Miller/Howard INVESTMENTS

Is Your Money Working for You or Corporate Management?

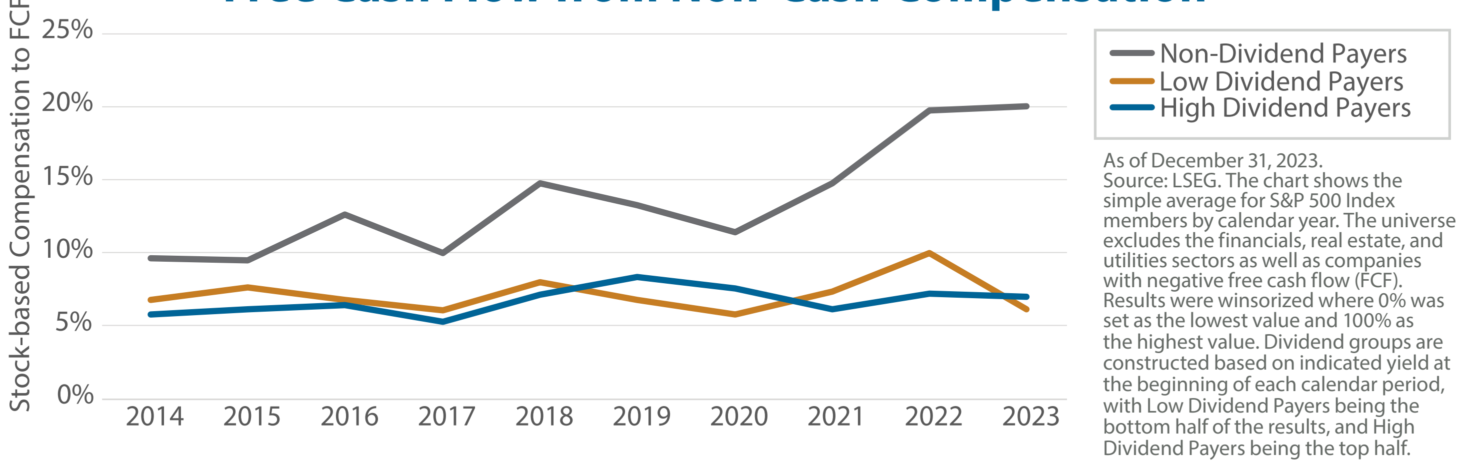
JUNE 30, 2024

THE INVESTMENT WORLD HAS BEEN SMITTEN with picking stocks based on free cash flow (FCF, defined as cash flow from operations minus capital expenditure) over the past decade. The basic idea of this approach is to favor capital-light business models or companies in "harvest mode," meaning that capital investments have been made and now cash flow is plentiful. At Miller/Howard, we largely embrace this viewpoint, but our research-driven culture demands that we examine the quality of free cash flow. Looking under the hood, one issue leaps out—high levels of non-cash executive compensation at many companies, particularly non-dividend payers.

The use of stock or option-based compensation schemes is common across all industries. Accountants estimate the expected value of the awards and treat it as a cost when calculating net income. When it comes to cash flow, the cost of stock and option compensation is *added back* to net income because these awards have no *current* cash costs. For investors, it's not that a check is in the mail—in contrast, a bill is coming. The ultimate cost of non-cash compensation will be higher the better a company does, taking the shine off the upside.

The good news is that cash flow statements tell us exactly how much of free cash flow is coming from companies using non-cash compensation rather than salaries and cash bonuses. Looking at the S&P 500 Index's core members (leaving out financials, real estate and utilities for which free cash flow is not a useful metric) over the past 10 years, companies without regular dividends have increasingly sourced their free cash flow from non-cash compensation. For the last two years, these non-dividend payers had roughly one-fifth of free cash flow come from using non-cash compensation. In contrast, regular dividend payers consistently sourced much less of their free cash flow from stock-based compensation. In our opinion, with their more judicious use of non-cash compensation, dividend-paying firms are sending a clear signal that they are managing their businesses for the benefit of shareholders.

Non-Dividend Payers Have Increasingly Sourced Free Cash Flow from Non-Cash Compensation



As of December 31, 2023.
Source: LSEG. The chart shows the simple average for S&P 500 Index members by calendar year. The universe excludes the financials, real estate, and utilities sectors as well as companies with negative free cash flow (FCF). Results were winsorized where 0% was set as the lowest value and 100% as the highest value. Dividend groups are constructed based on indicated yield at the beginning of each calendar period, with Low Dividend Payers being the bottom half of the results, and High Dividend Payers being the top half.

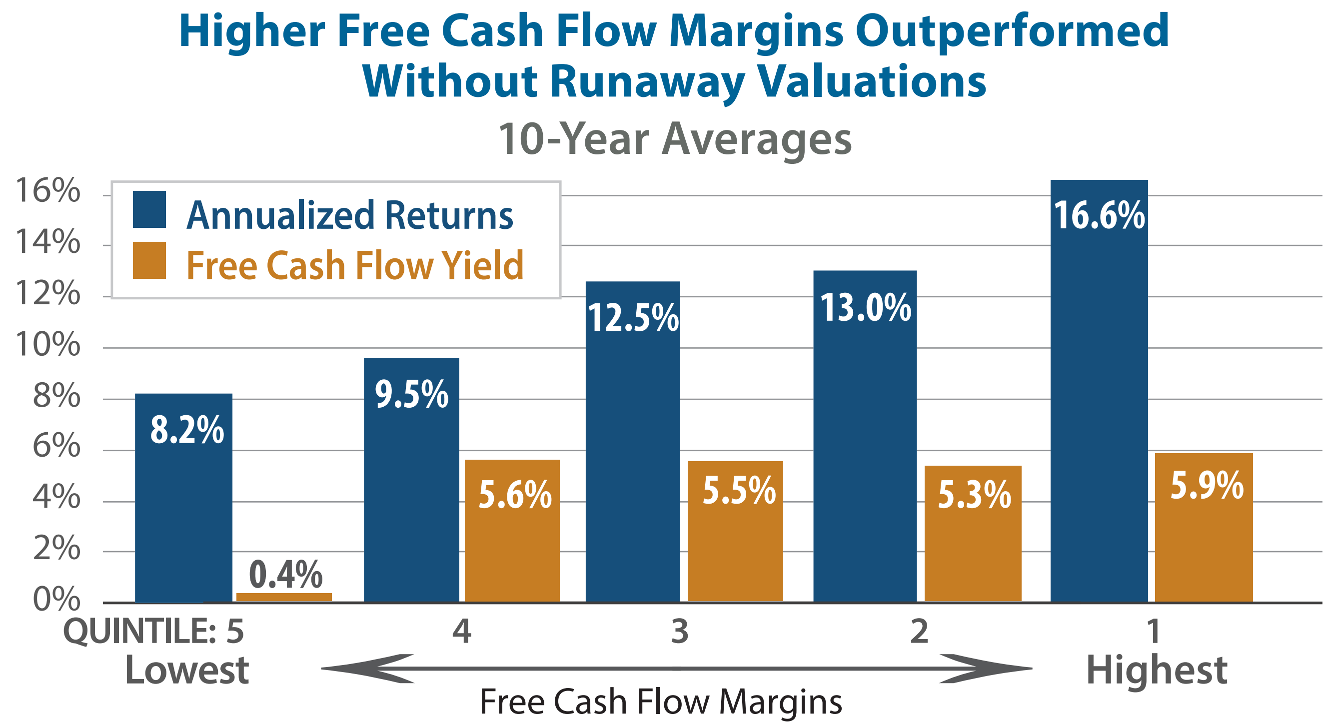
THE FREE CASH FLOW STORY

Before we analyze how investors may be missing the potential problems with heavy use of non-cash executive compensation, let's first review why investors have focused on free cash flow in recent years. From a stock-picking perspective, free cash flow *margin*, defined as free cash flow per dollar of revenue, has been an excellent predictor of total returns over the past 10 years. Stocks in the highest quintile of free cash flow margins have had more than double the returns of stocks in the lowest quintile.

High free cash flow margins suggest that firms can reliably convert revenue growth into higher levels of free cash flow. The key assumptions are that free cash flow margins will remain high, revenue will grow, and most importantly, valuation does not matter given that free cash margins are entirely independent of stock prices.

Free cash flow *yield*, defined as the amount of the free cash flow per dollar of market capitalization, is a useful valuation metric. The quirk of the trailing decade is that the top four quintiles of free cash *margins* averaged roughly the same valuation, between 5-6% free cash flow *yield*, allowing investors to tilt towards high free cash flow *margins* without having to compromise too much on valuation (meaning free cash flow *yield*).

Let's see how the free cash flow story intersects with dividend investing.



As of December 31, 2023. Source: LSEG. Free cash flow margins were quintiled using members of the S&P 500 Index as of each calendar year end. Calculations exclude the financials, real estate, and utilities sectors. Annualized return is calculated based on the average return of each quintile for each calendar year beginning 2014 through 2023. Free cash flow yield is the simple average for each quintile over the 10-year period.

