

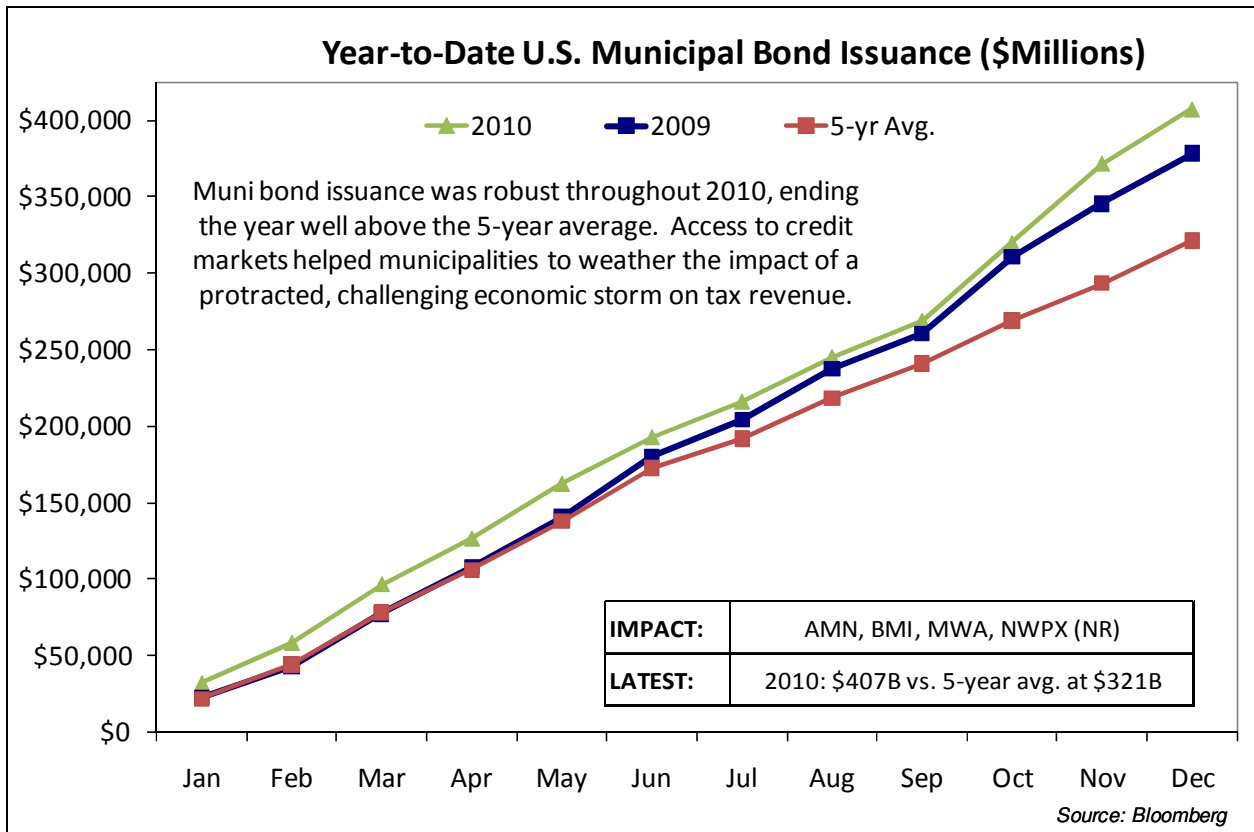
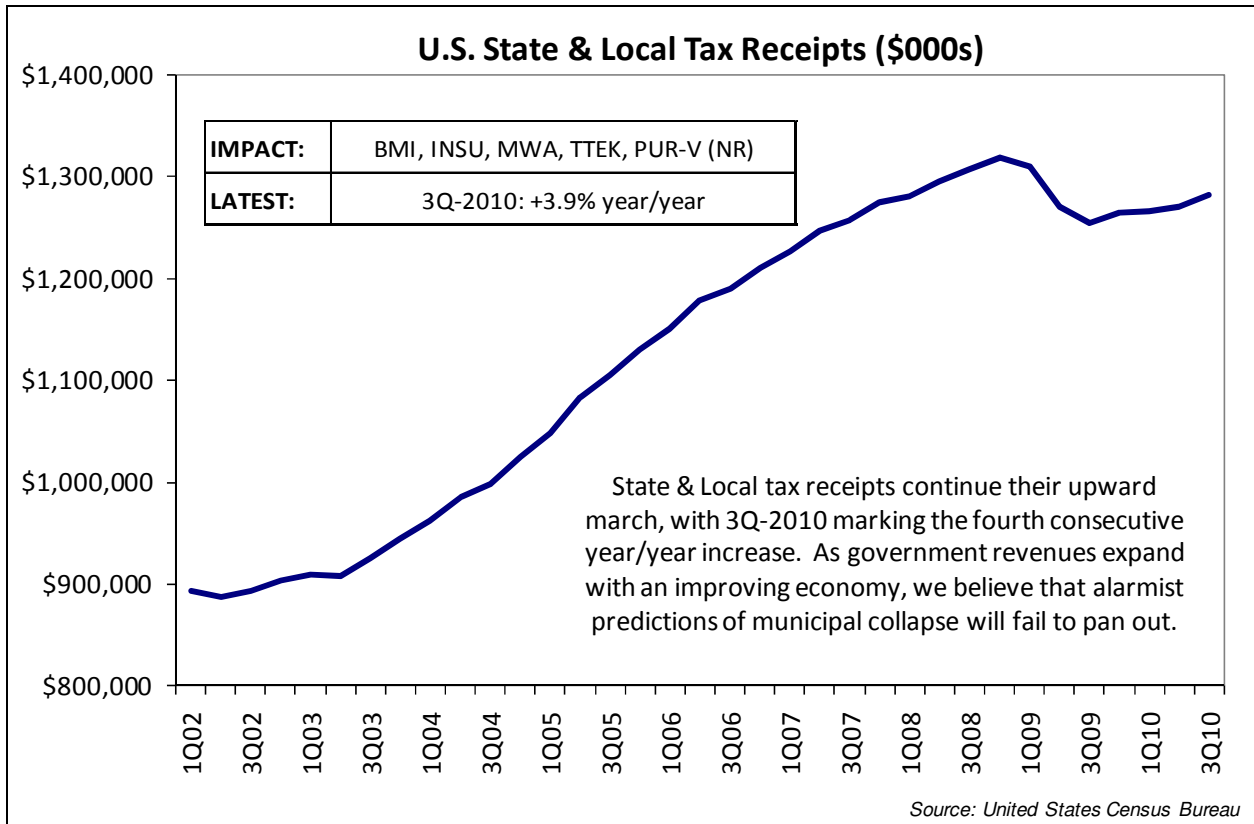
Improving Tax Receipts Drive Continued Municipal Recovery. Janney Water Meter - January 2011

