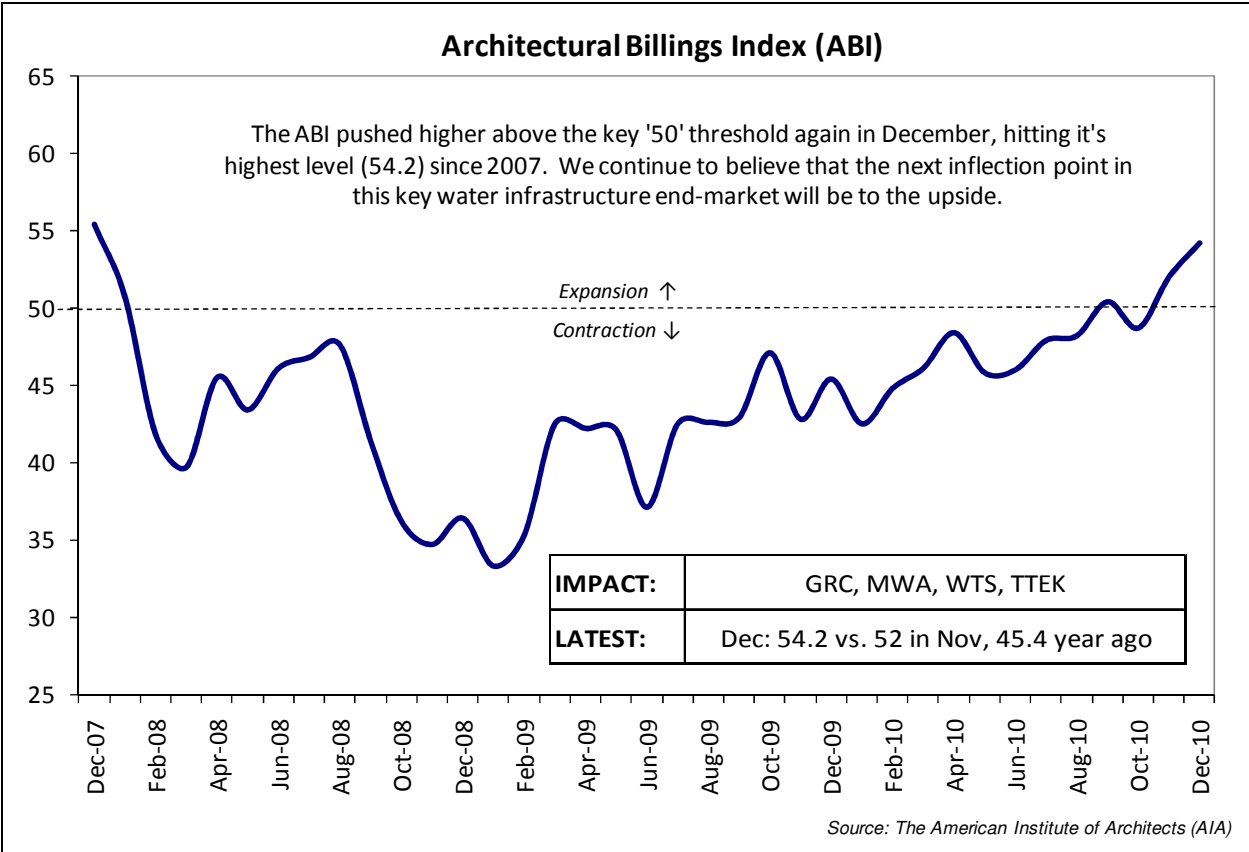
