Do Unprofitable Companies Belong in Your Portfolio?

JUNE 30, 2021

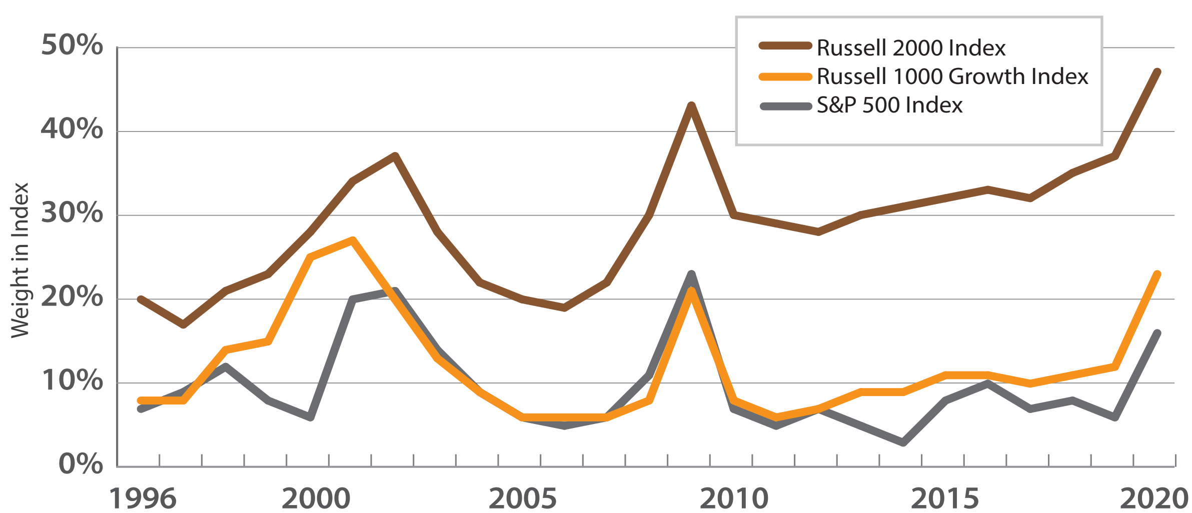
MOST INVESTORS SAVING FOR RETIREMENT WOULD answer, "Surely not!" And yet, turn on any business channel and you will hear experts lauding the shining future of various growth and small-cap stocks. Many of these stocks have positive and growing earnings, but a surprising number are currently losing money. In the Russell 1000 Growth Index, 23% lost money last year. In the small-cap Russell 2000 Index, fully 47% were unprofitable in 2020. Even 16% of the S&P 500 Index names were unprofitable last year. Unprofitable companies are so ubiquitous that they can be found in virtually all retirement accounts, particularly for investors using passive funds or ETFs.

This is not just an artifact of the pandemic. The chart below shows the fraction of unprofitable companies in the S&P 500, Russell 1000 Growth, and Russell 2000 indices over the last 25 years. As you can see, unprofitability rises in times of stress such as the end of the Internet Bubble, the Global Financial Crisis, and the COVID-19 pandemic. But the fraction of companies losing money in the broad market (as represented by the S&P 500) is persistently high. Among small-cap stocks, the percent of unprofitable companies has been trending up, reaching almost half of the Russell 2000 Index by weight. It seems unlikely that the average saver would be comfortable investing in unprofitable companies to this extent.

Many investors will try to comfort themselves with the notion that GAAP accounting is inherently conservative and includes many one-time, non-cash charges. At Miller/Howard, we are sympathetic to this viewpoint and focus mainly on free cash flow (FCF) as our profit metric. Free cash flow is defined as operating cash flow less capital expenditure. It's the ultimate "show me the money" metric in that it reflects the actual cash a company generates that can be used for dividends, share buybacks, strengthening the balance sheet, or acquisitions.

Percent of Members that are Unprofitable

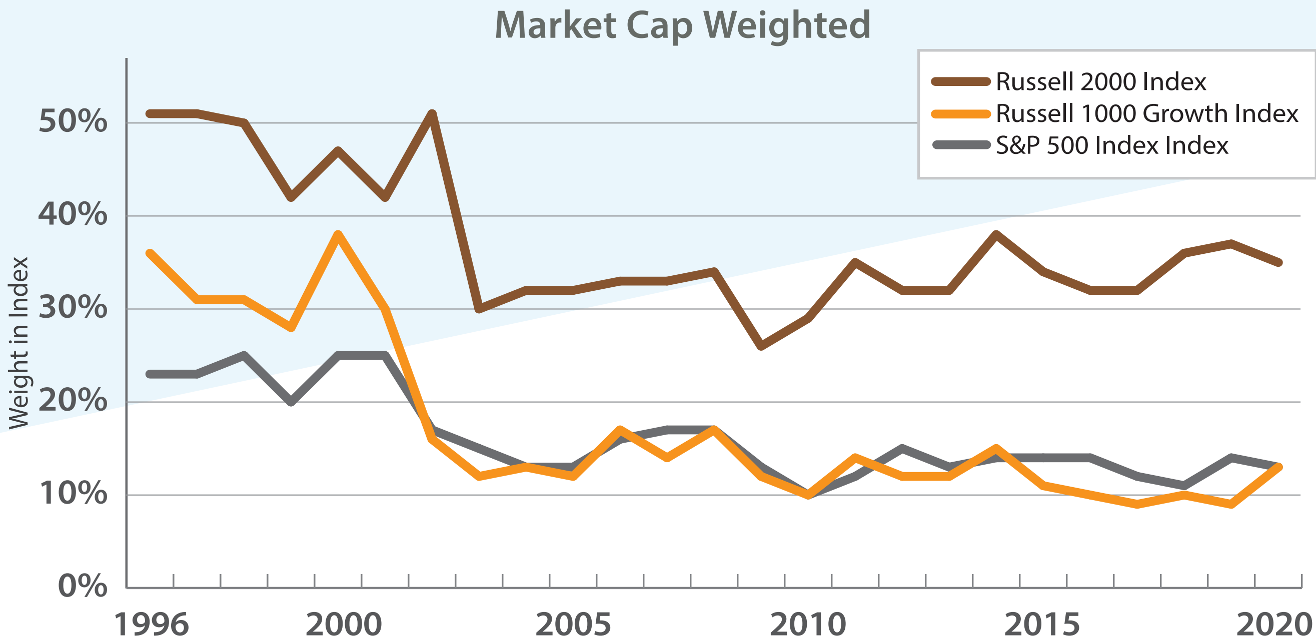
Negative TTM EPS - Market Cap Weighted*



As of December 31, 2020. Source: Bloomberg.
*TTM = Twelve Trailing Months; EPS = Earnings Per Share The universes are defined as members of the listed indexes (Russell 2000, Russell 1000 Growth, S&P 500) as of each calendar year end and are market-cap weighted.

GAAP = Generally Accepted Accounting Principles

Percent of Members with Negative Free Cash Flow Yield



As of December 31, 2020. Source: Bloomberg. Free cash flow is defined as operating cash flow less capital expenditure. The universes are defined as members of the listed indexes (Russell 2000, Russell 1000 Growth, S&P 500) as of each calendar year end and are market-cap weighted.

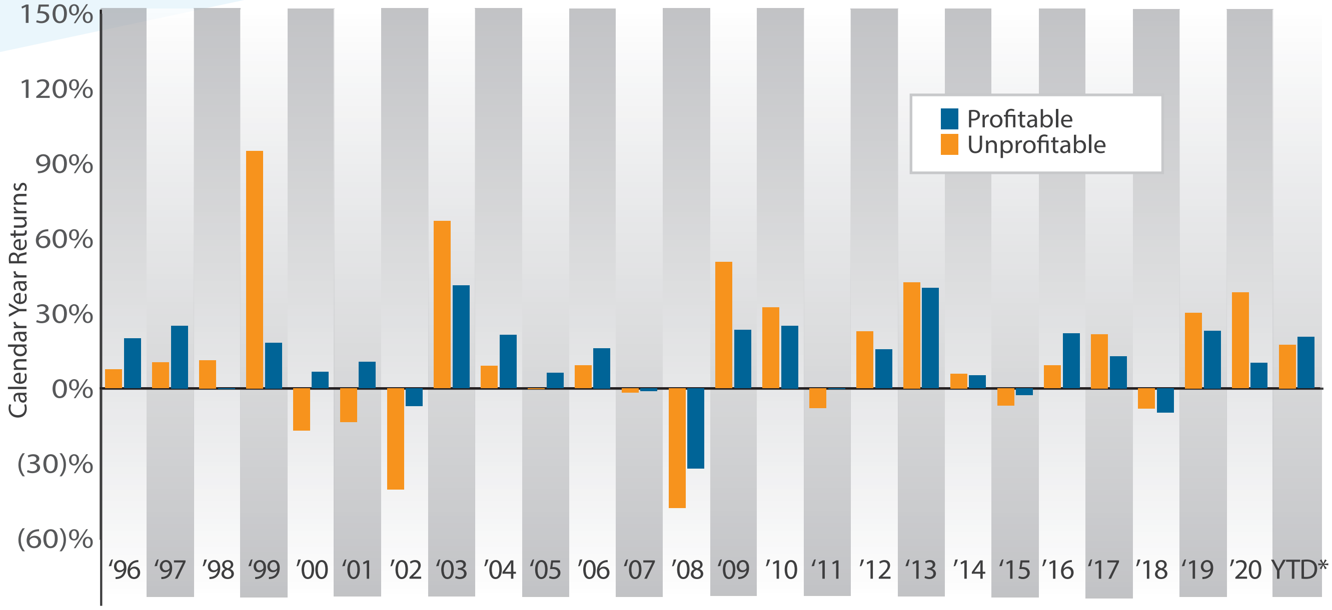
As the chart above shows, a significant percentage of stocks in the broad market have negative free cash flow. For small-cap stocks, roughly one-third of companies are investing more capital than operations generate. Even for the S&P 500, over 10% of the companies in the index have been free cash flow negative in recent years. For one unique sector of the economy, regulated utilities, negative free cash flow is not a significant concern. Utilities can invest more than their operating cash flow knowing that regulators will ensure that investment returns will indeed follow. In contrast, the vast majority of companies invest without guaranteed returns. Running with negative free cash flow means that executives are "betting the firm" with capital expenditures, depending on either good returns or the continued willingness of investors to inject new equity or debt capital.