INVESTMENT CONCLUSION:

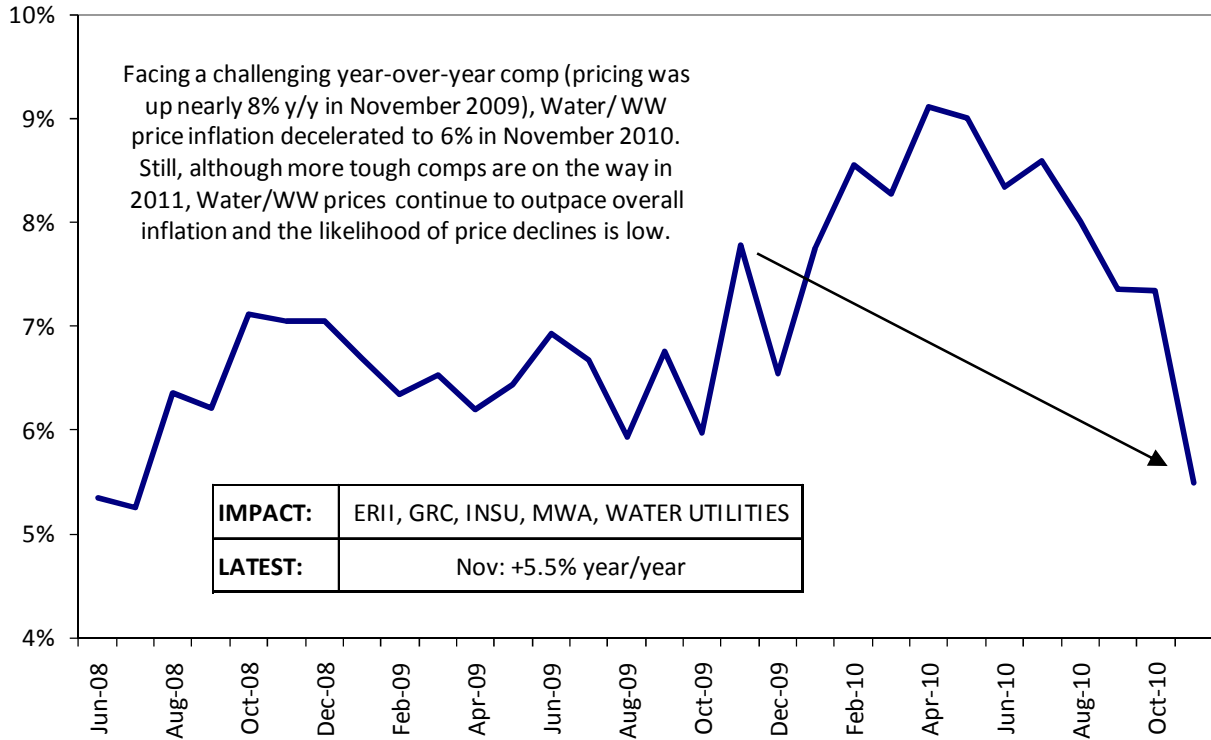
As the deadline for Build America Bonds approached, municipalities predictably crowded into the market in late 2010 to take advantage of this attractive financing alternative. This flood of supply drove yields up and prices down, leading many to conclude that BABs had created a "bubble" in the municipal bond market and that the ultimate result would be financial Armageddon for overstretched municipalities (and hence a downdraft in funding availability for municipal infrastructure projects). While discrete cases of municipal financial distress do exist (Eg. Birmingham, AL and Harrisburg, PA), we take the more sanguine view that the BAB program did precisely what it was (in part) intended to do: it provided municipalities with a timely alternative financing vehicle during a time when tax receipts remained depressed due to the economic hangover of the financial crisis of 2008. Looking forward, as tax receipts continue to rebound from the trough, we believe dire predictions of a broad meltdown in municipal finances will go unrealized. The upshot for water infrastructure providers: forecasts of weak demand due to lack of project funding will also prove false.