Read more about our thoughts on Free Cash Flow on our blog: mhinvest.com

DIVIDEND INVESTING
THROUGH THE FREE CASH FLOW LENS

As we have discussed in our past Quarterly Reports, total returns for dividend-paying stocks have trailed non-dividend payers over the past decade despite having a better long-term return record. Looking at the core of the S&P 500, non-dividend payers have outperformed dividend payers by 1.7% on an annualized basis over the last 10 years.

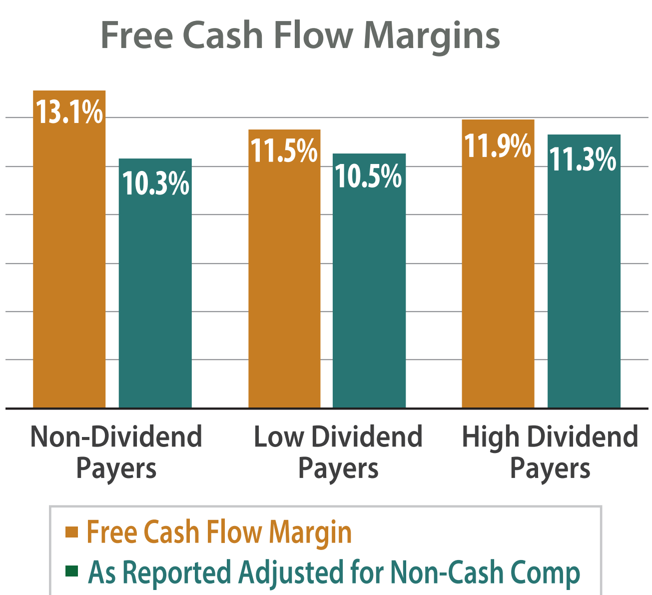
Through the free cash flow lens, the outperformance of non-dividend payers makes sense—free cash flow margins have been higher for non-dividend payers. This seems to be a good description of how the market has operated, *but does it make sense?* As discussed above, non-dividend payers have sourced a larger portion of their free cash flow from the use of stock-based compensation. In our view, generating more free cash flow by loading management up on restricted stock units and options rather than cash bonuses masks the very real costs of high executive compensation.

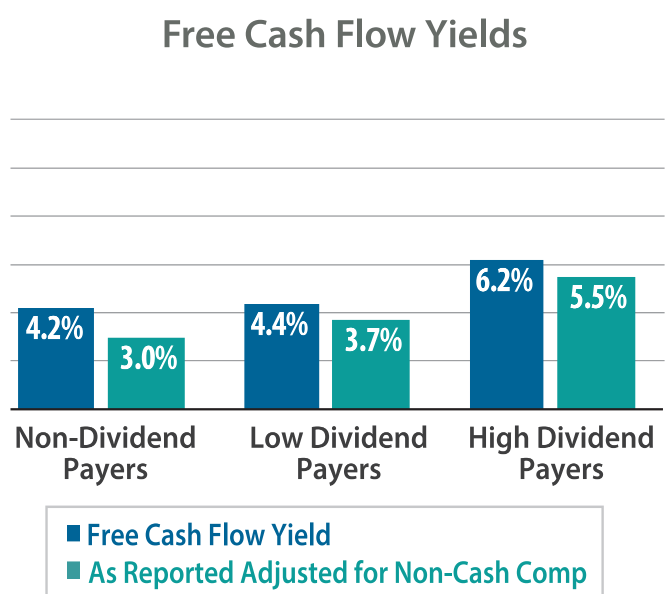
If we back non-cash compensation out of free cash flow, the picture changes significantly—high dividend payers have the best free cash flow margins after adjusting for stock-based compensation. Non-dividend payers may have benefitted over the past 10 years as the market focused on free cash flow margins without considering the quality of those cash flows.

From a valuation perspective, stocks in the top half of dividend yields had much higher free cash flow yields, both before and after pulling out the impact of stock compensation. Subtracting non-cash executive compensation from free cash flow for all stocks flips the entire story in favor of higher dividend yield stocks—both free cash flow *margins* and free cash flow *yield* are better for stocks with the high dividend yields. The impact of stock-based executive compensation continues to rise as a percentage of free cash flow for non-dividend payers, so at some point, we expect the market to wake up to this growing issue.

When Will Investors Recognize the Impact of Non-Cash Compensation?

10-Year Averages





As of December 31, 2023. 10-Year average (2014-2023). Source: LSEG. Dividend groups within the S&P 500 Index are constructed based on indicated yield at the beginning of each calendar period. Dividend groups are constructed based on indicated yield at the beginning of each calendar period, with Low Dividend Payers being the bottom half of the results, and High Dividend Payers being the top half. Averages are based on constituent groupings and are equal-weighted.

*"MAGNIFICENT 7"**
THROUGH THE FREE CASH FLOW LENS

Returns for the broad market have recently been dominated by the Magnificent 7: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.* These mega-cap tech stocks have had high free cash flow *margins*, fitting with current investor preferences. Not surprisingly, on a valuation basis the stocks are expensive, with free cash flow *yields* well below the average for the core S&P 500.

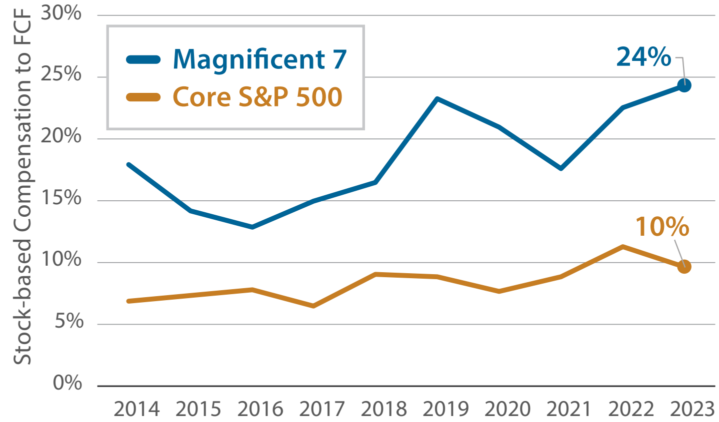
From a dividend perspective, the Magnificent 7 are underwhelming—five have regular dividends that are each well below 1% and two (Amazon and Tesla) are non-dividend payers.

As exciting as the Magnificent 7 businesses may be, investors should note that non-cash executive compensation represents a high and rising fraction of free cash flow. By using non-cash compensation in an era that's focused on free cash flow, it's likely that the companies are sidestepping the market consequences of high executive pay.

Backing out non-cash executive compensation, the free cash flow margins for the Magnificent 7 drop significantly, closing much of the gap with the core S&P 500. From a valuation perspective, removing stock-based executive compensation from free cash flow makes this group of high-flyers even more expensive relative to the core S&P 500.

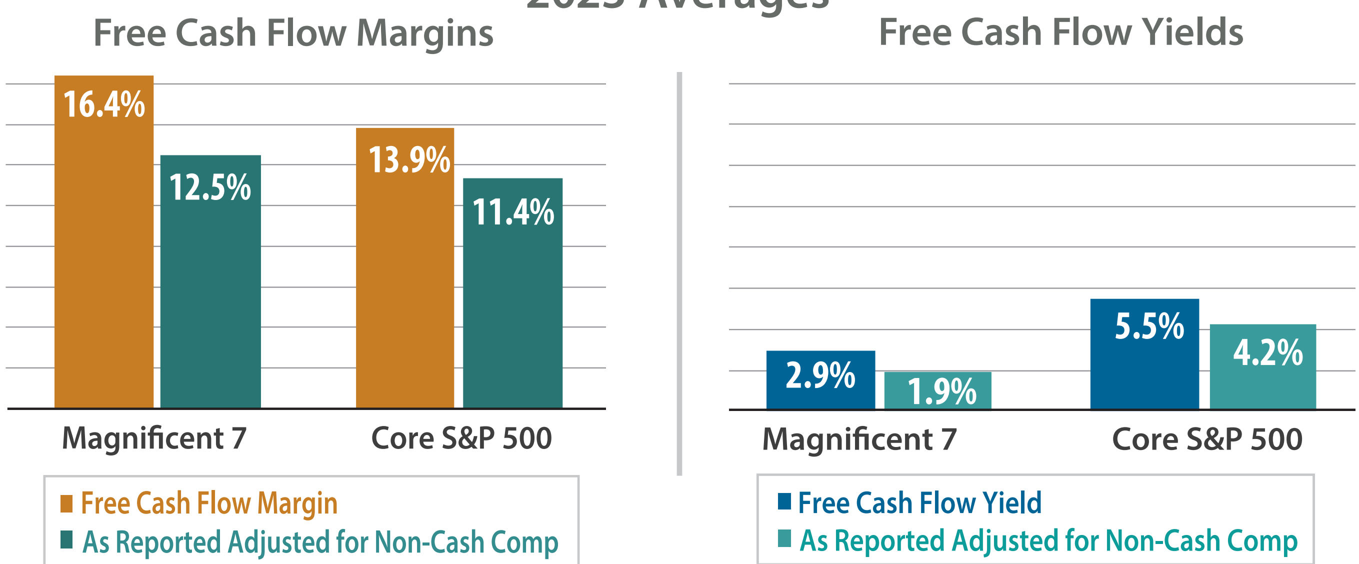
For the Magnificent 7, the portion of free cash flow coming from non-cash executive compensation is trending up, driving a larger and larger wedge between total free cash flow and the cash flow that could possibly fund dividends sometime far down the road.