Our view at Miller/Howard has always been that people saving for retirement are best served by investing in mature, self-sustaining companies—companies with enough free cash flow to fund a large and growing dividend. We would argue that venture capitalists are the right investors for young, money-losing enterprises. These sophisticated investors have greater access to management and detailed company information—much more access than any equity investor in a public company. Ideally, companies become profitable and then go public, but the rush to "cash out" has pushed money-losing companies into the public markets and thus into investors' portfolios. Is this a good thing?

Succeeding with Business Startups

Many people become wealthy by starting their own business, which, no doubt, has an unprofitable phase. Others do well by investing in small businesses started by friends or family members. But if your favorite niece or nephew is not destined to start the next mega-cap growth company, *can you reliably buy stocks to replicate that type of opportunity? Is investing in unprofitable public companies a good investment strategy?*

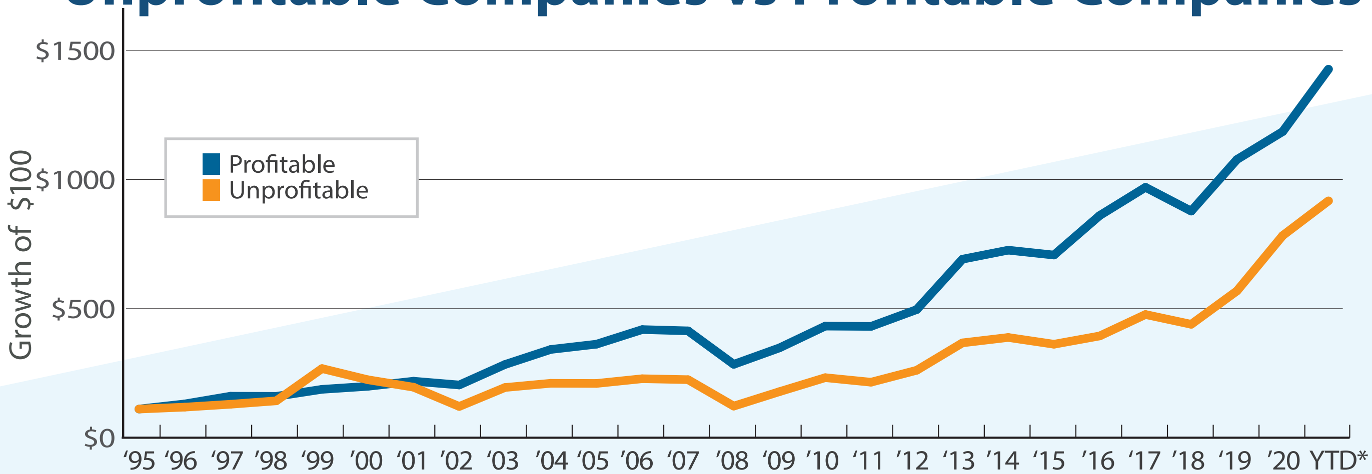
Annual Performance of Russell 2000 Index Unprofitable Companies vs Profitable Companies



*As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.

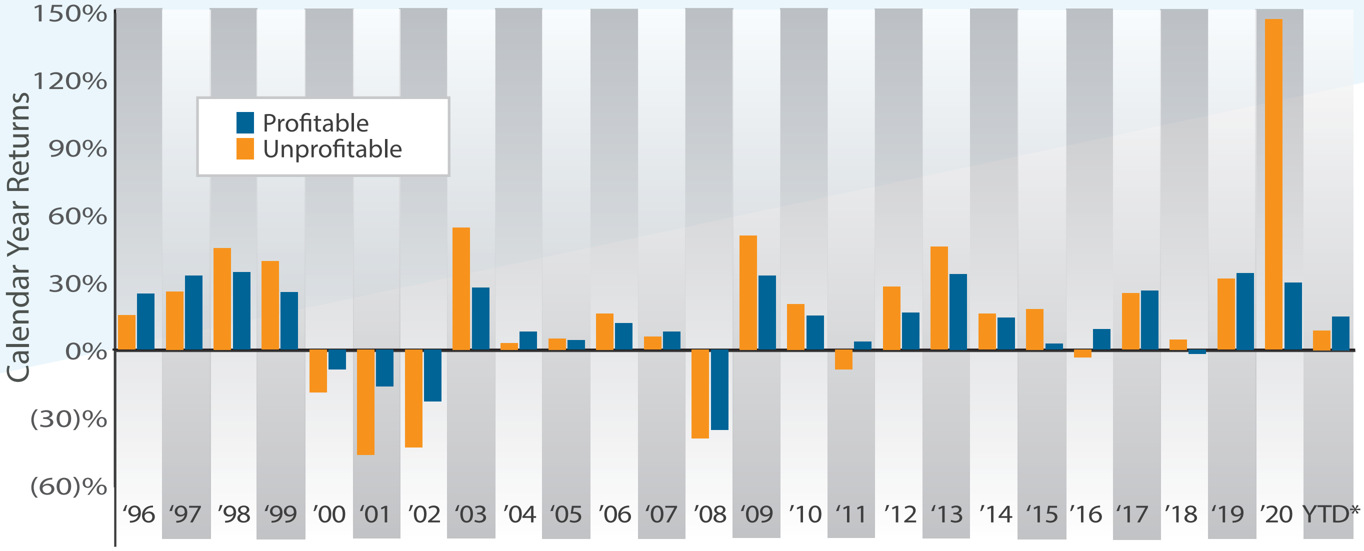
To answer these questions, we first looked at investing in small-cap stocks—surely this is where money-losing acorns may grow to mighty oaks. The chart above shows the results of investing in unprofitable companies versus profitable small-cap companies in the Russell 2000 Index. As you can see, investing in unprofitable companies worked well just as the Internet/New Economy Bubble was coming to an end, then did well again in the market recovery years of 2003 and 2009, and then had an excellent 2020. But the chart below shows that on a cumulative basis, there is no contest—investing in profitable small-cap companies has generated much higher cumulative returns.

Cumulative Performance of Russell 2000 Index Unprofitable Companies vs Profitable Companies



*As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.
Note for charts on this page: Unprofitable is defined as members of the Russell 2000 Index with negative trailing earnings per share as of each calendar year end. Profitable is defined as members of the Russell 2000 Index with positive trailing earnings per share as of each calendar year end. Both Unprofitable and Profitable are market capitalization weighted and rebalanced at year-end.