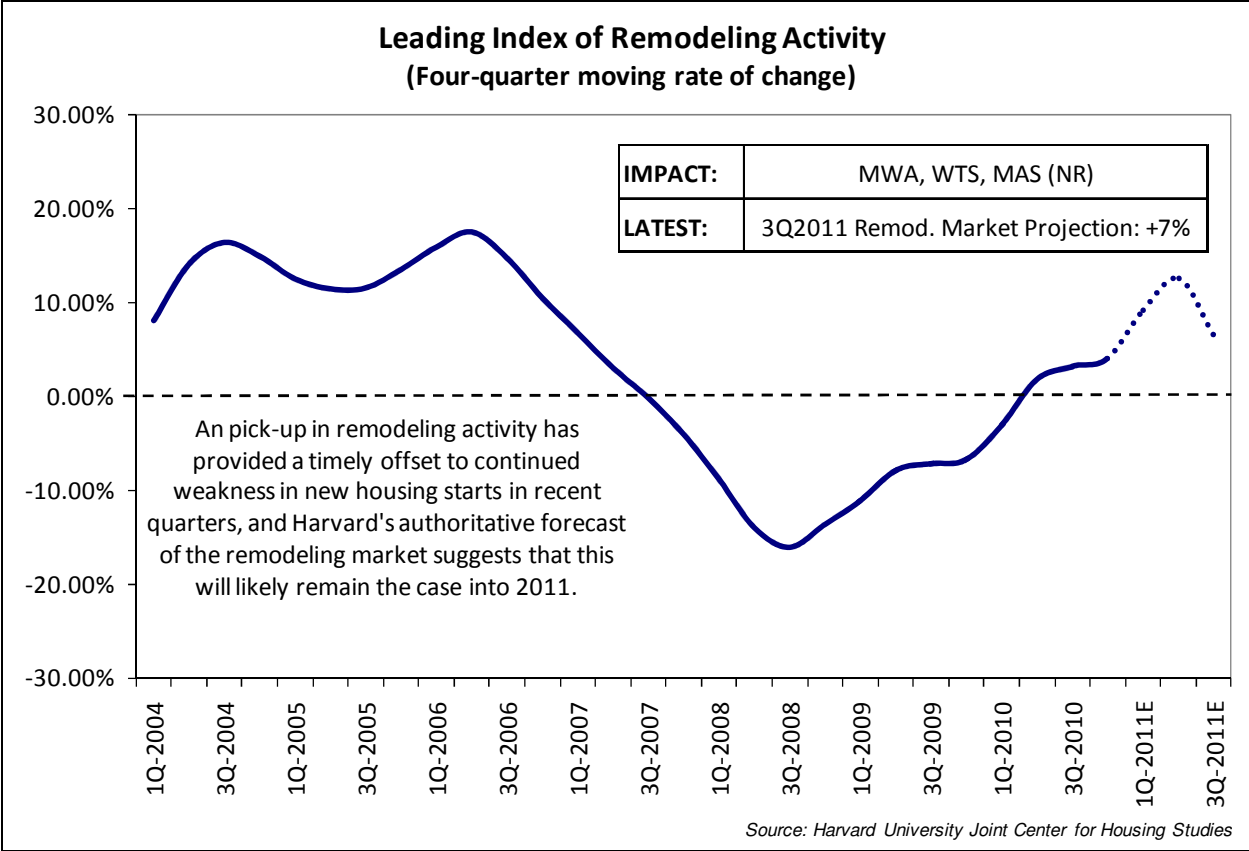
KEY POINTS:

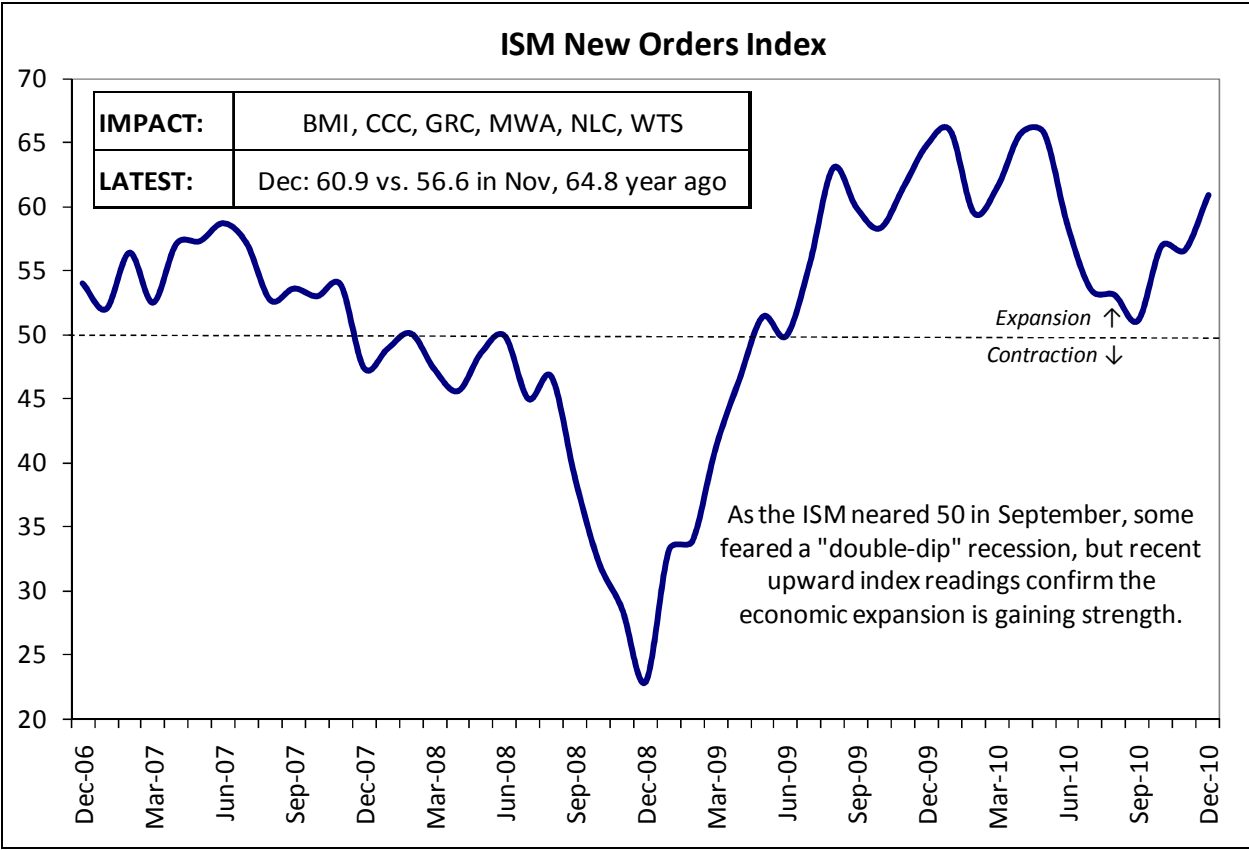
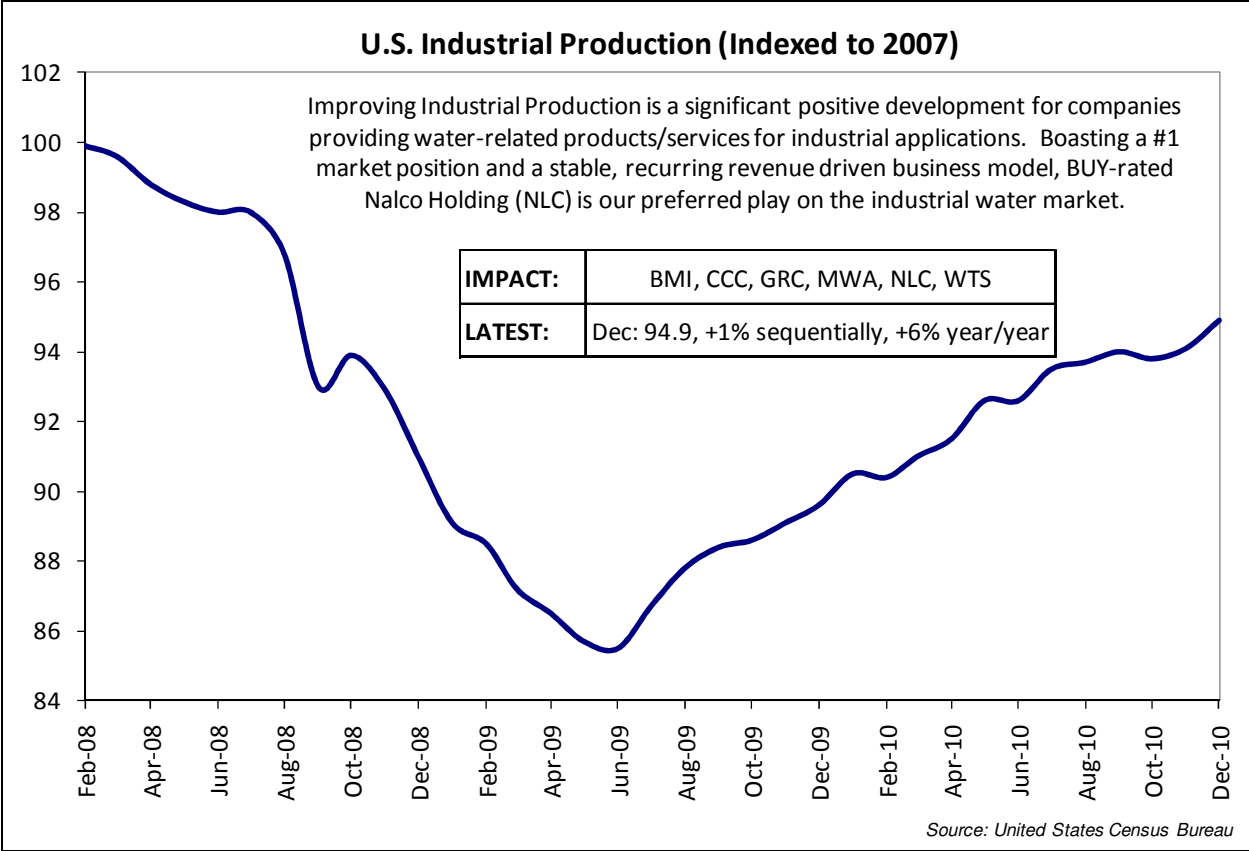
- **Industrial: Outlook improving along with broader economy (NLC the play).** U.S. Industrial Production surged 6% from a year ago in December, continuing an extended run that began way back in June 2009. Confirming the Industrial Production figures, the ISM New Orders index hit 60.9 in December, a bullish reading that suggests the industrial economy will continue to gain traction in the quarters ahead. Coupled with increasingly stringent industrial water regulations and greater water scarcity, this backdrop creates a positive demand environment for companies providing industrial water solutions, such as BUY-rated Nalco Holding (NLC).
- **Municipal: Forget the headlines - 2011 will be a good year (BMI, MWA the plays).** With the press breathlessly predicting Armageddon for state and local governments, it's hardly surprising that the current consensus sentiment is to avoid any and all stocks with exposure to municipal spending. Our research, however, unambiguously suggests that 2011 will be a solid year for water infrastructure spending. BUY-rated Badger Meter (BMI) and Mueller Water Products (MWA) offer concentrated exposure to municipal water infrastructure spending.
- **Ag/Irrigation: Market conditions there, but priced in (LNN, VMI the plays).** Corn prices averaged a whopping \$6.71 per bushel in January, nearly double their mid-2010 levels, and surging commodity prices are driving a robust outlook for net farm income in the near-term. This sets the stage for a strong 2011 center pivot selling season, and this was confirmed by our recent attendance at the 2011 AgConnect Expo (for details, see our report dated January 10). Still, stocks of major center pivot players such as Neutral-rated Lindsay Corporation (LNN) and Valmont Industries (VMI) are already discounting the good news, in our view.
- **Construction: The wild card; money to be made for contrarians? (WTS the play).** Similar to the municipal channel, construction markets are currently characterized by groupthink - with the conventional wisdom being that these markets will take years to rebound. Still, forward looking data points (such as January 54.2 ABI reading) suggest a positive inflection point lies in the offing for the non-residential market. On the residential side, a growing economy and declining unemployment could lead to an improved outlook by year-end. For investors looking to make a contrarian bet on a construction market recovery, BUY-rated Watts Water is a compelling choice.