KEY POINTS:

- **Muni bond alarmists overstating their case: This too shall pass.** With Build America Bonds no longer available for issuers, those convinced that there must be some new crisis on the horizon have seized on robust municipal issuance in 2010 as evidence of a "bubble," whose eventual bursting will wreak havoc not only on companies levered to municipal spending, but on the economy as a whole. Needless to say, we think these arguments are well off the mark. With tax receipts still depressed in the wake of a deep recession and an attractive financing alternative (BABs) available, *of course* municipalities accessed credit markets liberally in 2010. As the economic recovery continues to drive a rebound in tax receipts, we believe instances of municipal default will remain extremely rare.
- **Surging metals prices indicative of raw material headwinds in 2011.** While the economic recovery and the weak dollar have driven most commodities higher, none have had a more dramatic run than copper, which enters 2011 trading at new all-time highs. This provides a significant margin headwind for companies utilizing copper as a major raw material, including Badger Meter and Watts Water. Still, we believe both companies will ultimately have the pricing power necessary to pass higher input costs through to customers, and that improving demand will offset this headwind somewhat. Similar to past cycles, higher input costs are a necessary evil of any economic recovery.
- **Housing weak, but remodeling a timely offset, non-rez looking up.** While housing (as usual) continues to dominate popular discourse on the state of the construction markets, the reality is that other key segments of the market are exhibiting strength and/or girding for a turn. Indeed, residential remodeling activity has rebounded nicely and looks primed for strong growth in 2011 as low interest rates and a weak real estate market lead homeowners to pursue improvements, while forward-looking indicators such as the ABI suggest that commercial construction will begin to show positive comps in 2011. Overall, we expect demand in this key channel to improve as 2011 unfolds.
- **Irrigation primed for strong 2011 on back on elevated commodity prices.** With pricing for key agricultural commodities at their highest levels since the commodities boom of 2007-2008, payback periods on yield-enhancing center pivot systems are compressing - leading more farmers to seriously consider mechanized irrigation. In addition, farm income levels jumped significantly in 2010, meaning more farmers have the financial wherewithal to make the sizable up-front investment of installing a center pivot irrigation system. Still, stocks of irrigation related companies such as Lindsay Corporation (LNN) and Valmont Industries (VMI) enjoyed strong runs in 2010, and a significant portion of this good news is priced in. We believe investors should be price disciplined in initiating new positions.

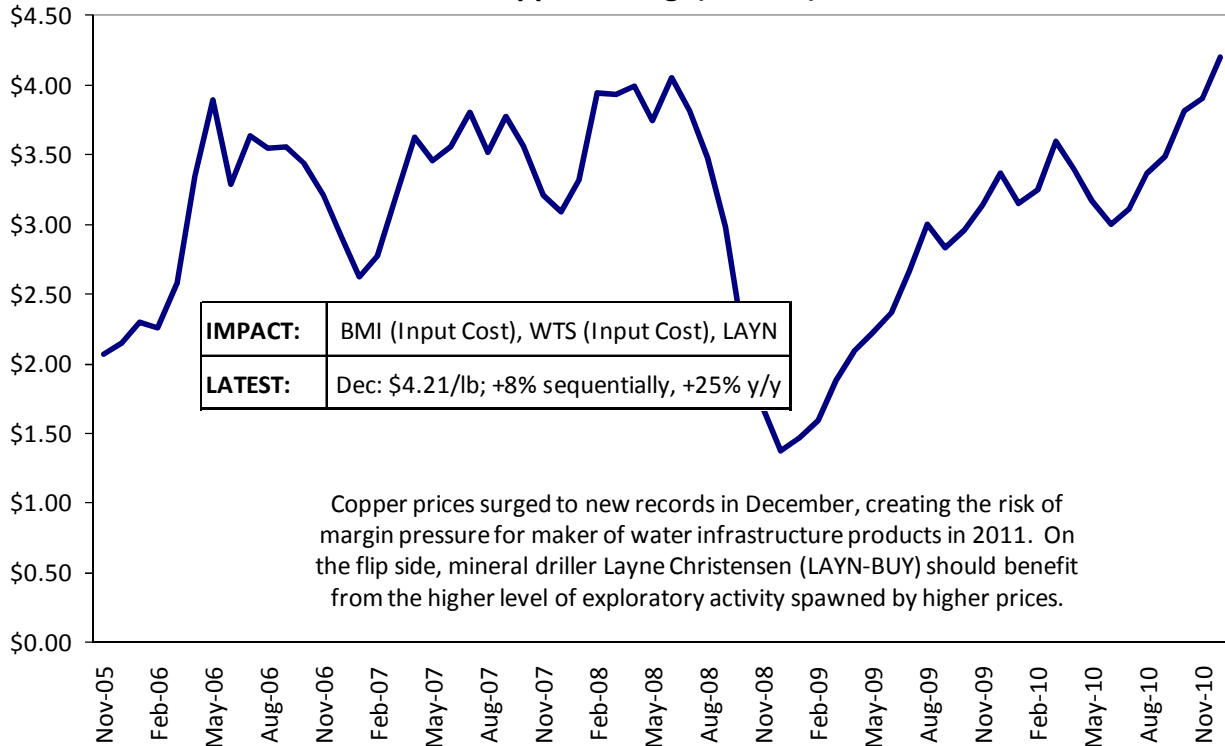


Municipal Water & Wastewater Pricing (Year/Year Rate of Change)