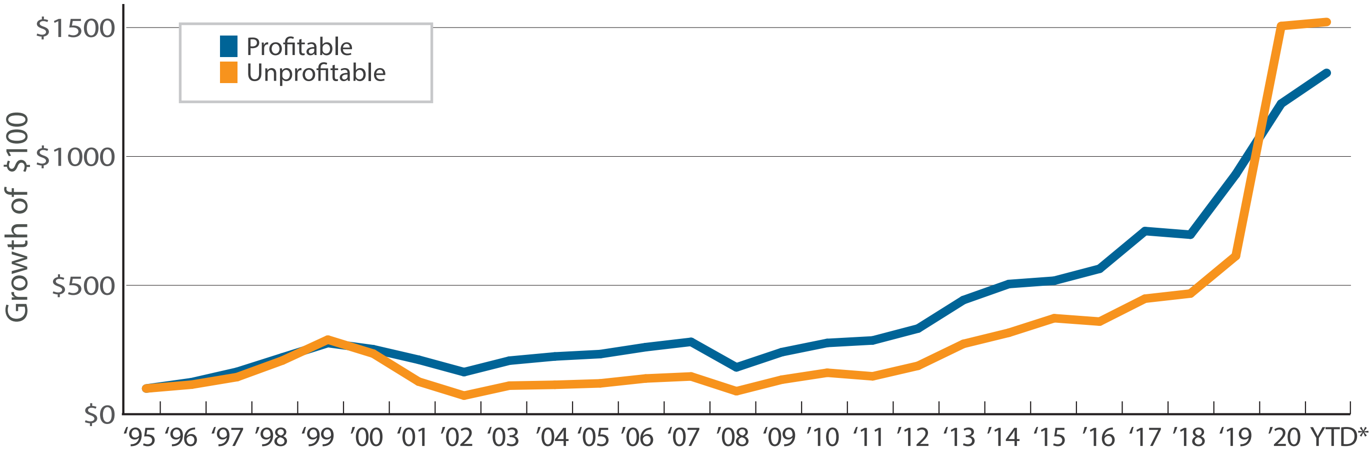
Annual Performance of Russell 1000 Growth Index Unprofitable Companies vs Profitable Companies



*As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.

A skeptic might argue that a broad market index of small-cap stocks is not the right place to look for the next big thing. The charts on this page show the results of investing in profitable versus unprofitable companies within the Russell 1000 Growth Index. Investing in unprofitable growth companies during 1995-2019 would have led to significant underperformance relative to owning profitable growth companies. Before 2020, the conclusion was clear: Within the growth stock universe, investing in profitable companies would be a better strategy. Results for 2020 were radically different—unprofitable growth companies outperformed profitable ones by such a magnitude that the cumulative returns for unprofitable companies are now above the returns for profitable growth companies. This year unprofitable companies are once again underperforming, and our view is that investing in money-losing public companies will ultimately prove to be unwise, regardless of recent results to the contrary.

Cumulative Performance of Russell 1000 Growth Index Unprofitable Companies vs Profitable Companies



*As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.
Note for charts on this page: Unprofitable is defined as members of the Russell 1000 Growth Index with negative trailing earnings per share as of each calendar year end. Profitable is defined as members of the Russell 1000 Growth Index with positive trailing earnings per share as of each calendar year end. Both Unprofitable and Profitable are market capitalization weighted and rebalanced at year-end.

As of June 4, 2021. Source: Wolfe Research; Standard & Poor's.
SPAC = Special purpose acquistion company; IPO = Initial public offering

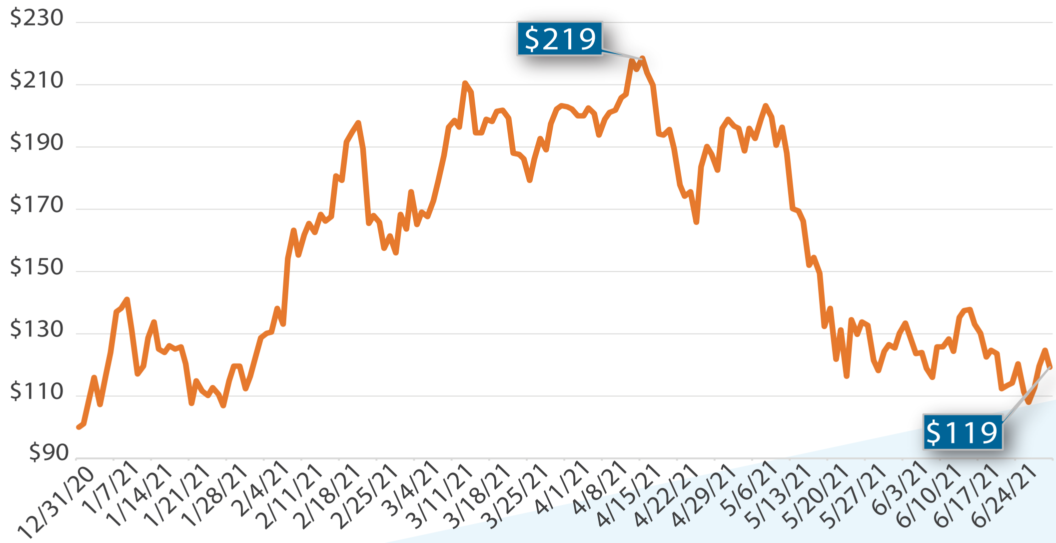
The Year of Speculation

The high returns for money-losing stocks in 2020 was just one more sign of the recent rise in speculation gripping the investment world. If you think this is just young people buying meme stocks based on social media posts, think again. Capital raised for Special Purpose Acquisition Companies (SPACs) soared last year, and the first half of 2021 has already surpassed the 2020 total. So far in 2021, more money has been raised for SPACs than regular IPOs. SPACs used to be called "blank check" companies, because capital was raised so that company executives could go shopping for acquisitions. Regulations have been tightened, but SPACs remain the exact opposite of investing in a known business with consistent cash flows.

But at least SPAC investors can hope that their investments might one day generate income. Cryptocurrency offers no such hope. Investors are lured into buying an asset that gyrates on investor moods and celebrity tweets. Is it more useful than currency for transactions? Probably not, after we set aside criminal activity. Is it a good store of value? The chart says "no." But like other popular speculative vehicles, it has made a lot of people rich recently. The time frame says it all—too many investors focus on what has worked recently, dismissing traditional wealth strategies with catch phrases such as, "You don't get it" or its latest rendition, the pithy "Okay boomer."

Bitcoin: Store of Value?

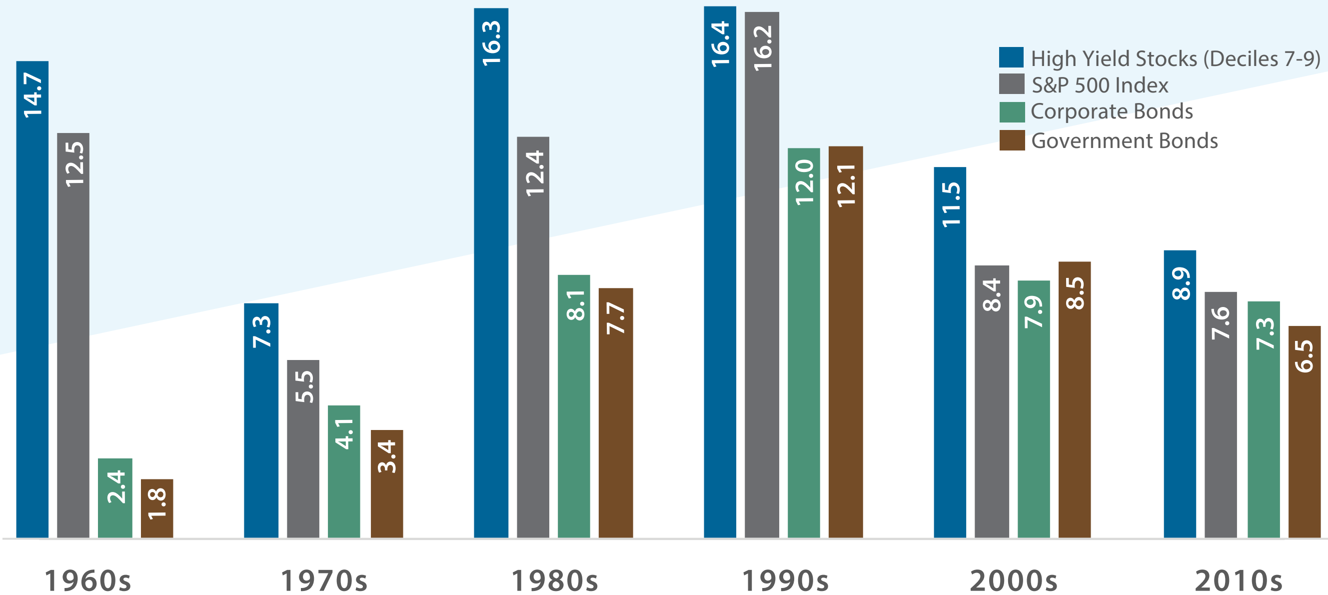
Growth of $100 USD Invested in Bitcoin Currency



As of June 30, 2021. Source: Bloomberg

Average Rolling 10-Year Total Returns by Decade

(January 1, 1951 - December 31, 2019)



Data are through December 31, 2019. Based on the rolling 10-year annualized total returns, ending each calendar year, averaged by decade.