Magnificent 7 Non-Cash Compensation:
High and Rising Fraction of FCF



As of December 31, 2023. Source: LSEG. *Magnificent Seven= Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla (not held, except, as of June 30, 2024, Tesla was held in a Miller/Howard portfolio that is not yet available to investors). S&P Core is all members of the S&P 500 Index excluding financials, real estate & utilities. S&P Core is reconstituted at each calendar year end. Stock-based compensation net of tax. FCF=Free cash flow.

Adjusting for Non-Cash Compensation, the Magnificent 7's Advantage Fades
2023 Averages



As of December 31, 2023. Source: LSEG. Magnificent Seven= Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla (not held, except, as of June 30, 2024, Tesla was held in a Miller/Howard portfolio that is not yet available to investors). S&P Core is all members of the S&P 500 Index excluding financials, real estate & utilities. Stock-based compensation net of tax. Averages are based on constituent groupings and are equal-weighted.

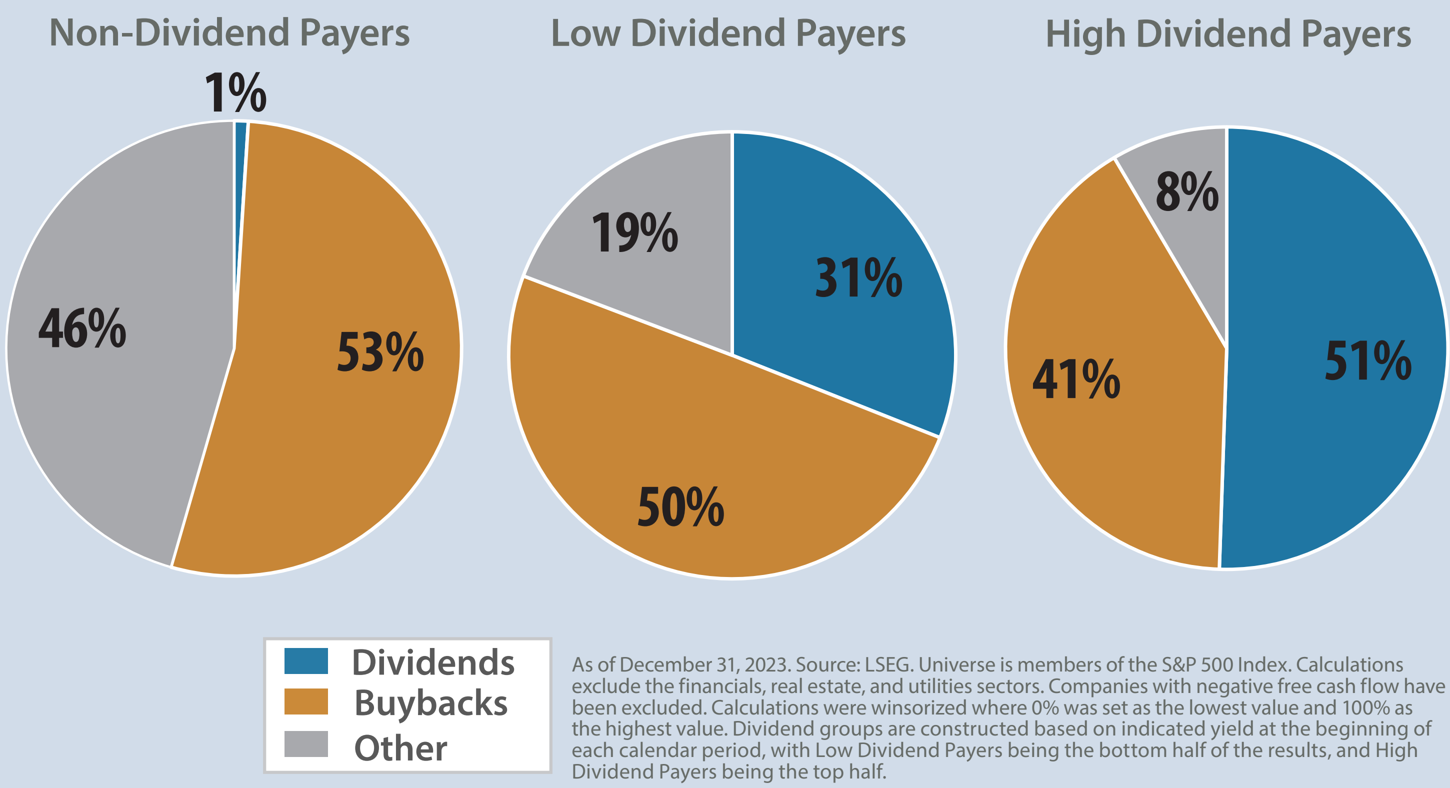
USE OF FREE CASH FLOW:
DIVIDEND PAYERS vs. NON-DIVIDEND PAYERS

In addition to having higher-quality free cash flow, companies with regular dividends return more of their free cash flow to shareholders in the form of dividends and stock buybacks. In the past 10 years, firms with the top half of dividend yields returned on average 91% of their free cash flow to shareholders through dividends and buybacks. In contrast, firms without regular dividends return an average of 53% of free cash flow in buybacks and 1% in the form of special dividends or dividend initiations. Firms in the bottom half of dividend yields return 81% of free cash flow, on average, to shareholders in terms of dividends and buybacks.

If free cash flow is not used for dividends or buybacks, where does it go? Some uses are positive, such as building cash or paying off debt. The other main use is making acquisitions. At Miller/Howard, we are wary of acquisitions, particularly large acquisitions with lines of business outside the acquiror's core competencies. Sometimes these deals can work out, but frequently, sellers are proven to understand the situation better than buyers. Classic examples of terrible deals include the AOL/Time Warner merger and the 2018 purchase of Time Warner by AT&T. Naturally, some deals create value, but our view is that investors are typically better served when free cash flow is returned to shareholders in the form of dividends or buybacks. Dividends are easy to understand, but let's examine how buybacks benefit investors.

Companies Have Varying Uses of Free Cash Flow —We Prefer Dividends

10-Year Averages



As of December 31, 2023. Source: LSEG. Universe is members of the S&P 500 Index. Calculations exclude the financials, real estate, and utilities sectors. Companies with negative free cash flow have been excluded. Calculations were winsorized where 0% was set as the lowest value and 100% as the highest value. Dividend groups are constructed based on indicated yield at the beginning of each calendar period, with Low Dividend Payers being the bottom half of the results, and High Dividend Payers being the top half.

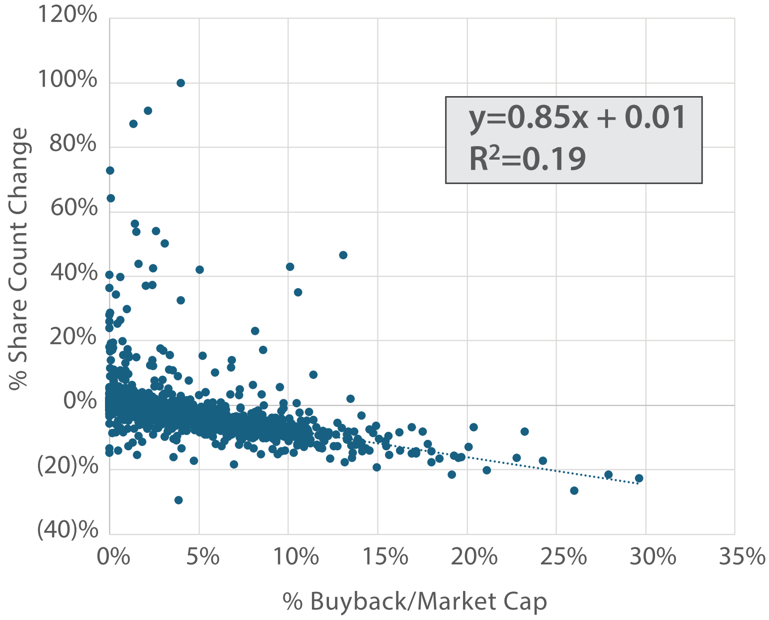
DO STOCK BUYBACKS HELP INVESTORS?

It would be hard to find a subject with more muddled thinking than share buybacks. Some observers view buybacks as a waste, as if the money actually disappears. Others see buybacks as a trick to "artificially" boost earnings per share. At Miller/Howard, we are skeptical of both large acquisitions and excessive capital spending, so we view buybacks as a sensible way for companies to return capital to investors so that the market can allocate it to better uses.