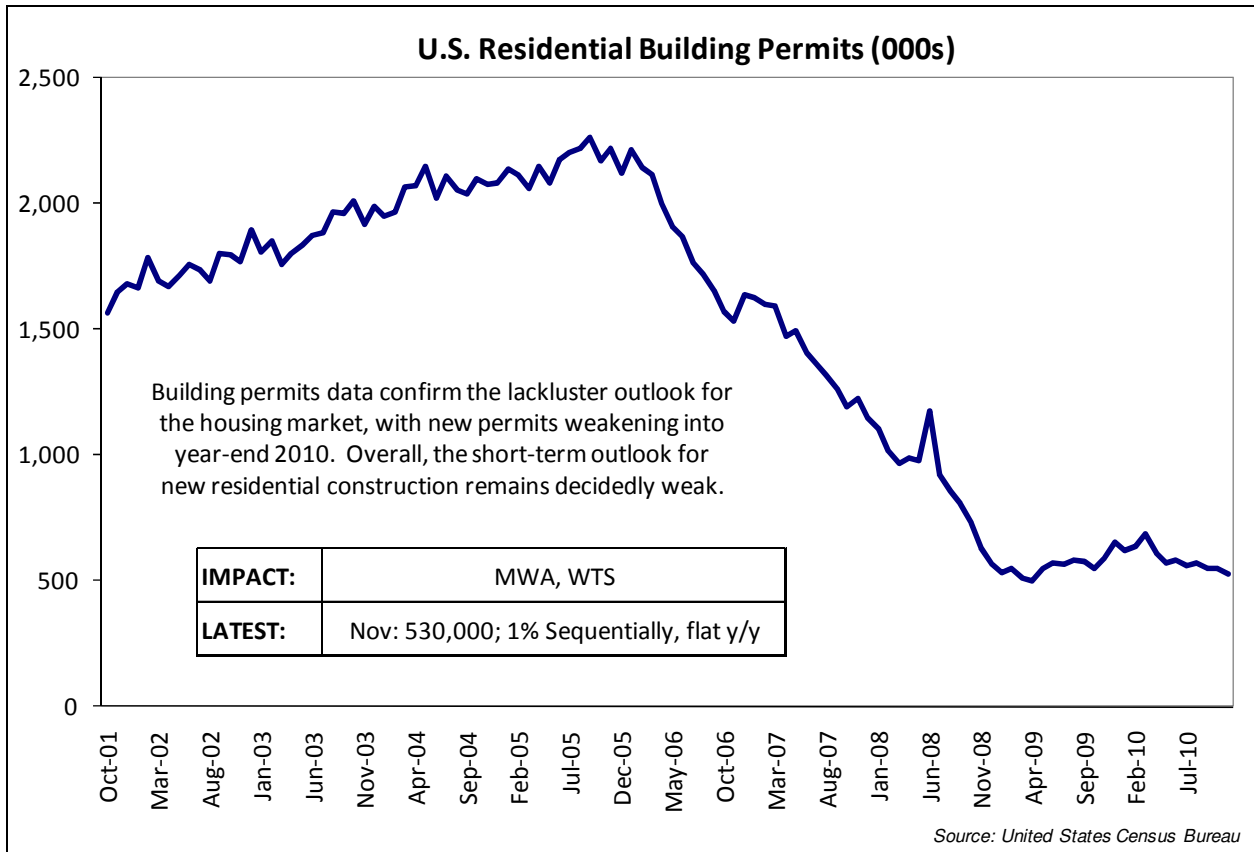
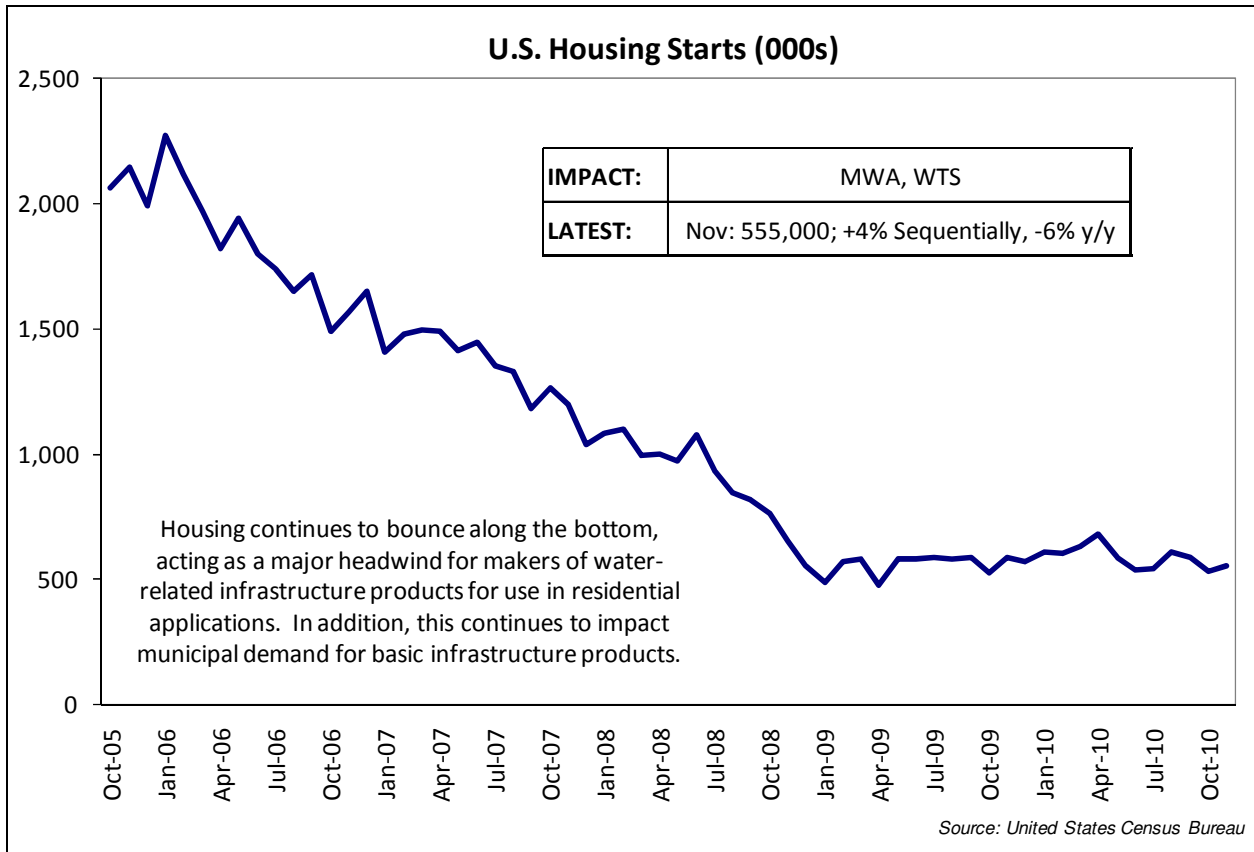