Source: Miller/Howard Research & Analysis; 2019 Stocks, Bonds, Bills and Inflation ("SBBI Yearbook") and S&P 500 Index data as reported to Morningstar Direct. High Yield Stocks data are provided by the Fama/French Research data library (value weighted deciles); Long-term government and corporate bond returns are based on the SBBI Yearbook.

The Dividend Investor

We have seen a move in the markets back towards value and income stocks, but the wide interest in SPACs, cryptocurrency, and meme stocks suggests that the speculative fever has not yet broken. When it does, we will no doubt hear stories of the winners. But what of the average saver who belatedly turns to the latest faddish asset just after its peak?

At Miller/Howard, we have long advocated high-yield dividend stocks for long-term investors. The stocks we choose for our portfolios tend to have reasonable price-to-earnings (P/E) multiples, good free cash flow, and relatively low debt levels. Studying unprofitable companies may seem odd given our investment discipline, but clients are always asking about our thoughts on the general market. We have written extensively about the outperformance of high P/E stocks prior to Pfizer's vaccine announcement (see page 6 of our 1Q 2021 Quarterly Report). Unmentioned was the rocket-ship performance of companies that were not merely expensive on a P/E basis but actually losing money.

Using data going back to the 1950s, we have established that high-yield stocks have produced excellent returns for 10-year holding periods in every decade, better on average than the S&P 500 and better than bonds. (Please see Miller/Howard's 2Q 2020 Quarterly Report for details.) Income investing works for the long term because, typically, companies must have durable, sustainable earnings to commit to a dividend.

Investing always involves risks, but good cash flow and earnings seems to be a logical place to start when researching a potential stock investment. In contrast, investing in unprofitable companies requires fairly heroic assumptions about the future. Income investing does involve having general views on the future, but ultimate success is much more dependent on the power of compounding than 20/20 foresight.

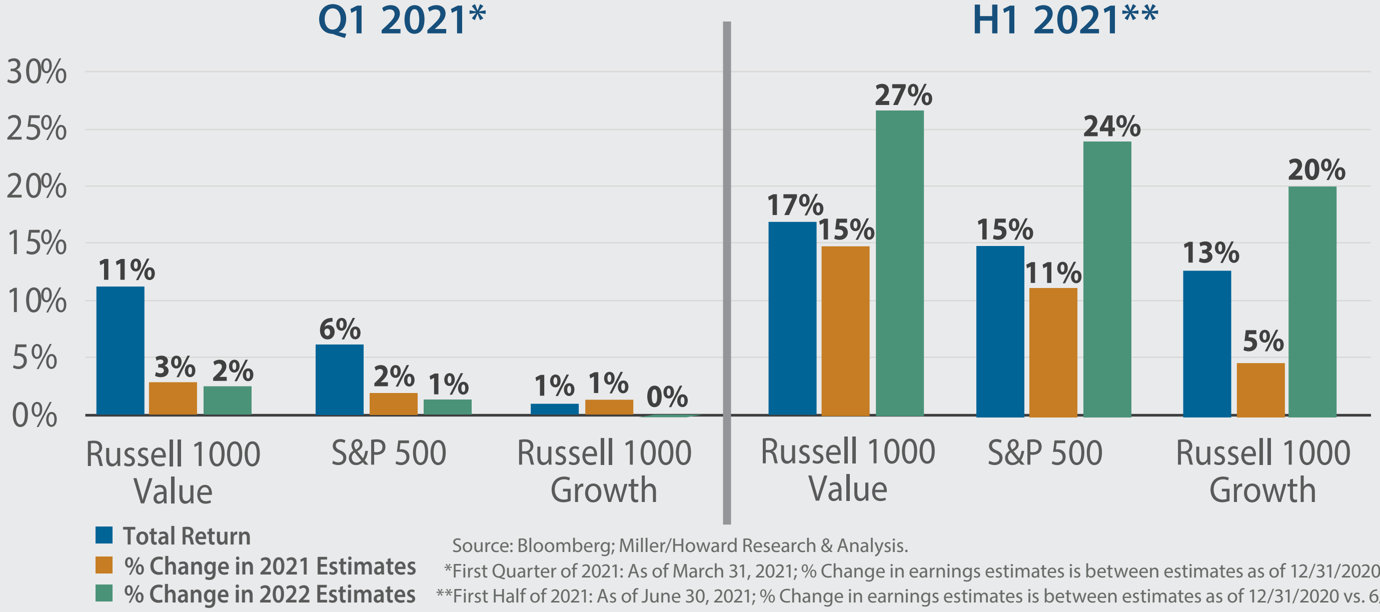
Better Earnings Outlook Driving Stocks Higher

MARKET RETURNS LAST YEAR WERE DRIVEN largely by price-to-earnings (P/E) multiple expansion, as discussed in Miller/Howard's 1Q 2021 Quarterly Report. The tenor of the market is changing this year, with the increase in earnings estimates becoming more important. This quarter, we witnessed very large increases in earnings estimates for both 2021 and 2022. Earnings estimates are up the most for cyclically-tilted value stocks. Consistent with the higher earnings estimates, value stocks have outperformed both the broad market and growth stocks year-to-date.

During the second quarter, growth stocks led value as many investors worried over the possibility of higher inflation and a potential re-emergence of COVID-19 linked to new variants. Growth stocks are viewed as less dependent on economic growth and therefore more defensive. Growth stocks are now up 13% year-to-date, despite their 2021 earnings estimates being up only 5% in the same period. In contrast, value stocks are up 17%, close to the 15% increase in their 2021 estimates.

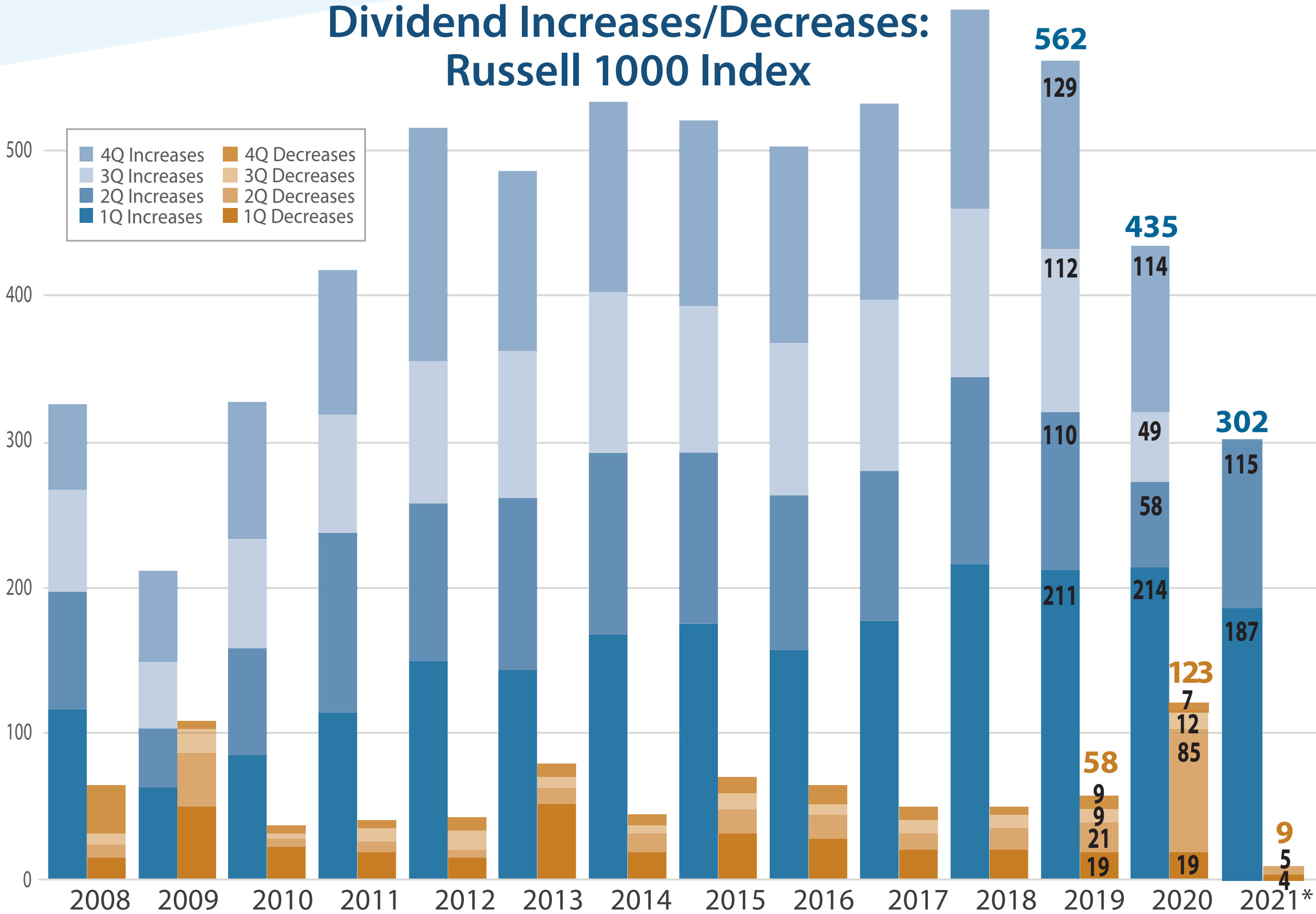
For the broad market, estimates for 2022 have risen 24% since the beginning of the year. There is a myth that "earnings estimates are always too high," and this was clearly contradicted by the increases this year, with analysts scrambling to catch up with the improving economy. The estimates for 2022 may prove to be optimistic, but so far, they appear to reflect the vigorous reopening that many expect. If forecasted earnings growth materializes, it will provide a rationale for continued positive stock market returns without relying on multiple expansion.