Holding everything else equal, share buybacks cause buy-and-hold investors to own a growing percent of the company. In addition, dividend increases become easier to afford because dividends are paid on a reduced share count. The caveat is that "holding everything else equal" potentially hides mischief. Share counts change for many reasons, but the two most important are using stock to make acquisitions and the fallout from executive compensation programs.

Looking at the entire S&P 500 over the past 10 years, buybacks on average have reduced the number of shares with 85% efficiency, meaning that a buyback of 1% of the market cap, instead, had an average reduction in market cap of 0.85%. Given all the sources of leakage, the 85% average is not bad. But the regression line explains less than one-fifth of the variability, meaning that acquisitions and stock-based compensation are much more important in determining the diluted share count.

Management Mischief: Buybacks Don't Always Result in Fewer Shares



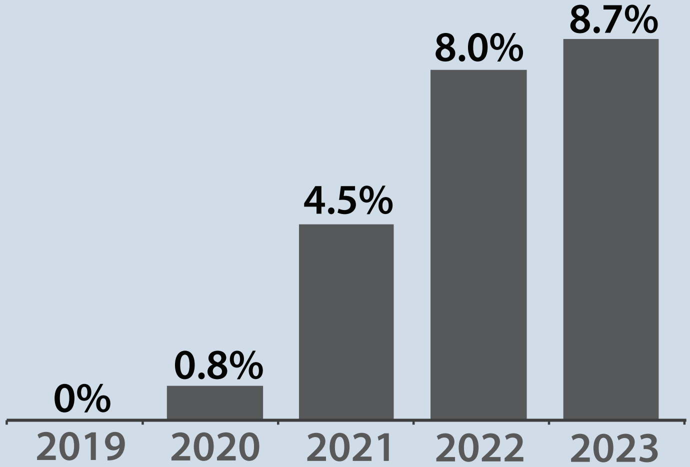
As of December 31, 2023. Source: LSEG. Universe is members of the S&P 500 Index as of calendar year end beginning 12/31/2013 through 12/31/2022.

Elon Musk's 2018 Pay Package

Elon Musk's controversial pay package illustrates how difficult it can be to control the share count using buybacks. Musk's compensation hinges on Tesla's stock price, revenue, and profitability. The conditions set out in 2018 were not met in 2019, so no shares were added to the diluted share count in 2019. Times were better for Tesla in 2021 and 2022, and many of the conditions were met, triggering massive dilution—much bigger than Tesla could possibly have offset even if it had directed all of its free cash flow to buybacks. Besides the magnitude of the dilution, the key takeaway from this example is that the impact of compensation programs can come with significant and unpredictable lags.

Non-Cash Compensation Can Trigger Massive Dilution

Musk's Stock Awards as a Percentage of Diluted Shares Outstanding



As of June 30, 2024. Sources: Tesla, Inc. proxy statements, annual reports, and quarterly reports; Miller/Howard Research & Analysis. Based on cumulative shares awarded to Elon Musk as part of Tesla's 2018 CEO Performance Award divided by Tesla's total diluted shares outstanding yearly. As of June 30, 2024, Tesla was held in a Miller/Howard portfolio that is not yet available to investors.

ARE DIVIDENDS BETTER THAN BUYBACKS?

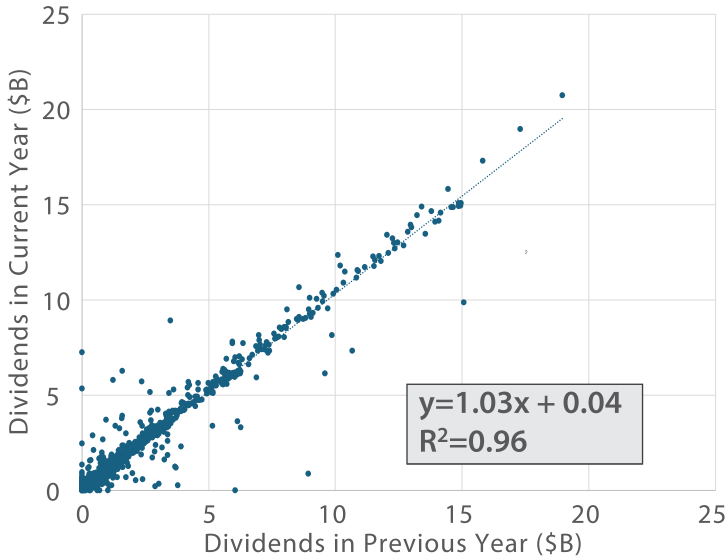
Both corporate executives and investors often ask whether we at Miller/Howard prefer dividends or buybacks. In speaking with corporate executives, we stress that a regular dividend is a commitment. The market punishes dividend cutters, so a commitment to a regular dividend must be based on conservative forecasts of future earnings and free cash flow. In contrast, one-off events such as the sale of a business unit, a favorable legal settlement or even an unusually good year can generate extra cash that is probably best returned to shareholders via a buyback rather than hiking the regular dividend.

When investors ask the question, the script is flipped. We know that corporate executives are loathe to risk a dividend cut, so a high regular dividend is a signal that management believes future profitability will be resilient, even in a changing environment. From the investor standpoint, regular dividends are preferable to buybacks, in our view, because they are more likely to continue.

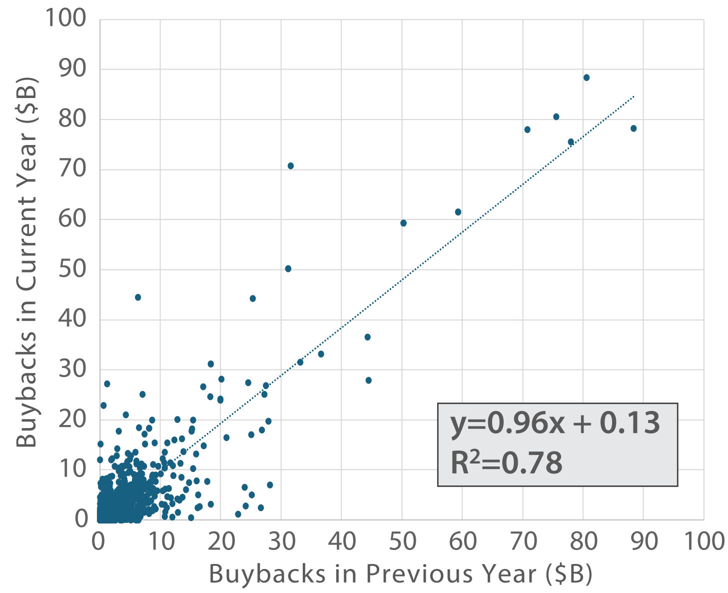
One way to test our thesis is to examine how well dividends and buybacks in one year predict dividends and buybacks, respectively, in the subsequent year. The resulting regressions lead to two strong conclusions in favor of dividends:

- **Dollars spent by a firm on dividends are highly predictive of dividend spending in the subsequent year, with 96% of the variation explained. Buybacks are less predictive of future buybacks.**
- **Dividend spending rises on average almost 3% per year. In contrast, buyback spending erodes by more than 4% per year on average.**

Past and Future Dividends Are Highly Correlated...



...But Past and Future Buybacks Are Less Linked



As of December 31, 2023. Source: LSEG. Universe is members of the S&P 500 Index as of calendar year end beginning 12/31/2013 through 12/31/2022. The buyback universe excludes members with net positive stock issuance.

Our Conclusions

We view stocks with higher dividend yields as underappreciated in the current market. The high and growing levels of stock-based executive compensation create misleading comparisons with non-dividend-paying stocks. Once non-cash executive compensation is adjusted out, stocks with higher dividend yields are actually superior on both free cash flow margins and free cash flow yields.

Not only do firms with higher dividend yields have better-quality free cash flow, but they also use it in a more shareholder-friendly manner, returning 91% to shareholders in the form of dividends and buybacks, well above the rates for both non-dividend payers and those with low dividend yields. Overall, our research shows two key points: dividend-paying stocks have higher free cash flow, adjusted for non-cash compensation, relative to both revenue and market capitalization, and current dividends are highly predictive of future dividends.

Income-Equity

QUARTERLY REPORT 2Q 2024

HAVE BANKS BEEN GOOD DIVIDEND STOCKS?