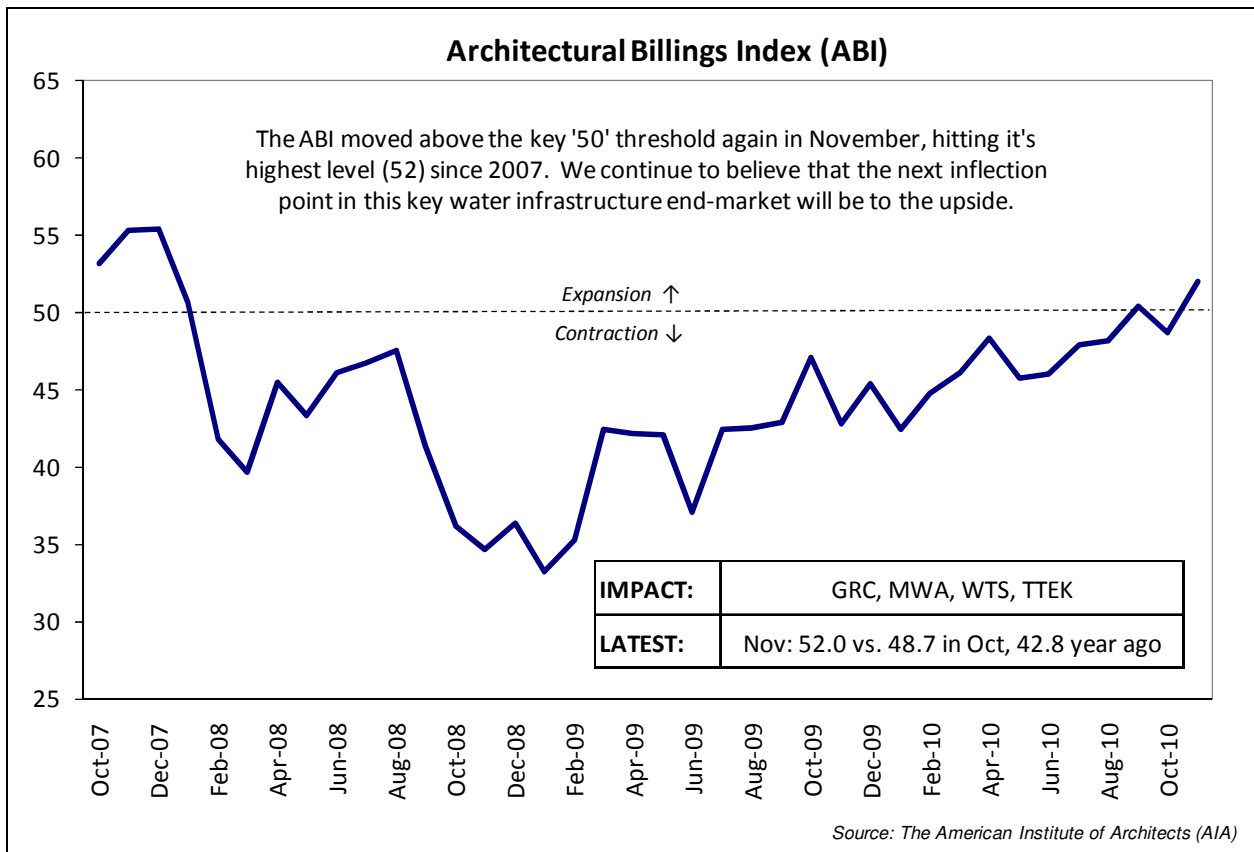