Increasing Earnings Estimates vs Total Returns



Source: Bloomberg; Miller/Howard Research & Analysis.
*First Quarter of 2021: As of March 31, 2021; % Change in earnings estimates is between estimates as of 12/31/2020 vs. 3/31/2021.
**First Half of 2021: As of June 30, 2021; % Change in earnings estimates is between estimates as of 12/31/2020 vs. 6/30/2021.

Dividend Increases/Decreases: Russell 1000 Index



*As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.

DIVIDEND INCREASES ARE RETURNING. One of the best arguments for equity income investing is that dividends grow over time while bond coupons are fixed. As you can see from the chart, dividend increases dropped for the broad market during the pandemic in 2020, but the number of dividend increases is now returning to normal levels. Perhaps more importantly, dividend decreases have virtually disappeared in 2021.

We believe that dividend increases should continue next quarter driven by the banking sector. All 23 of the banks in the 2021 Federal Reserve stress test passed, meaning that they can make their own decisions on dividends and buybacks, subject to maintaining their Fed-prescribed capital buffers. Some banks have already announced dividend increases for the third quarter, while others are waiting for their third quarter board meetings.

Miller/Howard's Income-Equity Strategies were up during the quarter, but trailed the broad market as investors migrated away from value and cyclical stocks in June. The move away from riskier assets appears to have been precipitated by two concerns: 1) The Federal Reserve is incrementally more concerned with inflation and communicated the increased likelihood of a federal funds rate increase in 2023. 2) The emergence of the Delta variant of COVID-19 is raising the possibility that case and death counts may rise again.

Looking Ahead

We continue to be optimistic regarding the economic recovery in the United States. At the close of the quarter, roughly half of the US population was fully vaccinated and about 10% of the population has had COVID-19, providing some natural immunity. Both vaccinations and cases continue to accumulate, meaning that the population should be in good shape to ward off a potential upturn in the fall. Our existing vaccines reportedly provide reasonably strong protection against known

Continued on page 9

Portfolio Highlights

- **Dividend Increases.** Six holdings in our Income-Equity Strategies increased their dividends this quarter. The largest increases were from **Target (TGT)** at 32% and **Whirlpool (WHR)** at 12%. Increases also came from **MDC Holdings (MDC), Portland General Electric (POR), Cardinal Health (CAH),** and **NetApp (NTAP).** So far this year, 20 holdings in Income-Equity (with MLPs) and 19 holding in Income-Equity (No MLPs) have increased their dividends, representing more than half the holdings in both versions of the strategy.

- **Sales.** We sold **Taiwan Semiconductor (TSM)** following its announcement of substantial planned increases in capital spending, foreshadowing a significant drop in free cash flow. The price of **Hartford Financial (HIG)** jumped on a takeover offer from rival Chubb. We sold HIG when it spurned the third offer, and Chubb's CEO stated that they were no longer going to pursue a deal. We sold **Huntington Bancshares (HBAN)** on concerns over valuation and its upcoming merger with TCF Financial. We sold **Western Union (WU)** due to a drop in margins linked to higher payments to its retail partners. We sold **Pfizer (PFE)** because earnings are now expected to drop as COVID-19 vaccine sales begin to decline. We sold **Citigroup (C)** when it declined to raise the dividend despite having passed the Fed stress test. Lastly, we sold the stock-dividend in **Organon (OGN)** that we received from **Merck**, as OGN does not have a good growth outlook.

- **Buys.** We initiated a position in **Best Buy (BBY),** which now pays a good dividend and is positioned to benefit from continued strong consumer demand. We bought **Omnicom (OMC),** expecting advertising demand to grow with the economic recovery. We added **Allstate (ALL)** as a high-quality company with a history of growing dividends that is selling at a depressed valuation. We bought **Regions Financial (RF)**, anticipating (correctly) that it would do well in the Fed stress test. We initiated a position in **Sabra Health Care (SBRA),** a skilled nursing home REIT which should benefit from lower COVID-19 infection rates. We bought **Bank of NY Mellon (BK),** a trust bank that did well in this year's Fed stress test, leading to a large dividend increase. Lastly, we bought **ONEOK (OKE)** whose high dividend should be well-protected at current oil prices.

variants. Much of the world trails the US vaccination rate, so international economies may lag the US.

We continue to monitor inflation data, but we view recent increases as transitory rather than as the beginning of a long-term trend. Many sectors have faced input shortages (e.g., lumber and semiconductors), leading to short-term supply and demand imbalances and resulting price increases. Some firms have faced upward wage pressures as employers must still compete with extended unemployment benefits. In our view, that reopening will dampen inflation as markets normalize.

Regardless of how inflation evolves, we believe that our holdings should be able to navigate the challenges. Relative to bonds, dividend-paying equities as an asset class should do better because dividends can rise while bond coupons are fixed. Relative to other dividend-paying stocks, our portfolio holdings tend to be in industries that are growing, which should provide some pricing power in the face of inflation.

Our portfolio retains a cyclical tilt with examples including banks, advertising companies, and home-related firms like **Whirlpool (WHR)** and homebuilder **MDC Holdings (MDC)**. We continue to own technology companies such as **Texas Instruments (TXN)** and **NetApp (NTAP)** that should benefit from a rebound in corporate and personal spending. Even our consumer staples such as **Coca-Cola (KO)** and **Amcor (AMCR)** should benefit from the reopening as much of their revenues are in the "away from home" category. More importantly, however, our Income-Equity holdings continue to have the financial strength to grow their dividends, giving investors the potential for high and rising income over time.

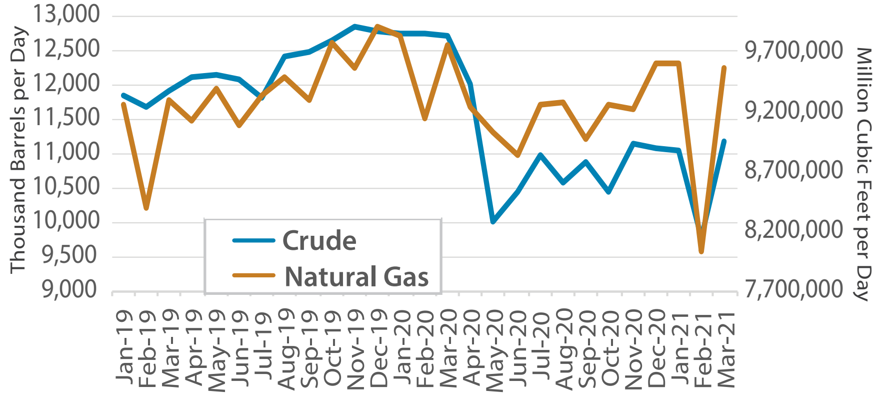
See more about
Income-Equity
on page 15.

MLP Strategy

Quarterly Report 2Q 2021

MIDSTREAM HAD ANOTHER STELLAR quarter, as a better US COVID-19 outlook, OPEC+ self-discipline, and increasing travel all contributed to an improving volume outlook. In addition, India and China have seen an uptick in demand, as the world slowly returns to a more normalized state. Although the summer waters are not totally clear due to the looming return of Iranian oil production and a slower pandemic recovery in some international countries, crude prices have moved steadily upward, and US production volumes are starting to follow.

US Crude & Natural Gas Production



As of March 31, 2021. Source: US Energy Information Administration (EIA); Miller/Howard Research & Analysis.

As can be seen in the chart above, US crude oil and natural gas production fell significantly during the COVID-19 outbreak and was impacted again this winter by severe weather. However, production has started a V-shaped recovery, which is a positive sign for midstream companies that depend on volumes to support cash flows.

In addition, we have seen a better demand outlook for refined products, as the pandemic impact has lessened in the US and resulted in increased economic activity.

We are now in the peak summer driving season and should see continuing positive demand trends, particularly for gasoline and diesel. Jet fuel demand is also heading in the right direction, but trails the robust rebound in gasoline and diesel demand. The US Energy Information Administration (EIA) expects US gasoline consumption to average 8.7 million barrels per day (Mmbpd) in 2021 and 9.0 Mmbpd in 2022. This compares with 8.0 Mmbpd in 2020 and 9.3 Mmbpd in 2019.