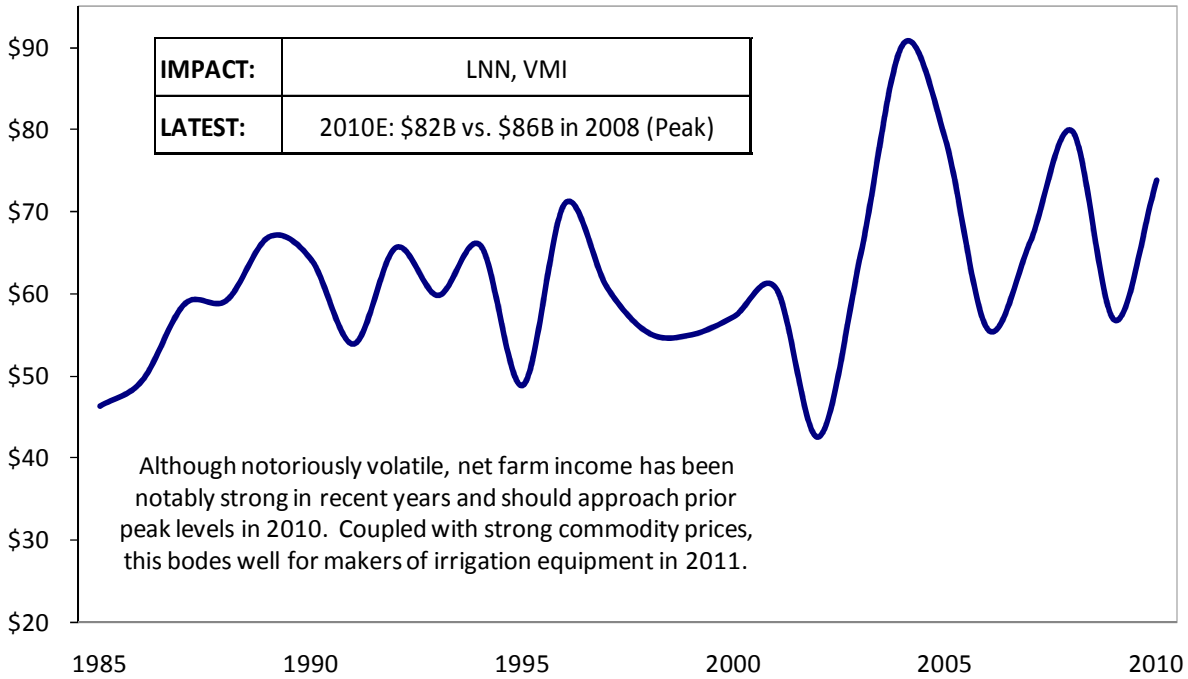






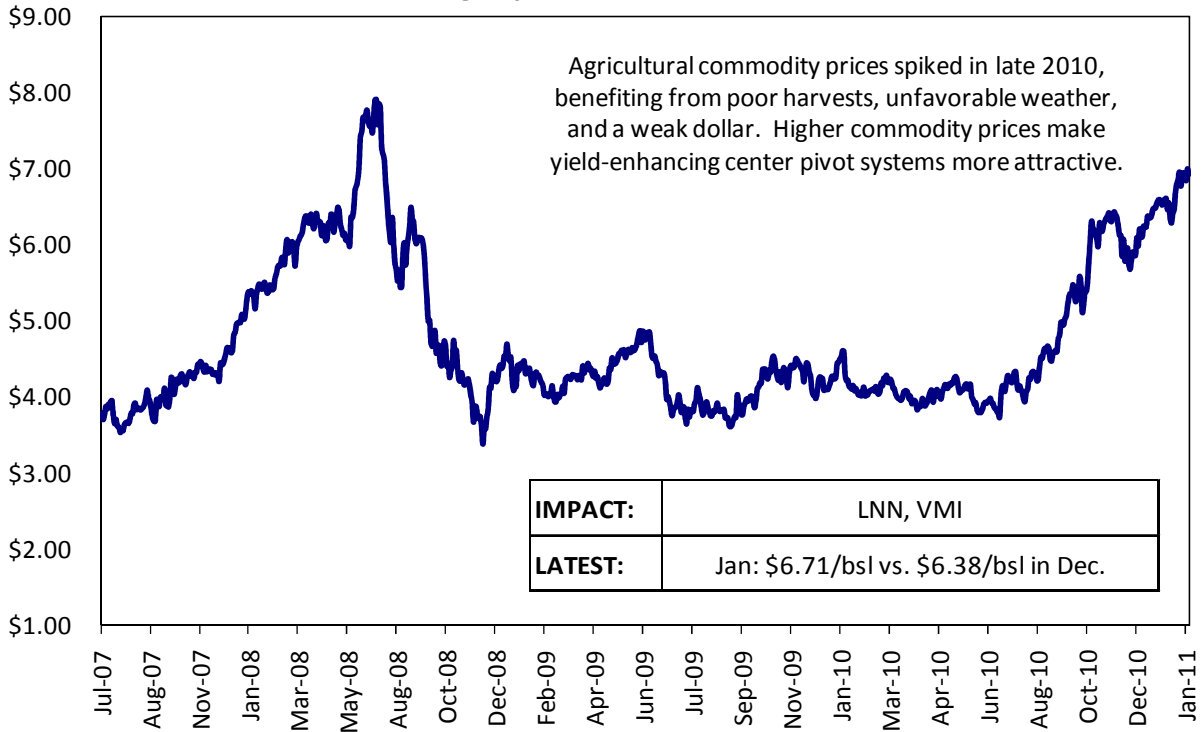


Net Farm Income (In constant 2005 \$ - Billions)