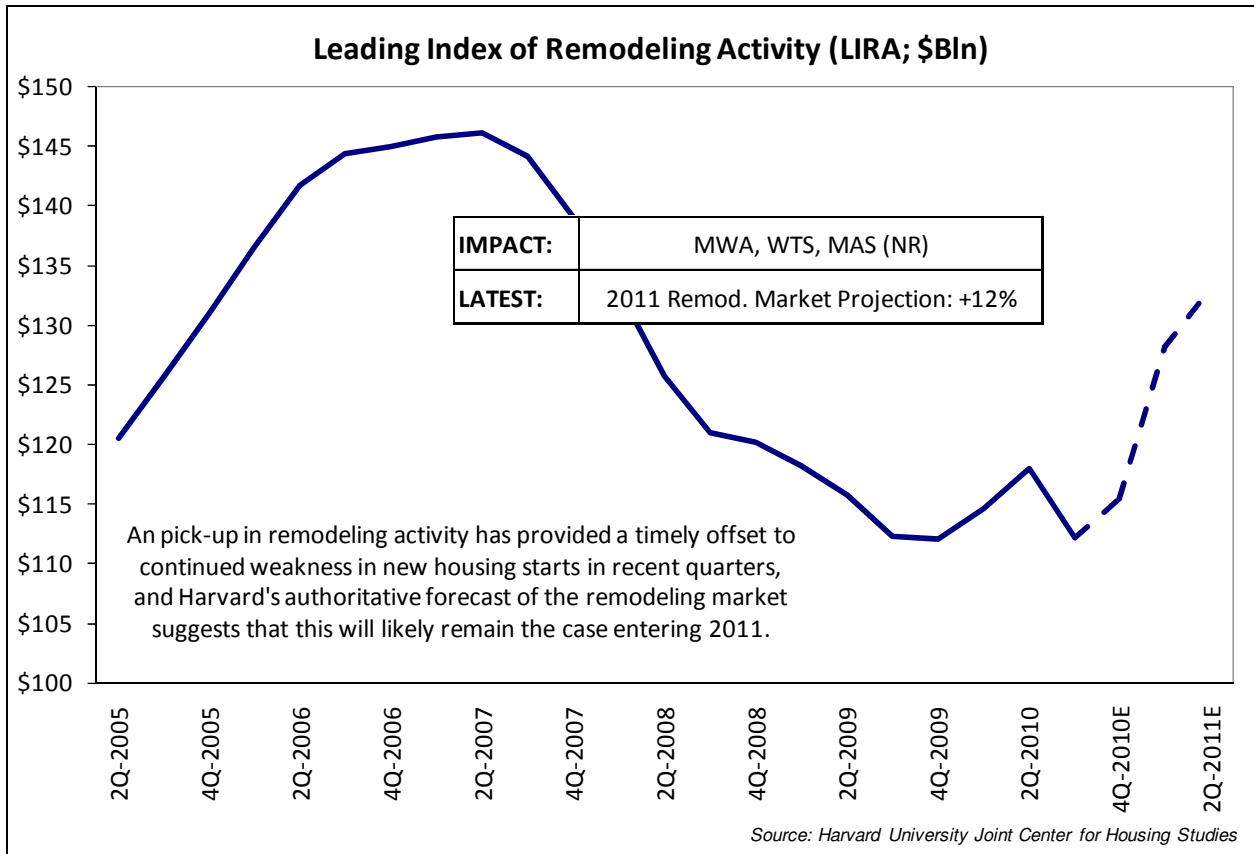
Source: United States Federal Reserve