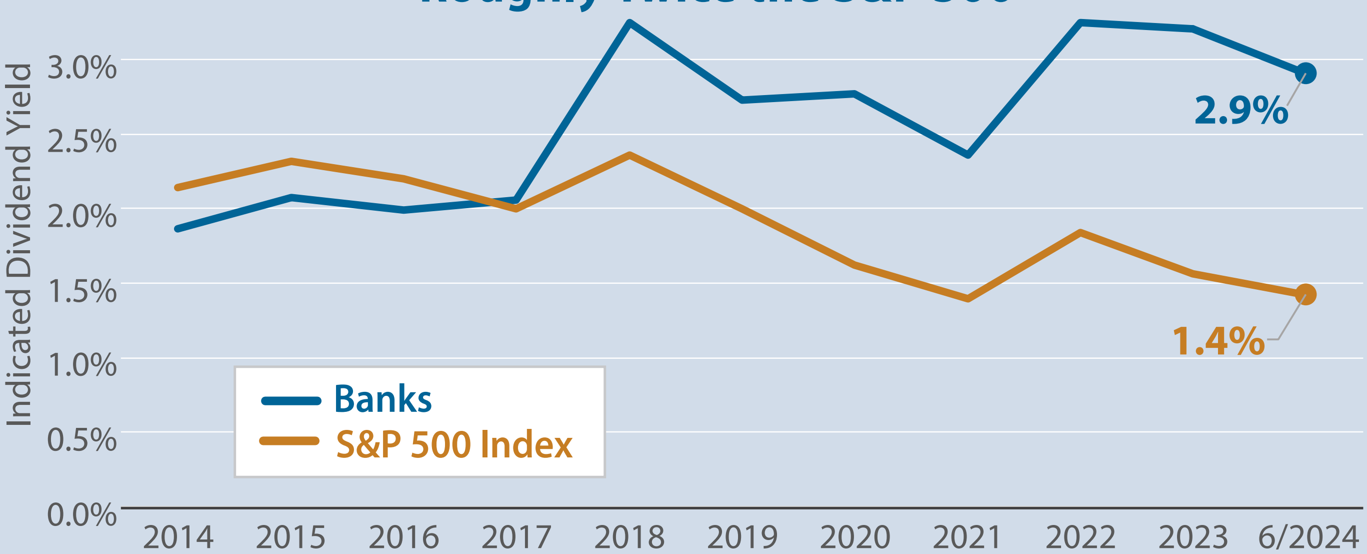
Coming out of the Global Financial Crisis, banks were not a great source of dividends. The Federal Reserve kept tight control over capital returns to shareholders, with the belief that US banks needed to accumulate capital so that they could withstand another major crisis. The Fed instituted its annual stress test for banks in 2011, and many banks struggled at the outset to meet the Fed's expectations. As the years went by, banks accumulated additional capital, making them more resilient and enabling them to perform better in the annual stress test.

In 2017, all US banks passed the stress test for the first time, and subsequently, the Fed began to allow larger dividend increases and buybacks. Bank yields rose relative to the market and have remained higher to date. The pandemic provided a real-life challenge to the safety and security of US banks, and only two banks, Wells Fargo and Capital One (neither held by Miller/Howard), cut their dividends. Overall, banks in the S&P 500 Index have raised dividends 73 times since the beginning of 2018, with only two cuts in the same period.

Portfolio Highlights

- **Dividend increases:** Income-Equity had 7 dividend increases in the quarter, including **Cardinal Health (CAH), Jefferies Financial (JEF), Johnson & Johnson (JNJ), LyondellBasell Industries (LYB), Medtronic (MDT), Paychex (PAYX),** and **Royal Bank of Canada (RY).** Income-Equity (No MLPs) had the same seven hikes plus an eighth increaser: **Phillips 66 (PSX).**
- **Exited positions:** We sold **Broadcom (AVGO)** on valuation concerns after its share price was swept up in the market's excitement over artificial intelligence. We sold **United Parcel Service (UPS)** over continued weakness in business trends.
- **New buys:** We initiated a position in **Conagra (CAG)** based on its high, well-covered dividend. Conagra dominates frozen heat-and-serve meals, a niche that we view as more defendable against store brands than other grocery categories. We also established a new position in staffing solutions company **Robert Half (RHI),** a capital-light business that has a record of producing high levels of free cash flow in a variety of economic environments.

Banks Offer Attractive Dividend Yields —Roughly Twice the S&P 500



Sources: Eikon; Bloomberg. S&P 500 Index members classified under the GICS industry "banks." Dividend yields are market-cap weighted, and members and values are as of calendar year ends 2014 - 2023 with the exception of the current datapoint as of 6/30/2024.

At the end of 2Q 2024, the Fed announced that all major banks had passed this year's stress test, having capital well in excess of what would be required in a severe recession. In turn, banks were able to establish both dividend and share buyback plans consistent with the capital minimums derived from the stress test. All of our large US bank holdings—**Bank of America (BAC), Bank of New York Mellon (BK), JP Morgan Chase (JPM),** and **Goldman Sachs (GS)**—announced dividend increases ranging from 8% to 12%. These dividend increases still require approval from the board of directors, but are highly likely to occur based on previous years.

Over the past 10 years, the average dividend yield for banks has grown to roughly twice the dividend yield of the S&P 500. At the same time, the gap between bank valuations and the broad market has ballooned, creating an interesting investment opportunity in our view. Our discipline is to look for high and rising dividends, boxes that many banks check. We also require strong balance sheets, an element confirmed by the Fed's stress test. To add another layer of safety, we have tilted away from riskier credit categories.

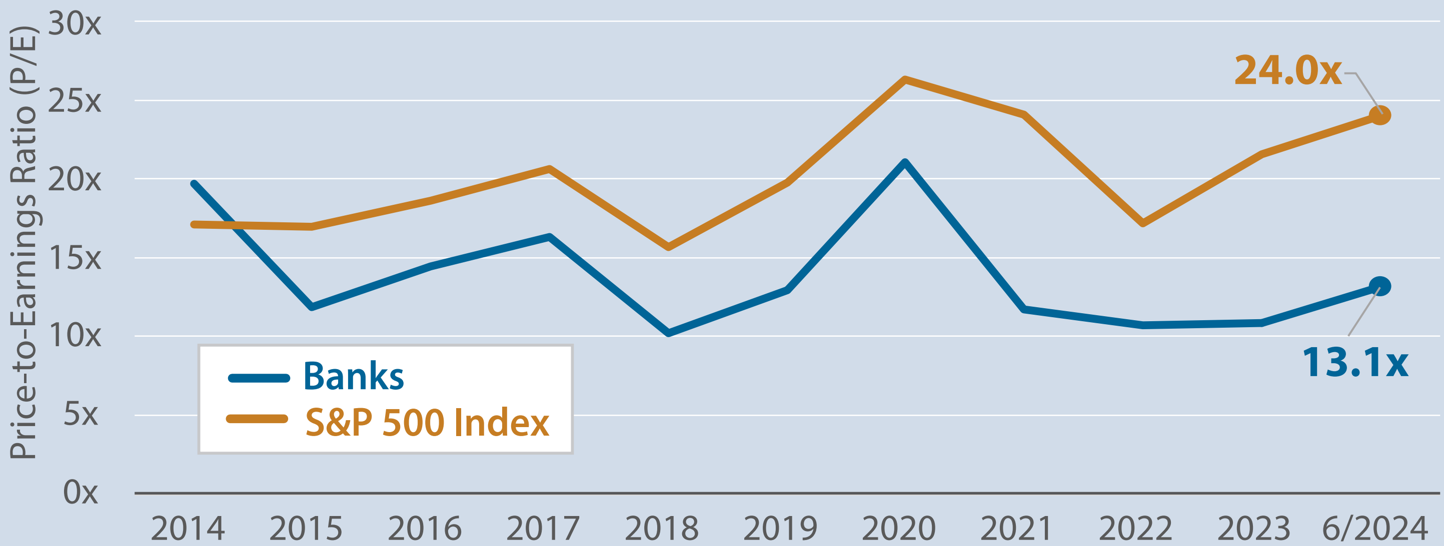
Looking Ahead

Economic news in the second quarter was mixed, with inflation coming down moderately but unemployment rising. We continue to view the environment as highly uncertain and best navigated with a well-diversified portfolio of stocks that have strong financial characteristics. Both Income-Equity portfolios have free cash flow yields and price/earnings ratios that are at a significant discount to both the Russell 1000 and Russell 1000 Value Indices, meaning that current dividends are well-covered by free cash flow and earnings.

In our view, future dividend growth in our portfolios should be driven by growth in free cash flow and earnings. We believe this is best achieved by skewing our holdings towards companies with high free cash flow *margins*—suggesting that they can convert future revenue growth into free cash flow at a high rate. The Income-Equity portfolios have higher average free cash flow margins than the Russell 1000 and the Russell 1000 Value Indices. A meaningful proportion of this advantage comes from our pharmaceutical holdings, **AbbVie (ABBV), Gilead Sciences (GILD), Johnson & Johnson (JNJ),** and **Merck (MRK).**

For the second quarter, both Income-Equity and Income-Equity (No MLPs) outperformed the Russell 1000 Value, but lagged the broad market as it continued to be buoyed by large-cap tech stocks that have low or no dividend yields (and remain outside of our investible universe). The dividend yields of Income-Equity and Income-Equity (No MLPs) remain high relative to the broad market and are 3.8% and 3.6%, respectively.

Gap Between Banks and Broad Market Valuations Has Ballooned



Sources: Eikon; Bloomberg. S&P 500 Index members classified under the GICS industry "banks." Price to earnings ratios (P/Es) are market-cap weighted, and members and values are as of calendar year ends 2014 - 2023 with the exception of the current datapoint as of 6/30/2024.