All of this adds up to a sunny outlook for midstream volumes, which should enable midstream energy companies to realize their goal of enhancing shareholder returns without the need for increased capital spending, in our view.

Looking Ahead

We believe current management teams finally understand their own businesses and what investors want from them. Management teams continue to talk about financial discipline, emphasizing free cash flow, and returning capital to shareholders through share buybacks and distribution increases. The companies are also focused on reducing leverage through the payoff of debt, although that goal was slowed somewhat in the tough 2020 environment. We expect de-levering should pick up again over the next few years. We believe these developments better position the sector to handle the inevitable volatility of the energy markets through future cycles.

Portfolio Highlights

- **Distributions increases.** This quarter 3 of our 16 holdings announced dividend increases. The average increase was 2.4% year-over-year.
- **Portfolio holdings:** We initiated a position in **EnLink Midstream (ENLC),** which provides exposure to mid-continent natural gas and natural gas liquids (NGLs). In addition, the company's free cash flow (FCF) yield was above the portfolio's FCF yield, and ENLC was selling at a discount on EV/EBITDA. We sold one holding, **Williams Companies (WMB)** to partially fund the ENLC buy. We trimmed **Targa Resources (TRGP),** which has been one of the portfolio's best performing names this year, and we also trimmed **Kinder Morgan (KMI)** to raise cash for the ENLC buy.

Infrastructure

Quarterly Report 2Q 2021

MARKETS MARCHED HIGHER AS ECONOMIC ACTIVITY CONTINUED TO ACCELERATE ON REOPENING progress and strong policy support. During the second quarter, the Miller/Howard Infrastructure Strategy largely kept pace with the broad market, maintaining outperformance year-to-date.

News flow was dominated by talk of inflation and interest rate expectations and reached a crescendo when the Fed suggested an earlier-than-previously-forecasted rate hike. Somewhat counterintuitively, the yield on the 10-year Treasury actually declined in the quarter as the yield curve flattened.

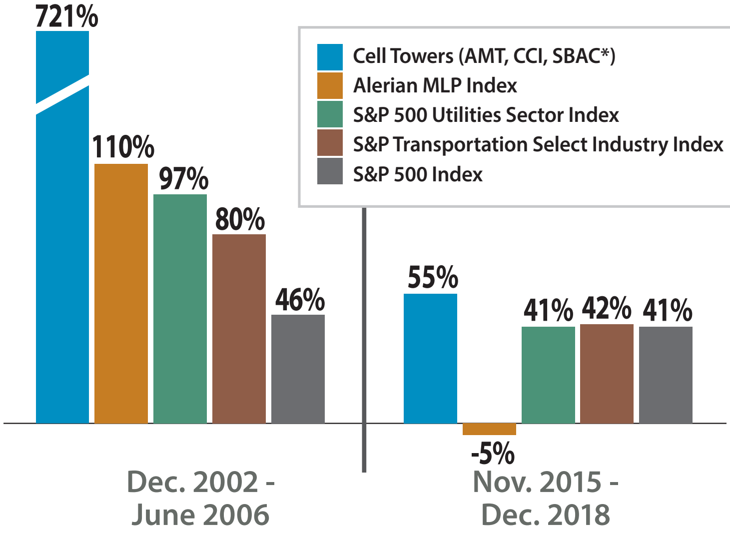
Amid this backdrop, the lower-yielding and non-dividend-paying constituents of the S&P 500 Index posted superior quarterly performance, marking a reversal of the strong relationship we noted in the first quarter. Within the portfolio, performance was more idiosyncratic. Our midstream energy holdings bucked this relationship as commodity prices were supportive of development activity and volume growth. Cell towers were also relative outperformers, due in part to declining longer-term interest rates. Midstream energy and cell tower companies represented four of the top five performing securities in the quarter.

Looking Ahead

Given the deluge of commentary around the path of future rates, we turned to the last two periods of rising rates to provide some historical context on their relationship with infrastructure assets. As illustrated here, major infrastructure sectors handily outperformed the broad market from December 2002 to June 2006. From November 2015 to December 2018, the relative outperformance was less pronounced, although most sectors still kept pace or outperformed the broad market. Midstream was the notable exception as the industry struggled to adjust to a lower commodity price environment. On an absolute basis, returns were robust over both time periods.

While the historical performance is encouraging, we have no intention of pointing to rising rates as a potential tailwind for the strategy. Instead, we would like to suggest that no matter how the ultimate trajectory of interest rates plays out, our Infrastructure Strategy remains well positioned to deliver high and growing dividends supported by durable cash flows, creating lasting value for investors.

Infrastructure Performance During Periods of Rising Interest Rates vs S&P 500 Index



Source: Bloomberg; Federal Reserve Bank of St. Louis (FRED); Miller/Howard Research & Analysis. Based on the two most recent periods of sustained rising rates; Performance is cumulative total returns.
*During the Dec 2002 – June 2006 period, SBAC was excluded from the Cell Towers average as it was a significant outlier to the upside versus peers AMT and CCI.

Portfolio Highlights

- **New additions:** We added **Targa Resources (TRGP)** with the expectation that its Permian and natural gas liquids (NGL) systems would drive above-average growth and generate an attractive free cash flow profile. We also added **NextEra Energy Partners (NEP),** increasing our exposure to renewable energy. Going forward, we expect NEP to benefit from a deep backlog of renewable growth projects at NextEra Energy Inc. (NEE).
- **Tactical allocations:** We increased our position in **Marathon Petroleum (MPC)** early in the quarter and trimmed the position late in the quarter on relative strength. We also trimmed **MDU Resources Group (MDU)** after a period of relative strength. We added to the position close to a year ago with the expectation that it would benefit from any type of fiscal stimulus related to infrastructure spending.

Utilities Plus

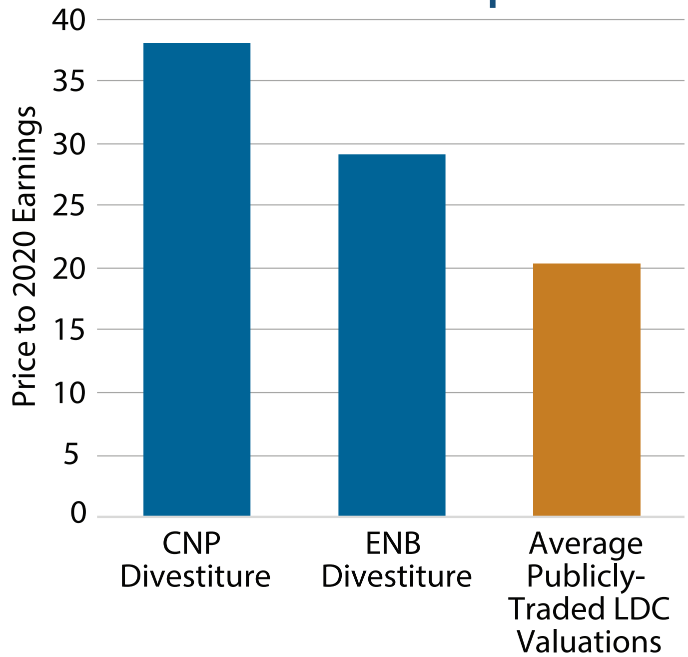
Quarterly Report 2Q 2021

UTILITIES HAVE CONTINUED TO LIVE UP TO THEIR billing as a defensive asset class. After protecting value at the onset of the pandemic (1Q20), they simply haven't been able to keep pace with the market recovery.

During the quarter, markets were inundated with talk of inflation, "talking about talking about" tapering, and the Fed's dot plots. Despite the hand-wringing, interest rate movements were fairly benign, with the yield on the 10-year Treasury declining ~25 bps. Diversified utilities, particularly those with exposure to non-traditional assets, were relative winners while renewable developers appear to have been the most impacted by inflation fears.

Also making headlines was **CenterPoint Energy's (CNP)** divestiture of its gas distribution companies in Arkansas and Oklahoma, valued at an impressive 2.5x 2020 rate base and 38x 2020 earnings. A month later, Enbridge (ENB–not held) sold its interest in a gas distributor in Quebec and Vermont for 29x 2020 earnings. These transactions highlight a disconnect between public and private valuations for gas LDCs ("Local Distribution Companies"), a group that has faced headwinds from energy-transition concerns.

Gas Local Distribution Companies (LDC) Transaction Multiples



As of June 30, 2021. Source: Bloomberg; Miller/Howard Research & Analysis. Note: LDC average includes ATO, CPK, NI, NJR, NWN, OGS, SJI, SR, SWX.