Source: USDA

Average Spot Corn Price (\$/bushel)



Source: Bloomberg

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Ryan M. Connors, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

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Individual disclosures for the companies mentioned in this report can be obtained by calling or writing Janney Montgomery Scott LLC as provided on the first page of this report. [Disclosure Site](#)

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

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			Count	Percent
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NEUTRAL [N]	155	46	4	3
SELL [S]	7	3	0	0

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Gary R. Schatz, Managing Director
Director of Research (215) 665-6234

TECHNOLOGY, MEDIA and TELECOM

Financial Technology

Thomas C. McCrohan – Managing Director (215) 665-6293
Leonard A. DeProspero, CFA – Associate (215) 665-4559

Entertainment / Digital Media

Tony Wible, CFA – Director (215) 665-6529
Randolph Lee – Associate (215) 665-4572

Internet and Interactive Entertainment

Shawn C. Milne – Managing Director (415) 981-9539
Cara Petonic – Associate (215) 665-4574

IT Outsourcing / BPO / Consulting

Joseph D. Foresi – Director (617) 557-2972
Jeffrey Rossetti - Associate (617) 557-2989

PC & Enterprise Hardware

Bill Fearnley – Managing Director (617) 367-3268
Chad Wood - Associate (617) 557-3291

Semiconductors

Nicholas Aberle – Director (415) 229-7012

CONSUMER and RETAIL

Casino Gaming and Lodging

Brian T. McGill - Managing Director (215) 665-6485
Brian Mullan, CFA - Associate (646) 840-4604

Food / Beverage / Tobacco

Jonathan Feeney, CFA – Managing Director (215) 665-6679
Mark Williams – Associate (215) 665-6358

Mitchell B. Pinheiro, CFA – Managing Director (215) 665-6280
Brian Holland - Associate (215) 665-4478

Household & Personal Care

John San Marco - Vice President (646) 840-4607
Amy Babington - Associate (646) 840-3207

Restaurants

Mark Kalinowski – Director (212) 940-6997
Ned Grace - Associate (212) 940-6985

Hardline Retailers

David Strasser – Managing Director (646) 840-4609
Sarang Vora - Associate (646) 840-4605

Softline Retail – Specialty Apparel

Adrienne Tennant – Managing Director (703) 448-7807
Simeon Siegel – Associate (646) 840-4606

FINANCIALS

Banks / Thrifts

Rick Weiss - Director (215) 665-6224
Stephen M. Moss – Vice President (215) 665-4595
David C. Peppard - Associate (215) 665-6457

BDCs

John T. G. Rogers, CFA - Vice President (202) 955-4316

Insurance

Robert Glasspiegel, CFA – Managing Director (860) 724-1203
Larry Greenberg, CFA – Managing Director (860) 724-1203
Steven Labbe, CFA - Managing Director (860) 724-1203

REITs

Andrew DiZio, CFA - Vice President (215) 665-6439
Daniel Donlan - Vice President (215) 665-6476

Trust Banks

Thomas C. McCrohan – Managing Director (215) 665-6293
Leonard A. DeProspero, CFA – Associate (215) 665-4559

INFRASTRUCTURE

Industrials

James C. Lucas – Managing Director (215) 665-6196
Michael J. Wherley - Associate (215) 665-4476
Kaitlin Lunny – Associate (215) 665-6213

Industrials / Special Situations

Liam D. Burke - Director (202) 955-4305

Infrastructure/Water

Ryan M. Connors - Director (215) 665-1359
Christopher J. Purtill – Associate (215) 665-6601

TECHNICAL ANALYSIS

Technical Strategy

Dan Wantrobski, CMT - Director (215) 665-4446

SUPERVISORY ANALYSTS

Richard Jacobs - Director (215) 665-6290
Irene H. Buhalo – Vice President (215) 665-6510
Suzanne Hannigan, CFA - Vice President (215) 665-4475