Copper Pricing (US\$/lb.)

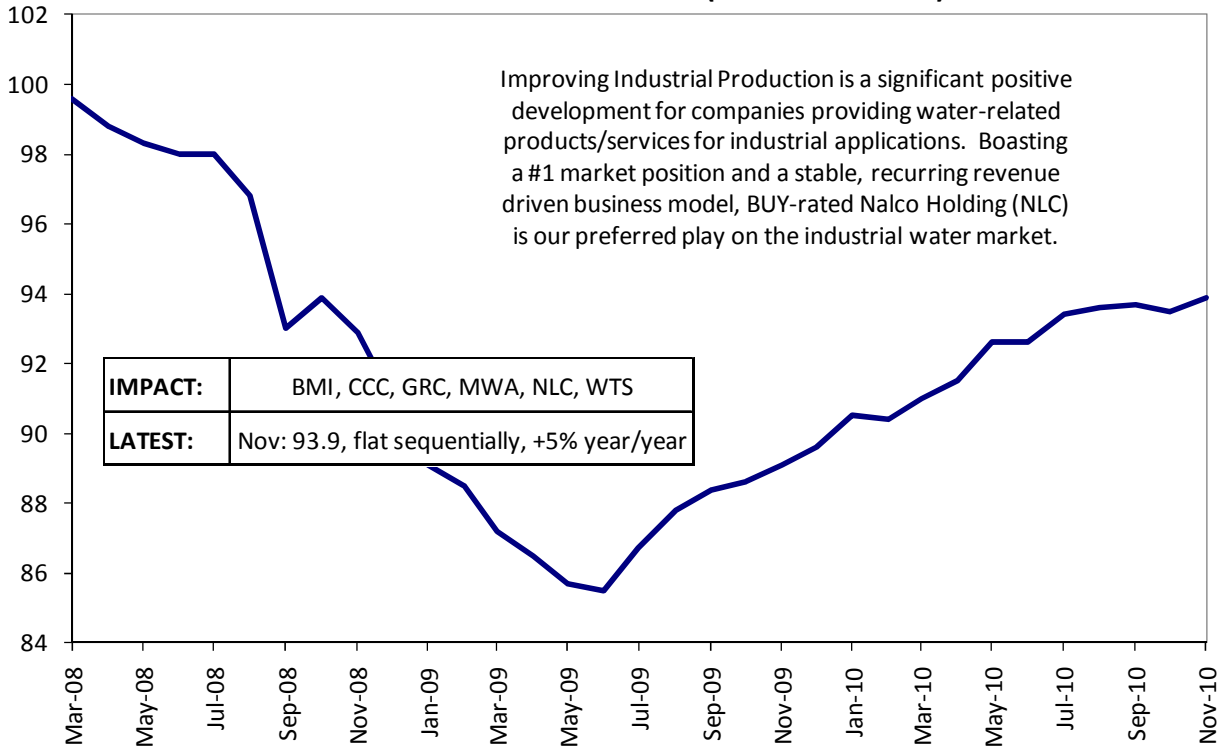


Source: Bloomberg



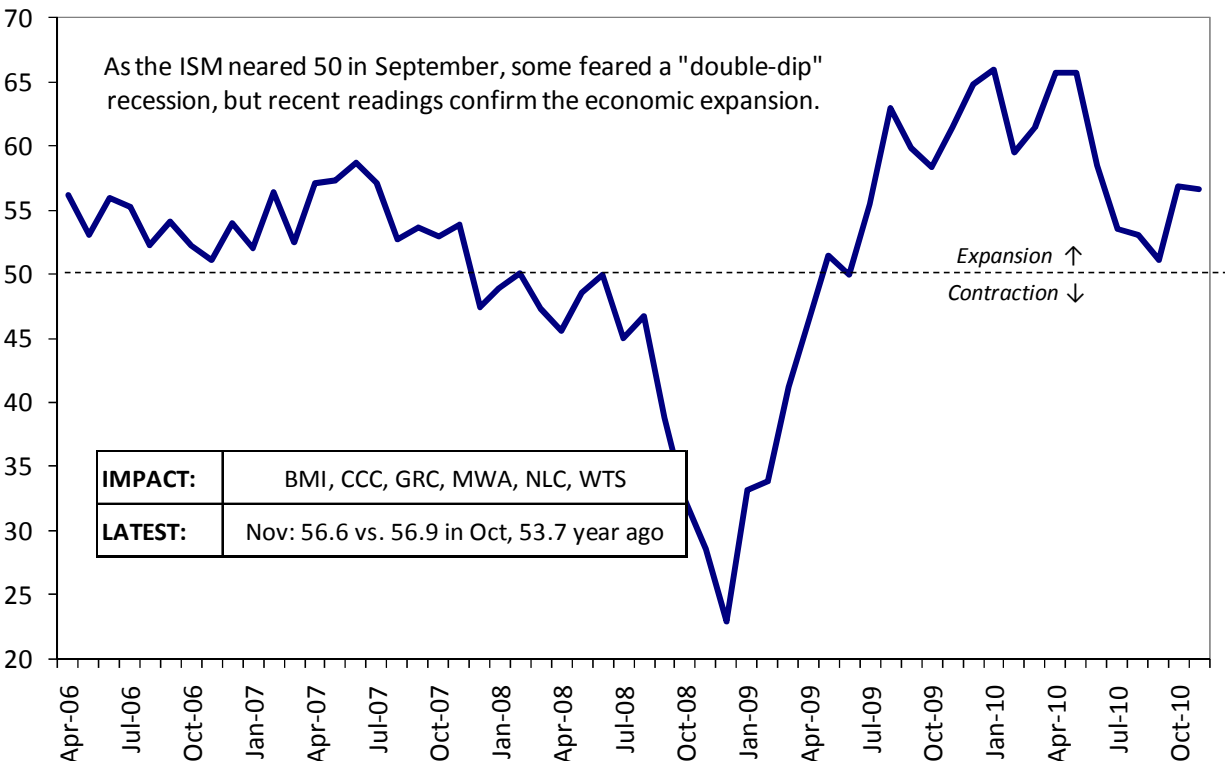


U.S. Industrial Production (Indexed to 2007)