Looking Ahead

Going forward, we see multiple ways for LDCs to win. First, the recent transaction multiples provide immediate valuation support and a pathway to multiple expansion. Second, it stands to reason that companies will pursue additional accretive divestitures—or even corporate-level M&As—if the public/private valuation discrepancy doesn't dissipate. Third, recent messaging around opportunities in renewable gas and hydrogen should reinforce the notion that cash flows are long-lived, even in a decarbonizing world, and aid investor sentiment. We believe our current portfolio is well positioned to take advantage of any of these outcomes.

As broader market leadership has shifted from growth to value, utilities have been the odd man out as they don't neatly fit into either camp. However, for those willing to take a longer view, we believe the market will inevitably reward utilities' stable business model and ability to provide income and growth of income to investors.

Portfolio Highlights

- **Increasing renewable exposure:** After green-energy names rolled over in May, we took the opportunity to increase our positions in **NextEra Energy Inc. (NEE)** and **NextEra Energy Partners (NEP)**. Both entities benefit from NEE's deep backlog of renewable growth projects.
- **Increased conviction:** We added to our position in **UGI Corp. (UGI)** in April due to an attractive valuation and growth profile.
- **Trimming our largest position:** In June, we trimmed our position in **MDU Resources Group (MDU)** after a period of relative outperformance, driven in part by the company's leverage to a potential infrastructure bill.

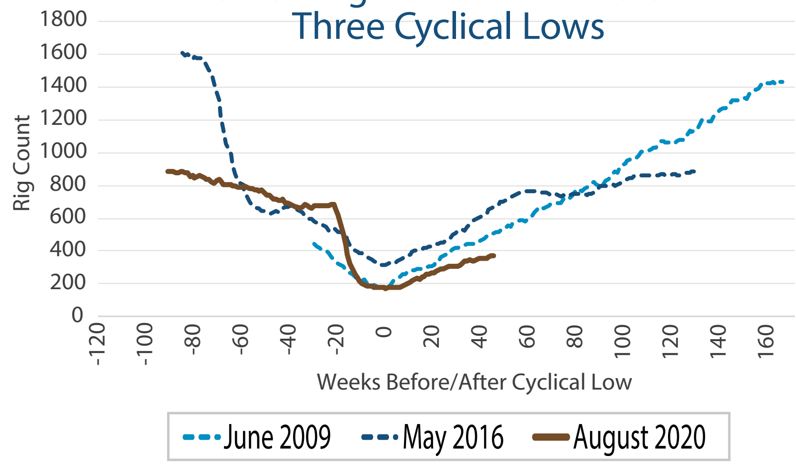
Drill Bit to Burner Tip®

Quarterly Report 2Q 2021

THE 2ND QUARTER OF 2021 offered more of the same for energy investors, with crude prices rallying over 20%, and our portfolio gaining on the S&P 1500 Energy Index. Energy markets continue to be driven by four major bullish factors. On the demand side, despite some speed bumps in India and Europe, a global reopening is fostering rising oil-driven mobility. On the supply side, OPEC+ maintained its massive production curtailment and signaled a slow return to higher levels of crude exports. Meanwhile, US producers are demonstrating unprecedented capital discipline, plowing robust cash generation less into incremental rigs and production, and more into dividends, buybacks, and deleveraging. Finally, value remains in vogue. Despite the rally, our portfolio trades at a free cash flow yield of nearly 10%, over twice that of the S&P 500 Index.

E&Ps Slower to Add Rigs vs. Prior Shale-Era Recoveries

US Oil Rig Count Centered on Three Cyclical Lows



As of June 25, 2021. Source: Bloomberg

Looking Ahead

For years, we've articulated the advantages of North American shale vis-à-vis the international oil and gas industry. The distinction received a major endorsement this quarter when a small activist investor successfully rallied large institutional investors to obtain three seats on the board of ExxonMobil, the world's most valuable public energy company (not held). While press reports mainly focused on the groundbreaking ESG-related components of the activist's platform, an equally important issue that won the day was a demand that Exxon eschew complex, long-cycle international projects in favor of smaller investments in predictable, short payback US shale production. In other words, investors loudly told Exxon that it should spend less money on drilling, more money on dividends, and that the ideal way to achieve that is by reorienting their massive company towards US shale. Fortunately, dividend investors can ditch the baggage of a complex global behemoth such as Exxon and invest directly in those companies generating significant and increasingly steady cash flows from producing, transporting, processing, and delivering domestic-sourced oil and gas via this "pure-play" North American energy portfolio.

Portfolio Highlights

- **Energy and income.** As the shale industry matures, cash returns via buybacks and dividends are a growing component of energy investor returns. In coming quarters, exploration and production companies (E&Ps) are poised, in our view, to join refiners and pipelines as among the highest dividend payers in the market. While not the absolute highest-yielding energy investment, this portfolio offers a healthy 3.8% yield that we estimate is sustainable at $40/barrel oil, and carries projected 12-month growth of 5%.

- **Along the energy value chain.** The strategy continues to lean into the energy recovery. We were, again, less active than in quarters past, though we did further increase upstream exposure with positions in high free cash generating E&Ps **Occidental Petroleum (OXY)** and **Continental Resources (CLR)**, while we pared our natural gas exposure via the sale of **EQT Corporation (EQT)**. At current oil prices, we expect double digit free cash yields for nearly all upstream producers.

Small Cap Dividends

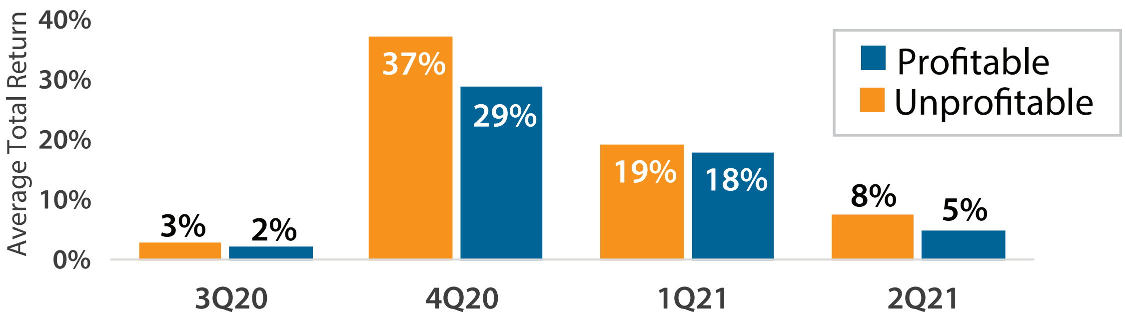
Quarterly Report 2Q 2021

SMALL-CAP STOCKS CONTINUED TO RISE WITH the rest of the market in the second quarter. Investors once again favored unprofitable companies, pushing the performance of money-losers significantly ahead of profitable small-caps. The trend was pronounced in June when fears regarding inflation and the emergence of the COVID-19 Delta variant caused a sell-off of the more cyclical small-cap stocks.

Despite the headwind of the shift towards unprofitable companies, the Miller/Howard Small Cap Dividend Strategy marginally outperformed the Russell 2000 Index in the second quarter and remains well ahead year-to-date.

Some of our stocks were impacted by macro trends while others had idiosyncratic stories. For example, **Select Medical Holdings (SEM)** benefitted from patients being diverted to its facilities from hospitals that were overwhelmed with COVID-19 cases. **Meridian Bioscience (VIVO)** was negatively impacted by falling COVID-19 cases as demand for some of their scientific research materials waned. Examples of more idiosyncratic stories were **Kulicke & Soffa (KLIC)** and **Arcbest (ARCB).** KLIC benefitted from strong demand for semiconductor manufacturing equipment while ARCB was hurt by slowing demand for less-than-truckload shipping services.

Average Performance within the Russell 2000 Index* Unprofitable Companies vs Profitable Companies



Sources: Bloomberg; Eikon; Miller/Howard Research & Analysis. Unprofitable is defined as members of the Russell 2000 Index* with negative trailing GAAP net income as of each quarter end. Profitable is defined as members of the Russell 2000 Index* with positive trailing GAAP net income as of each quarter end. Total returns for both Profitable and Unprofitable are simple averages based on the trailing performance of index members at each quarter end. * The IWM ETF is used as a proxy for the Russell 2000. GAAP = Generally Accepted Accounting Principles.

Looking Ahead

Our portfolio focuses on companies with positive earnings or free cash flow, with strong balance sheets, selling at reasonable valuations. Holdings come from a wide variety of industries and are sensitive to different factors. Over time, we believe that earnings and cash flows will compound, generating good returns. Dividends tend to be lower in the small-cap universe with many non-payers, but our portfolio offers a yield well above the Russell 2000, offering income investors diversification opportunities without walking away from dividends.

