Miller/Howard – an MLP ahead of its time

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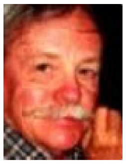

"The individual is always welcome and new and creative beginnings are always possible," according to the Historical Society of Woodstock, N.Y. Fast forward from its founding origins as a township in 1787 to today's era of business consultancies of every stripe, and Miller/Howard Investments Inc. emerges, a boutique investment firm with $8.3 billion of assets under management.

Veteran asset manager Dana C. Troxell, Jr. took on the job of president this past May, joining an already stunning team of investment brain power. Troxell's arrival coincided with the planned retirement of Senior Managing Director, Helen Hamada. Ms. Hamada assumed the position of Senior Advisor and remains on the Board of Directors.

Troxell became a part of one of the most sophisticated investment operations extant. Miller/Howard is located a couple of hours north of Wall Street on a winding idyllic wooded lane at 324 Upper Byrdcliffe Road in a comparatively isolated Woodstock setting – headquartered in a 109-year old home on four thickly wooded acres. While the Chamber of Commerce lists 30 "investment" firms scattered throughout the township and the 287,500 acres of the Catskill Forest Preserve, few if any deal with the complexities involved in the Miller/Howard management of C-Tracks Exchange Traded Notes (MLPC) and The Miller/Howard MLP Fundamental Index™.

The firm has developed proprietary indexing under the direction of Chief Investment Officer Lowell G. Miller for more than three decades. Miller is also the author of three critically acclaimed books on investing, including "The Single Best Investment: Creating Wealth with Dividend Growth" published in 2006 and described on Amazon as a "witty guide." He has also written on financial subjects for The New York Times Magazine, was a featured guest on Louis Rukeyser's Wall $treet Week and Bloomberg TV. He is often quoted in such financial media as The Wall Street Journal, Dow Jones Newswires, Bloomberg, and Barron's.

An Early Performance Measure

The new (one-a-year-old) MLPC, an ETN underwritten by Citigroup, has returned about 18.55 percent compared with the JP Morgan Alerian Index MLP over the same time period (August) which returned only 16.65 percent, according to one outside analyst.

Citigroup explains C-Tracks to investors this way: they are designed for investors who seek exposure to the performance of the Index and any distributions paid on the securities included in Index. The Index is a rules-based proprietary index developed by Miller/Howard Investments, Inc., designed to measure the performance of 25 master limited partnerships (MLPs) selected by a methodology based upon quantitative fundamental factors of publicly traded MLPs. The methodology tracked by the Index is intended to provide exposure to a target basket of 25 MLPs selected using specific factors of MLPs, including distribution growth, estimated capital expenditures and distribution coverage. The methodology aims to achieve this through a quarterly, rules-based selection of MLPs to be included in the Index for the following quarter based on certain observable fundamental factors.

So who's behind this innovative creation in the rapidly changing investment world? The "why" of its creation is fairly obvious, of course, because, as Lowell Miller has phrased it, "We like to call MLPs 'utilities without walls' because they have similar capital structure, but they aren't limited as to how they grow."

The MLPs have something that very few of the other dividend stocks have. They have a tremendous tailwind, Lowell Miller has noted, calling it the "North American energy revolution." The MLPs are in this peculiar situation where they have the highest yield in the market but they also have a really strong growth story. Very few other groups can boast of this tremendous growth.

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Master Limited Partnerships are a type of limited partnership whose units most often trade like a stock on a public stock exchange, provided certain requirements are met. By law, MLPs must derive at least 90 percent of their income from select sources, notably energy, natural resources or real estate, and must pay out most of their cash flows as quarterly distributions.

As forecast by the International Energy Agency, created in response to the early 1970s oil crisis by the Organization for Economic Co-operation and Development, there are hundreds of billions of dollars of U.S. midstream assets that can potentially find their way into the MLP structure. In addition, it is estimated that $130 billion to $160 billion will be needed for new pipeline infrastructure development from 2009 to 2030 as the petroleum industry enters into a new "Golden Age of Natural Gas."

Rising Dividends Must Rule

Miller/Howard portfolios invest in companies across the broad markets that are financially strong with the ability to pay and consistently raise dividends. Firm portfolio strategies include: income-equity broad market stocks, master limited partnerships (MLPs), utilities, infrastructure, and components of the energy commercial value chain.

Because the investment professionals, from classroom to boardroom, often quote from Lowell G. Miller's writings as though they were Biblical teachings, it behooves the wise investor to at least peek into the 265 pages of "The Single Best Investment: Creating Wealth with Dividend Growth." Take for example, this excerpt that very well may constitute the heart and soul of the Miller/Howard philosophy:

"A moment's reflection will confirm for you that this is an absolutely powerful secret, and yet there are very few investors actually using it. If this were not the case, if this factor were in widespread use, you would see a nation of happy investors whistling their way toward retirement. But you don't. All you see are nervous nellies, checking the price of the Dow Jones daily and intra-day, scanning the most-actives list for some key to the future, subscribing to the newsletters filled with hyperbole and sketchy research, breathlessly hanging on every word of some smug talking head on the business news channel.