MLP & Midstream Energy Income

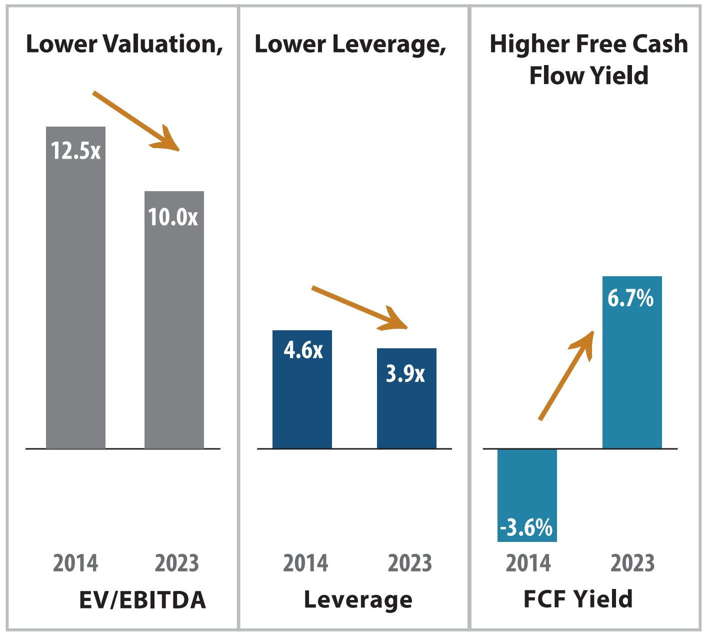
QUARTERLY REPORT 2Q 2024

THE MIDSTREAM SECTOR TURNED IN another good quarter. We see the sector participating in growing thematic tailwinds—long-term natural gas demand trends from liquefied natural gas (LNG) exports and data center electricity demand—that should increase volumes over the long term. Most importantly though, we view these growth drivers as just a small part of the current investment opportunity in the space, as current fundamentals are attractive, even relative to 10 years ago at the 2014 sector peak.

First, during 2023, the sector traded 2.5 turns lower on EV/EBITDA than it did in 2014. We argue that investors are getting a much healthier investment opportunity—but at lower valuation.

Second, the sector has much stronger balance sheets. The sector's EBITDA has been increasing, primarily from new projects becoming operational. Midstream companies have taken some of this windfall to pay down debt. The combination of higher EBITDA and declining debt has resulted in lower leverage, with the midstream energy universe's net debt/EBITDA coming in at 3.9x in 2023—about 15% lower than in 2014. What's more, management teams continue to lower their target leverage ratios.

Better Fundamentals at Lower Valuations



As of December 31, 2023. Sources: Company reports and Miller/Howard Research & Analysis. Capex includes contributions to joint ventures. EBITDA is from company filings and press releases. Enterprise value (EV) includes preferred equity. Based on the midstream energy universe, market-cap weighted.

Third, the sector has much higher free cash flow (FCF). Several years ago, FCF yield inflected from negative to positive and has continued to grow in recent years. Higher FCF can result in several different positive events: dividend increases, debt reduction, share repurchases, or even special dividends. We have seen all of these over the last few years. Many investors rely on the income from midstream energy, and the sector's higher FCF yield demonstrates more financial stability for the midstream companies.

Putting these pieces together—the midstream sector continues to trade at discount to historical levels, but with lower leverage and higher free cash flow. We believe this makes for a compelling reason to take a look at midstream.

Looking Ahead

As we approach the next earnings season, we will continue to monitor the tailwinds for the midstream sector—including LNG exports, reshoring and electrification trends, and updates on AI/data centers, among others. We think that these developments should have a positive impact on midstream gathering, transportation, and storage volumes—ultimately reinforcing midstream as a source of high and growing income for investors.

Portfolio Highlights

- **Distribution increases:** This quarter 4 of our 15 holdings announced dividend increases. The average increase was 17% year-over-year, including a 50% increase from Targa Resources (TRGP).
- **Sales:** We trimmed **NuStar (NS)** as the company was taken over by **Sunoco (SUN)**. We also trimmed **Plains GP Holdings (PAGP)** to deploy cash to a better opportunity. We continue to view PAGP as a core holding.
- **Buys:** We initiated a position in **Oneok (OKE)** as the company is projected to have strong FCF for debt reduction, dividend increases, or share repurchases. We increased our weight in **MPLX LP (MPLX)** as the company offers a high relative yield plus distribution growth to go along with a strong balance sheet.

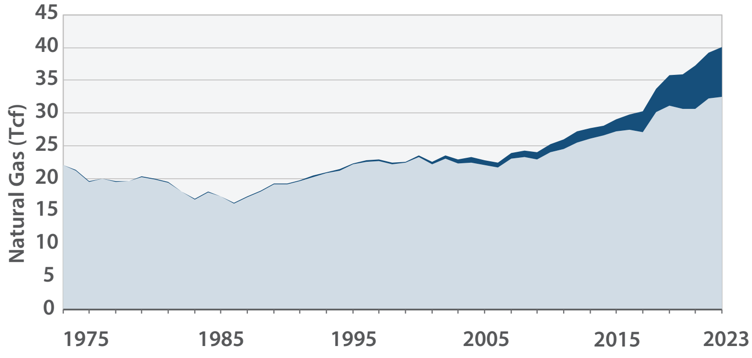
Infrastructure

QUARTERLY REPORT 2Q 2024

FOLLOWING ITS BEST BACK-TO-BACK QUARTERS in two years, our Infrastructure portfolio largely treaded water in the second quarter. While performance couldn't keep pace with the S&P 500 Index, it did outperform the S&P 500 Equal Weight Index—indicating that market strength remains rather narrow and concentrated in mega-cap names.

Within our portfolio, performance was consistent with the market's preference for growth over value. Thematically, natural gas-focused midstream, independent power producers (IPPs), and renewable developers outperformed on growing demand trends. Industrials lagged, as transportation names continue to face volume and margin headwinds.

US Natural Gas Demand Reached Record Highs



As of December 31, 2023. Sources: LSEG; Miller/Howard Research & Analysis.

Looking Ahead

In 2023, US natural gas demand reached record highs, seeing accelerating consumption and liquefied natural gas (LNG) exports. Natural gas consumption has been driven by the power generation sector (despite flat electricity demand for the last two decades), as coal plants continue to be retired and replaced with natural gas (and renewables). LNG exports have also seen rapid growth. After exporting its first cargo in 2016, the US became the world's largest exporter of LNG in 2023.

Going forward, we expect demand to continue to increase thanks to a myriad of catalysts. Electricity demand is poised to inflect higher due to nearshoring, electric vehicles (EV), and data center trends. Natural gas will likely be used to meet a portion of the incremental demand, as renewable power sources will have to be supplemented with on-demand, dispatchable generation from gas. Additionally, LNG export facilities under construction in North America are expected to double export capacity through 2027.

Our Infrastructure portfolio is well positioned to take advantage of these opportunities with exposure in key areas of the energy value chain. We expect utilities to benefit from regulated generation and transmission projects, independent power producers to benefit from tighter power markets, and midstream to benefit from higher throughput volumes. Overall, we feel that these growth drivers should bolster the Infrastructure portfolio's ability to provide a high- and rising-income stream for investors.

Portfolio Highlights

- **Dividend increases:** This quarter, 3 of our 34 holdings announced dividend increases with an average increase of 19% year-over-year, including a 50% increase from Targa Resources (TRGP).
- **M&A: Waste Management (WM)** announced the acquisition of Stericycle (SRCL, not held), a premier provider of medical waste services. While we expect the transaction to prove accretive, we trimmed our position as the acquisition temporarily increases leverage and pauses share repurchases.
- **Trimming positions:** We trimmed **Marathon Petroleum (MPC)** on the expectation that crack spreads would continue to deteriorate.
- **Increasing positions:** We added to **NextEra Energy Inc. (NEE)** and **T-Mobile US (TMUS)** on increased conviction in their long-term outlooks, and to **TC Energy (TRP)** on an attractive valuation.

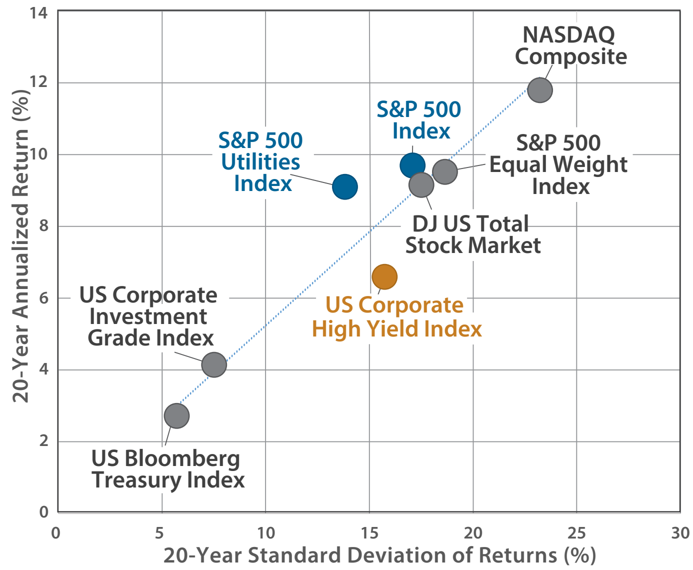
Utilities Plus

QUARTERLY REPORT 2Q 2024

UTILITIES MAINTAINED THEIR MOMENTUM and finished in positive territory for the third consecutive quarter. The sector outpaced the S&P 500 Index for the first time since 4Q 2022 amid a benign interest rate environment and continued excitement around power demand trends. In the first two months of the quarter, utilities were outperforming the broad market by 10% before cooling in June.