Portfolio Highlights

- **Dividend increases:** Seven holdings increased their dividends including **Bank OZK (OZK), MDC Holdings (MDC), Altra Industrial Motion (AIMC), Radian Group (RDN), HNI Corporation (HNI), Benchmark Electronics (BHE),** and **Methode Electronics (MHI)**. In addition, two holdings paid special dividends, **Ethan Allen Interiors (ETH)** and **Boise Cascade (BCC).**

- **Sales:** We sold **Luminex (LMNX)** after management agreed to sell the company to Diasorin at a significant premium.

- **Buys:** We initiated a position in **NextGen Healthcare (NXGN),** a provider of software to medical and dental practices with a good history of generating substantial free cash flow. We bought **Movado (MOV)**, a maker of watches and jewelry with good free cash flow and a relatively high dividend for a small-cap stock. We bought **Sabra Health Care REIT (SBRA)**, an owner of skilled nursing homes that should benefit from a reduction in COVID-19 cases. Lastly, we bought **PDC Energy (PDCE),** an oil & gas producer that pays a dividend.

Yield, Growth, Strength, Stability

- Our Income-Equity Strategies each offer a high dividend yield that is nearly 2.5x the yield on the S&P 500 Index, and have ample dividend coverage and reasonable leverage levels (net debt/EBITDA).
- Both portfolios trade at a significant discount to the broad market on price-to-earnings as well. Value investing historically has done best coming out of a recession, so the historically low valuations should set the Income-Equity Strategies up for a strong recovery, in our view.
- We believe the portfolios are well-positioned to weather a downturn and poised to return to dividend growth as economic conditions improve.

Income-Equity Strategy (with MLPs)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2Q 2021
Income-Equity Yield	5.1	4.8	4.4	4.2	4.7	4.0	3.7	4.3	3.7	3.6	3.4
S&P 500 Yield	2.1	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.4
Ratio	2.4x	2.1x	2.3x	2.1x	2.2x	1.9x	2.0x	2.0x	2.0x	2.3x	2.4x
Income-Equity Projected Dividend Growth*	6.8	7.5	7.5	7.5	5.8	5.0	6.3	7.8	7.3	5.1	6.4
S&P 500 Projected Dividend Growth**	5.9	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.8
Ratio	1.1x	1.5x	1.3x	1.6x	1.4x	1.2x	1.5x	1.5x	1.7x	1.5x	1.1x
Income-Equity Dividend Coverage Ratio	1.4x	1.5x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.2x
Income-Equity Net Debt/EBITDA***	2.4x	2.5x	2.6x	4.2x	2.8x	2.0x	1.9x	1.4x	1.9x	1.9x	1.5x
Income-Equity P/E Ratio Trailing	13.3	14.1	13.4	16.4	14.2	17.2	17.7	12.6	12.8	16.7	14.9
S&P 500 P/E Trailing	13.4	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	30.3
Premium/Discount	-1%	-2%	-23%	-10%	-24%	-16%	-18%	-23%	-41%	-40%	-51%

Income-Equity Strategy (No MLPs)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2Q 2021
Income-Equity (No MLPs) Yield	5.0	4.7	4.1	4.0	4.6	3.9	3.7	4.2	3.6	3.5	3.3
S&P 500 Yield	2.1	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.4
Ratio	2.4x	2.1x	2.2x	2.1x	2.1x	1.9x	2.0x	2.0x	2.0x	2.3x	2.4x
Income-Equity (No MLPs) Projected Dividend Growth*	7.0	7.6	8.2	7.7	5.9	5.0	6.4	7.9	7.5	5.2	6.4
S&P 500 Projected Dividend Growth**	5.9	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.8
Ratio	1.2x	1.5x	1.4x	1.6x	1.4x	1.2x	1.5x	1.5x	1.8x	1.5x	1.1x
Income-Equity (No MLPs) Dividend Coverage Ratio	1.4x	1.4x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.2x
Income-Equity (No MLPs) Net Debt/EBITDA***	2.4x	2.5x	2.7x	2.6x	2.6x	2.2x	2.1x	1.4x	1.9x	1.9x	1.5x
Income-Equity (No MLPs) P/E Ratio Trailing	13.5	14.5	14.6	17.2	16.5	18.2	18.0	12.9	13.5	16.8	15.5
S&P 500 P/E Trailing	13.4	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	30.3
Premium/Discount	0%	1%	-16%	-6%	-12%	-12%	-17%	-22%	-38%	-39%	-49%

Source: Bloomberg; S&P 500; Miller/Howard Research & Analysis.
The data above are based on representative accounts in our Income-Equity Strategies both with and without MLPs and are subject to change. Median P/E ratio trailing is published for our Income-Equity Strategies.
* Projected Dividend Growth—Miller/Howard Portfolio Team's 3-year annualized projected dividend growth based on data from various sources, adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.
** Bloomberg Dividend per Share 3-year forward estimates.

*** Excludes financials.
Dividend yields shown for Miller/Howard portfolios exclude cash.
All data are as of year-end, unless otherwise noted.
Common stocks do not assure dividend payments. Dividends are paid only when declared by an issuer's board of directors, and the amount of any dividend may vary over time. Dividend yield is one component of performance and should not be the only consideration for investment. See definitions and full disclosure on page 16.

Shareholder Advocacy & Engagement Report

2020–2021

We work to provide *Sustainable Income Opportunities®* to our clients

We believe that integrating ESG and fundamental analysis helps us uncover risks and opportunities that might not be obvious otherwise. We evaluate companies using our **Guiding Values** in an effort to protect shareholder value, and we may engage companies through our shareholder advocacy program when we identify risks.

GUIDING VALUES

EXEMPLARY GOVERNANCE & CORPORATE CITIZENSHIP

SUSTAINABILITY, EQUITY, & INCLUSION

STRONG DISCLOSURE & RESOURCE MANAGEMENT

RESPONSIBLE CLIMATE CHANGE STRATEGY

RESOLUTIONS

4 Resolutions Filed:

- Results range from 23 – 36% support

PROXY VOTING

87.2% of companies at which we voted FOR a shareholder proposal on ESG issues, when the company recommended against it.

COMPANY ENGAGEMENT

- 13 on governance issues
- 15 on environmental issues
- 26 on social issues

PARTNERSHIP ACTIVITY

- **43** investor statements urging improved ESG action by regulators, sectors, and governments
- **Worked with >10** investor groups & NGOs

DIVESTMENT

- **Custom exclusions** (where feasible under platform & custodian restrictions)

Proxy Data for FY 2020
Engagement Data from 2Q20-2Q21
Full Report Available on at mhinvest.com

Miller/Howard Investments Inc. is an independent, research-driven investment boutique with nearly three decades of experience managing portfolios for major institutions, mutual funds, and individuals in dividend-focused investment strategies. The firm is 100% employee-owned through an Employee Stock Ownership Plan (ESOP).

We continue to evolve and develop strategies that strive to provide investors with various levels of current income and dividend growth. Our objectives are to generate total returns in line with the broad equity market and provide a high and rising stream of income with the lower volatility that an investor might seek from bonds or other income alternatives. With a primary goal of reliable income and long-term returns, coupled with a belief that investors can play an important role in securing a sustainable future, our shareholder advocacy efforts include environmental, social, and governance (ESG) research and/or screening, direct engagement with companies, filing shareholder resolutions, proxy voting, coalition building, and public policy involvement.

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DEFINITIONS: Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)—A non-GAAP measure used to provide an approximation of a company's profitability. This measure excludes the potential distortion that accounting and financing rules may have on a company's earnings; therefore, EBITDA is a useful tool when comparing companies that incur large amounts of depreciation expense because it excludes these noncash items, which could understate the company's true performance. **High-Dividend Yield Stocks** consists of Decile 7, 8, and 9 of a universe of US dividend paying common stocks with a market capitalization equal to or greater than $1 billion. **Net Debt to EBITDA—**A measure that computes the company's ability to pay off its debt by utilizing the earnings before interest, taxes, depreciation, and amortization (EBITDA). **Enterprise Value/EBITDA (EV/EBITDA)**—A valuation ratio used to compare the enterprise value (the market value of the company's total operating assets including debt and equity) to the company's EBITDA. The metric allows comparisons across companies with differing capital structures and tax rates. **Price-Earnings Ratio (P/E)—**The ratio of a company's share price to its earnings per share. The ratio is used as a valuation tool and can help determine whether a company is overvalued or undervalued. **S&P 500 Index®** widely regarded as the best single gauge of large-cap US equities and serves as the foundation for a wide range of investment products. The Index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **The S&P Composite 1500® Energy Index** comprises those companies included in the S&P Composite 1500 that are classified as members of the GICS® energy sector. **The Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. **Russell 2000 Index** measures the performance of the small-cap segment of the US equity universe and is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

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Notification to Clients: Contact your Advisor with any material changes to your financial profile that would impact your appropriateness for investment.

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