"This hidden key is, in a simple phrase, dividend growth.

"As we know, mature companies pay dividends from their earnings. Every quarter the company sends a check to investors, sharing a small fraction of the profits, and many investors love those checks. The feature that few have heeded, though, is that a significant number of companies raise their dividend every year (or nearly every year). To most, this seems merely a nice amenity, but because most people don't have a long-horizon worldview, they totally underestimate the potency of this factor. It is, in fact, the electricity that will make your compounding machine run. It's the gas for your engine. Dividend growth is the critical piece in the puzzle for creating a portfolio that will serve you over the years.

"Pay attention. This is a simple idea, but is also the single most important idea for long-term investors. The reason it is so important is that dividend growth drives the compounding principle for individual stocks in a way that is certain and inevitable. It is an authoritative force that compels higher returns regardless of the other factors affecting the stock market.

"Let's say you have two bonds with equal credit ratings and equal time to maturity. Bond A pays you $100 per year and bond B pays you $200 per year. Which bond will have a higher price? Of course bond B will sell for twice the price as bond A, at which point they will both offer the same percent yield. The important point is that an instrument that produces income is valued based on the amount of income it produces. And if it produces more income, it is worth more. The same would be true for, say, an apartment building—the more income it produces, the higher the market value. Or a hardware store—again, the more income, the more an owner could get for the store if he wanted to sell the business.

"What makes rising income that comes from a growing dividend so attractive in a yield stock? You not only receive greater income as the years go by, you also get a rising stock price—because the instrument producing the income (the stock) is worth more as the income it produces increases. In effect, you get a 'double dip' when you invest in high-yield stocks that have rising dividends. You get the income that increases to meet or surpass inflation, and you get the effect of that rising income on the stock price, which is to force the stock price higher . . .

"And I can repeat, and repeat, so you don't forget: you get rising income, and the increasing income makes the stock that's producing that income increasingly valuable." ■

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$$\ln(tu) = \int_1^{tu} \frac{1}{x}\,dx \overset{(1)}{=} \int_1^{t} \frac{1}{x}\,dx + \int_t^{tu} \frac{1}{x}\,dx \overset{(2)}{=} \ln(t) + \int_1^{u} \frac{1}{w}\,dw = \ln(t) + \ln(u).$$

When you get into the proprietary nature of Miller/Howard operations you are likely to run into complexity far more complicated than this fundamental:

Don't worry, it's not contagious. Basically, after all candidate MLPs have been narrowed down to, say for example, an elite 25 to 40, MLPs are subjected to further ranking and filtering according to the quantitative fundamental factors: Distribution Growth, Estimated Fiscal Year Capital Expenditure, and Distribution Coverage. Without revealing proprietary tasking, Miller/Howard makes available in great detail just how it goes about doing this on the company website (**http://www.mhinvest.com/home.html**).

The Miller/Howard MLP Fundamental Index™ is rebalanced to their target equal weights each quarter. After index constituents are selected on the quarterly selection date, the notional number of units will be determined during the rebalancing period. For each Index Constituent the number of units is determined according to proprietary formulae.

The Part 2B of Form ADV: Brochure Supplements on file with the SEC further explores details and direct queries may be directed to Miller/Howard by Email: marilyn@mhinvest.com.

Miller/Howard also advises others on investments, including firms that subscribe to Socially Responsible Investing (SRI), involving the integration of environmental, social and corporate governance (ESG) criteria with financial standards when making investment decisions. Miller/Howard believes that this integrated approach provides a framework for achieving better long-term investment returns while building sustainable global economies and markets.

The main factors considered for each potential investment are governance and ethics; environmental record; workplace issues; human rights, especially regarding international operations; products and services and their contribution to revenues. Miller/Howard does not invest in companies that produce alcohol, tobacco, gambling equipment or firearms. The firm is on record as stating Miller/Howard views this extra layer of due diligence as a risk control measure.

In line with its ESG endeavors, Miller/Howard this past June strongly endorsed the Environmental Protection Agency's proposed standards cutting U.S. carbon dioxide emissions 30 percent by 2030 from 2005 levels.

That endorsement issued from the firm's wooded encampment in the historical Woodstock Township pretty much added to Woodstock history; because U.S. energy related businesses have not since the industry's origins in 1859 exactly "hastened" to endorse such emission reductions, according to records maintained by the American Petroleum Institute. The API shows that began to change about five years ago with the 2009 Compendium of Greenhouse Gas Emissions Methodologies.

"The (EPA) standards will be the first national comprehensive effort to combat one of the key causes of climate change," said Lowell Miller. "Climate change creates additional risk for investors. These standards will help reduce risks."