Large-cap utilities outperformed mid- and small-cap utilities, and growth outperformed value. This was driven by continued thematic investment during the quarter. Independent power producers (IPPs) led for a fifth straight quarter as rising electricity demand from data center trends remained at the forefront of investors' minds. Renewable developers also outperformed as they began to be identified as additional beneficiaries of rising demand. After leading the sector over the prior year, gas local distribution companies (LDCs) stalled during the quarter.

Utilities Offer the Most Favorable Historical Return/Risk Ratio



20-Year Annualized Return/Risk Ratio	
S&P 500 Utilities Index	0.66
S&P 500 Index	0.57
US Corporate Investment Grade Index	0.55
DJ US Total Stock Market Index	0.52
S&P 500 Equal Weight Index	0.51
NASDAQ Composite Index	0.51
US Bloomberg Treasury Index	0.48
US Corporate High Yield Index	0.42

As of December 31, 2023. Sources: Bloomberg; Miller/Howard Research & Analysis. Based on 20-Year annualized data. See definitions on last page.

Looking Ahead

Investors have long recognized, and wrestled with, the relationship between risk and return. While we acknowledge utilities' recent inability to keep pace with the explosive performance of mega-cap names in an increasingly narrow market, we don't think the discussion is complete without acknowledging risk.

An evaluation of risk-adjusted returns, defined as return divided by the standard deviation of returns (similar to a Sharpe ratio, but excluding a risk-free rate), over the last 20 years paints a very different picture. Utilities offered the most attractive ratio (0.66), surpassing the high-flying NASDAQ (0.51). Utilities' risk-adjusted returns also exceeded bond alternatives as the sector provided superior equity-like returns with modest incremental risk. We continue to believe utilities' ability deliver high and growing income with attractive risk-adjusted returns makes them a compelling solution for client portfolios.

Portfolio Highlights

- **Dividend increases:** This quarter, 4 of our 33 holdings announced dividend increases with an average increase of 6%.
- **New position:** We initiated a position in **American Water Works Company (AWK)** and expect the company to benefit from peer-leading growth that is supplemented by consolidation opportunities across a fragmented industry. In our view, AWK is among the highest quality names in the sector due to its diversified footprint across constructive jurisdictions, track record of execution, and solid balance sheet.
- **IPP Mania:** We trimmed **Vistra Corp. (VST)** for the second quarter in a row as independent power producers leapt on data center demand implications. VST was added to the S&P 500 Index during the quarter, further reinforcing our view that it is a core position.

North American Energy (without K-1s)

QUARTERLY REPORT 2Q 2024

ENERGY STOCKS PULLED BACK, ROUGHLY IN line with oil prices, as economic data were weaker than expected and OPEC+ announced a plan to begin unwinding production cuts later this year. Natural gas prices reversed their steep first quarter losses on a hot start to summer (driving electricity demand for AC) and enthusiasm around rising data center demand. After leading in 2023, Canadian producers lagged this quarter as a key new pipeline faced delays reaching design capacity. Refiners also struggled following a lightning start in the first quarter and as demand for gasoline disappointed.

Looking Ahead

In previous Quarterly Reports, we've reviewed how our research shows that some upstream companies have nearly exhausted their best drilling acreage, requiring a shift to less prolific fields that will likely provide lower returns for these companies. We believe that our proprietary analyses of these producers' remaining drilling inventory serves as a key area of differentiation, informing our portfolio construction.

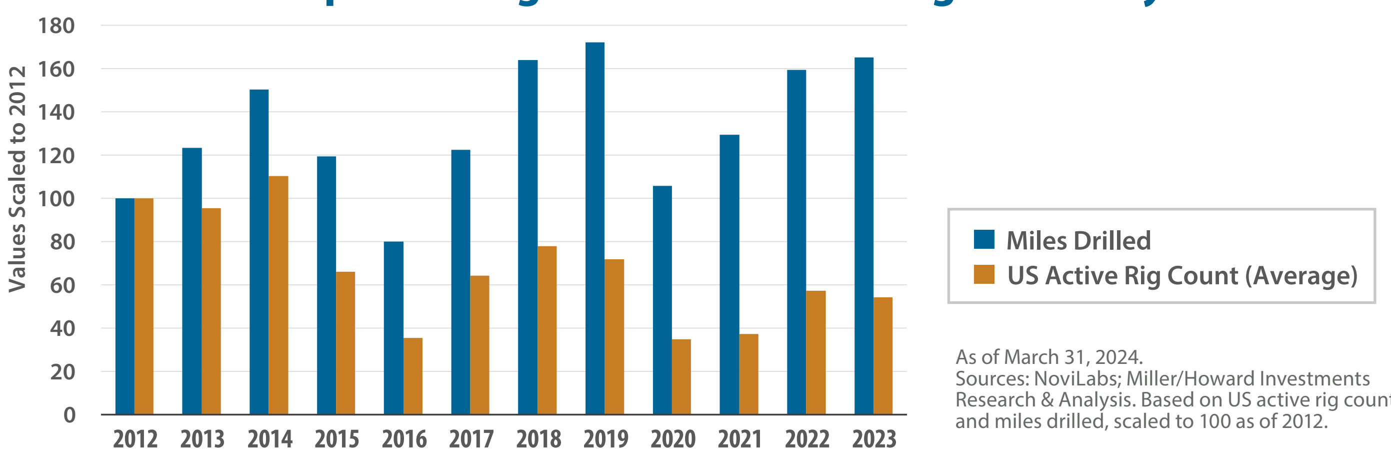
While this work illuminates relative weaknesses among companies, it ignores that the shale industry overall remains technology driven. From the earliest breakthroughs that first allowed commercial production to more recent evolutions in drilling techniques and materials, the shale industry's past and present are dominated by innovations that improve overall efficiencies and drive down costs.

Recently, we examined the number of active US drilling rigs versus the total annual miles these rigs have drilled, scaled to 2012 levels. Last year, the US drilled 60% more miles using 50% fewer rigs than it did in 2012. As total well costs are closely tied to how long it takes to drill, this remarkable efficiency gain represents a step change in the margin profile of US shale, the world's swing producer. This, in turn, is a central reason why we feel the cash and dividend profiles of US shale companies are much brighter than a decade ago.

Portfolio Highlights

- **Energy and income:** The portfolio currently offers an indicated yield of 3.4%, which we project is well-supported down to approximately $40/Bbl oil, combined with significantly larger variable return-of-capital commitments at higher commodity prices. This year, companies are slightly favoring buybacks compared to special dividends, given C-suite views on current stock valuations.
- **Along the energy value chain:** This quarter, we added two new Canadian stocks: gas pipeline operator **TC Energy (TRP)** and oil producer **Cenovus Energy (CVE).** TC Energy has lagged in recent years as it pursued large, expensive expansion projects. We think, however, that strong volume growth in Canada should quickly fill these assets, while high capex comes down, improving free cash flow. Cenovus, a leading oil sands producer, was projected to rapidly grow dividends after reaching its deleveraging targets. One week after our purchase, the company boosted its cash return by 29%.

US Shale Experiencing Remarkable Drilling Efficiency



As of March 31, 2024.
Sources: NoviLabs; Miller/Howard Investments Research & Analysis. Based on US active rig count and miles drilled, scaled to 100 as of 2012.

Small Cap Dividend

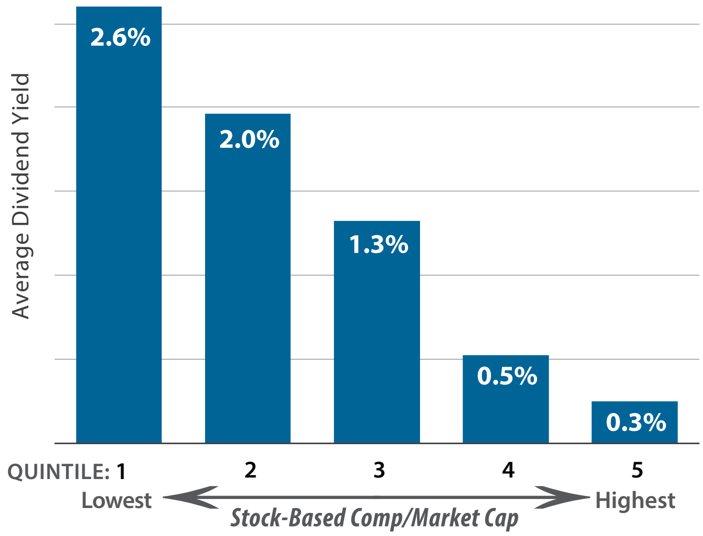
QUARTERLY REPORT 2Q 2024

EVERYONE WANTS TO WIN THE LOTTERY. Given the slim odds of picking a winning ticket, we find it puzzling when money managers also embrace a lottery-ticket approach to small-cap stock selection. In our view, investing in unprofitable, publicly traded ventures is akin to gambling: A few might succeed, but many will see losses.