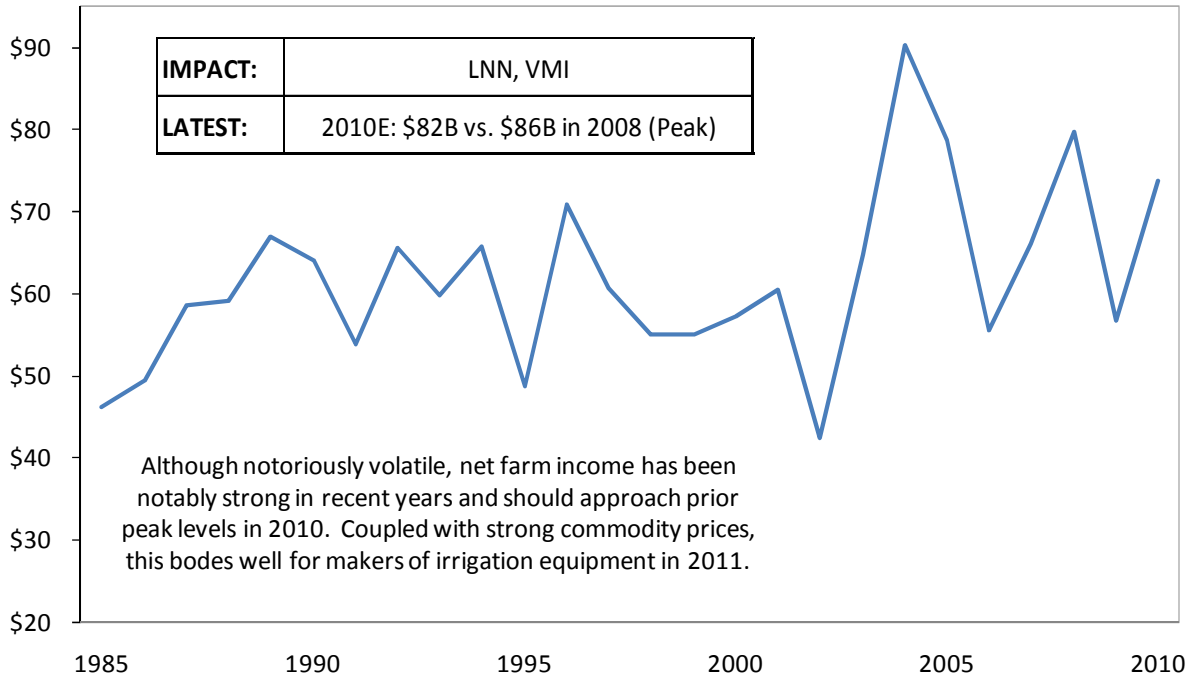


Source: United States Census Bureau

ISM New Orders Index

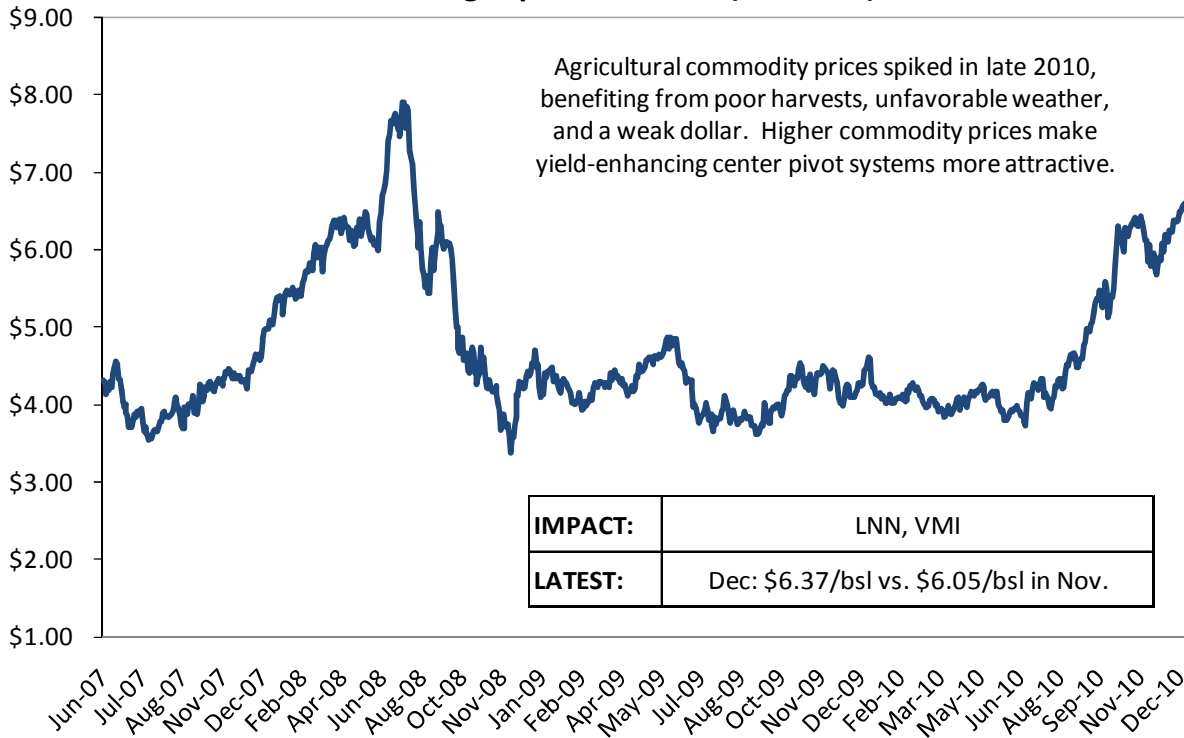


Net Farm Income (In constant 2005 \$ - Billions)



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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			Count	Percent
BUY [B]	195	54	20	10
NEUTRAL [N]	157	43	10	6
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