Shareholders in money-losing companies face an uphill battle for positive returns. The largest hurdle, in our view, is that these investors are swimming against the tide—history shows that profitable and dividend-paying companies, especially among small-caps, tend to outperform over long holding periods. Equity dilution, a common theme among unprofitable companies, also presents a significant headwind. Publicly traded companies that can't rely on internal profits often resort to raising cash by issuing shares. Unfortunately, a higher share count reduces each shareholder's claim on earnings; each investor now has a smaller slice of the pie.

Early-stage ventures also tend to rely more heavily on stock-based compensation (rather than cash-based) to pay their employees. Just like raising equity, "stock comp" increases a company's share count and dilutes existing shareholders. It's our view that profitable, well-run businesses don't need to use stock comp as a crutch. Financially-sound companies are profitable enough to cover their expenses, so they don't need to dilute shareholders just to pay employees. We've found that companies with relatively lower stock comp also tend to have higher dividend yields—this jibes with our view that a strong dividend policy is a signal from management that long-term shareholders should be rewarded, not diluted.

Small-Caps With Less Stock Comp Tend To Have Higher Dividends



As of December 31, 2023. Sources: LSEG; Miller/Howard Research & Analysis. Russell 2000 Index holdings as of December 31, 2022 were quintiled based on FY23 stock-based compensation ("stock comp") as a percent of market capitalization on December 31, 2022. Indicated dividend yields are as of December 31, 2023. Members without data were excluded.

Looking Ahead

It was a relatively slow quarter for small-cap stocks as mega-caps continued to dominate market headlines and returns. Profitable small-caps remain at a meaningful valuation discount to comparable large-caps. This quarter, our Small Cap Dividend portfolio outperformed its benchmark, benefiting from another period of strong relative returns among profitable, dividend-paying, positive free cash flow (FCF) stocks. We remain committed to a quality-focused, small-cap portfolio that should provide greater income potential and better downside protection compared to its benchmark.

Portfolio Highlights

- **Dividend increases:** Nine holdings raised their regular dividend this quarter—**Winmark (WINA), KB Home (KBH), Ethan Allen (ETD), Evercore (EVR), Tegna (TGNA), OneMain Financial (OMF), Brink's (BCO), Matson (MATX),** and **Cabot (CBT).**
- **Special dividend:** One holding declared a special dividend this quarter—**Chord Energy (CHRD).**
- **Sales:** We exited **Adecoagro (AGRO), Lantheus (LNTH), Kulicke and Soffa (KLIC),** and **Universal Health Realty Income Trust (UHT).**
- **Buys:** We initiated positions in **Select Medical (SEM), Organon (OGN), QCR Holdings (QCRH), National Healthcare Corp (NHC),** and **Sunstone Hotel Investors (SHO).**

Yield, Growth, Strength, Stability

- Our Income-Equity portfolios each offer a high dividend yield that is over 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.
- We believe the portfolios are well-positioned for dividend growth throughout the full market cycle.

Income-Equity (with MLPs)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2Q24
Income-Equity Yield	4.2	4.7	4.0	3.7	4.3	3.7	3.6	3.3	3.6	3.7	3.8
S&P 500 Yield	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.8	1.5	1.4
Ratio	2.1x	2.2x	1.9x	2.0x	2.0x	2.0x	2.3x	2.2x	2.0x	2.4x	2.8x
Income-Equity Projected Dividend Growth*	7.5	5.8	5.0	6.3	7.8	7.3	5.1	6.0	6.1	5.5	5.3
S&P 500 Projected Dividend Growth**	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	4.8	4.5	5.0
Ratio	1.6x	1.4x	1.2x	1.5x	1.5x	1.7x	1.5x	1.0x	1.3x	1.2x	1.1x
Income-Equity Dividend Coverage Ratio	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.7x	2.1x	2.1x
Income-Equity Net Debt/EBITDA***	4.2x	2.8x	2.0x	1.9x	1.4x	1.9x	1.9x	1.2x	2.0x	1.8x	2.1x
Income-Equity P/E Ratio Trailing	16.4	14.2	17.2	17.7	12.6	12.8	16.7	14.0	13.6	14.5	14.8
S&P 500 P/E Trailing	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	18.6	21.9	23.9
Premium/Discount	-10%	-24%	-16%	-18%	-23%	-41%	-40%	-42%	-27%	-34%	-38%

Income-Equity (No MLPs)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2Q24
Income-Equity (No MLPs) Yield	4.0	4.6	3.9	3.7	4.2	3.6	3.5	3.2	3.5	3.4	3.6
S&P 500 Yield	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.8	1.5	1.4
Ratio	2.1x	2.1x	1.9x	2.0x	2.0x	2.0x	2.3x	2.1x	2.0x	2.2x	2.6x
Income-Equity (No MLPs) Projected Dividend Growth*	7.7	5.9	5.0	6.4	7.9	7.5	5.2	6.0	6.0	5.6	5.5
S&P 500 Projected Dividend Growth**	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	4.8	4.5	5.0
Ratio	1.6x	1.4x	1.2x	1.5x	1.5x	1.8x	1.5x	1.0x	1.3x	1.2x	1.1x
Income-Equity (No MLPs) Dividend Coverage Ratio	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.8x	2.3x	2.3x
Income-Equity (No MLPs) Net Debt/EBITDA***	2.6x	2.6x	2.2x	2.1x	1.4x	1.9x	1.9x	1.2x	1.8x	1.6x	2.0x
Income-Equity (No MLPs) P/E Ratio Trailing	17.2	16.5	18.2	18.0	12.9	13.5	16.8	14.0	13.8	14.6	15.2
S&P 500 P/E Trailing	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	18.6	21.9	23.9
Premium/Discount	-6%	-12%	-12%	-17%	-22%	-38%	-39%	-42%	-26%	-33%	-37%

As of June 30, 2024. Sources: Bloomberg; S&P; Miller/Howard Research & Analysis. The data above are based on representative accounts in our Income-Equity portfolios both with and without MLPs and are subject to change. Median P/E ratio trailing is published for our Income-Equity portfolios.
* 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.

Sustainable Income Opportunities®

Integrating ESG and fundamental research to provide high and rising dividend income

Including ESG criteria in our investment process gives us a more complete picture of the risks facing a company, the way that company manages those risks, and how the company identifies and seizes opportunities.

STANDARD ESG EXCLUSION SCREENS

COAL MINING	ALCOHOL & TOBACCO	FIREARMS	WEAK GOVERNANCE	CONTROVERSIAL WEAPONS
Companies that extract thermal coal	Companies with significant business in the production of tobacco or alcohol products *	Companies with significant business in the manufacture of firearms or other conventional weapons, and/or their necessary and tailor-made parts *	Companies that show repeated failures to prevent or mitigate serious ESG risks, such as serious and persistent human rights violations or environmental abuses	Companies that provide parts or services that are tailor-made and necessary for the effective function of cluster munitions or nuclear, chemical, or biological weapons

Effective June 30, 2024, our Income-Equity portfolios may include owners or operators of nuclear power generation facilities, resulting in a larger pool of utility sector candidates and aligning with our approach for the Infrastructure portfolio.

*Significant business indicates that >10% of company revenue is derived from the activity.
Exclusion screens are used in our Income-Equity suite and Infrastructure portfolios

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

We continue to evolve and develop portfolios that strive to provide investors with various levels of current income and dividend growth. 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 portfolios include environmental, social, and governance (ESG) research and/or screening, direct engagement with companies, filing shareholder resolutions, proxy voting, coalition building, and/or public policy involvement.

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DEFINITIONS:

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.
Crack spread is the difference in price between crude oil and the petroleum products it's refined into.
MLP = Master Limited Partnership.
Bloomberg US Corporate Index measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg US Treasury Index** measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. **Bloomberg US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. **Bloomberg US Corporate Investment Grade Index** defined as investment grade, fixed rate, publicly issued US denominated corporate taxable securities. **Bloomberg US Corporate High Yield Index** defined as US denominated, high yield, fixed rate corporate securities with a middle rating from Moody's, Fitch, and S&P of Ba1/BB+/BB+. **Dow Jones US Total Stock Market Index** is designed to measure all US equity issues with readily available prices. **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. **S&P 500 Equal Weight Index** includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance. **S&P 500 Sec/Utilities** defined as the companies in the S&P 500 classified as members of the GICS utilities sector. **Russell 1000 Index®** measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000 Index® and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 Index® represents approximately 92% of market capitalization of the US market. **Russell 1000 Value Index** offers investors access to the broad value segment of US equity value universe and is constructed to provide a comprehensive and unbiased barometer of the broad value market. **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. **NASDAQ Composite Index** measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market.

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To receive a list of all recommendations for the previous year, please email compliance@mhinvest.com.

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