

PRODUCTS SUMMARY

MLP STRATEGY

A high yielding portfolio (with tax-deferred income) primarily composed of high-quality pipelines and energy facilities, with strong prospects for growth of distributions. Holdings generally have utility-like businesses, with much less restraint on growth than conventional utilities, that we believe will increase distributions faster than inflation or typical common stocks.

INCOME-EQUITY STRATEGY

A diversified dividend-growth strategy providing high current income, growth of income, and growth of underlying principal. Stocks are conservative, high quality, high yield, and are projected to have a rising stream of income.

GLOBAL UTILITIES + INFRASTRUCTURE

Providing both rising income and growth, the portfolio focuses on opportunities in the broad utilities industry: electric, gas, telephone, sanitation and water. Investors participate in both the stability and the dynamic growth of the most important economic sector — with environmentally friendly companies.

EXECUTIVE SUMMARY

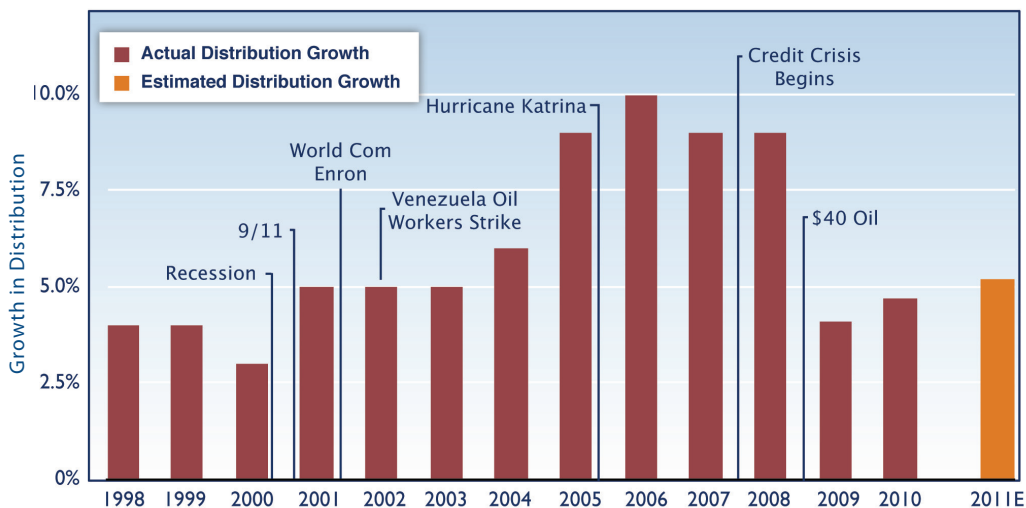
MLPs Defined

Master Limited Partnerships (MLPs) are publicly traded partnerships offering high tax-deferred income and growth of income. They are designed to pass through cash flow to unit-holders (limited partners) without prior corporate taxation. They are traded on national exchanges and may be bought or sold at any time, just like stocks. Many are highly liquid. With a few exceptions, MLPs hold and operate assets related to the transportation and storage of energy. While there is minority exposure to commodity prices, for the most part MLP revenues derive from the volume of products shipped or stored.

Why We Invest in MLPs

Since the format began to develop about 10 years ago (the actual assets and operators are far older) our research indicates that the group has been one of the best performing US equity segments, far outpacing the broad indices. Cash distributions and the annual increases in cash distributions have also been among the highest for any group.

Growth of Annual Distributions - Alerian MLP Index



Note: this is not the total distribution but the percentage of increase in distributions each year.
Source: Citi January 2009, and Wells Fargo Securities-MLP Monthly January 2011

MLPs have been an excellent fit for our basic investment model: we favor the stability of cash flow, the distribution of increasing cash flows to investors, the effect of increasing distributions on unit prices, and the general transparency of the organizational structure.

We think of MLPs as similar to utilities in the sense that they provide a “toll-based” service supplying constant demand. Unlike utilities, we project that growth for an individual MLP could be theoretically unlimited. A great deal of MLP revenues are market-based and unregulated, but when MLPs operate under regulation it is generally through the Federal Energy Regulatory Commission, which we have found to be more rational and liberal than most state regulation.

MLP distributions, historically larger than most other publicly traded securities, are generally tax-deferred. Because MLPs have high depreciation expenses and sometimes can take advantage of other special credits or deductions related to the energy industry, the cash distributions are typically treated as return-of-capital for tax purposes. Many commentators have suggested that 80-90% of distributions are tax-deferred, but that in our experience is a conservative estimate.

As with the depreciation deductions for Real Estate, the “return-of-capital” designation of the income for tax purposes means that a taxpayer’s tax cost basis is reduced each year by the amount of the untaxed distribution. In theory, upon sale the difference between the aged tax cost (reduced basis) and the original real cost would be recovered as ordinary income, with any market gain in the MLP price taxed as long-term capital gains. But the paper “losses” reported annually from each MLP may be carried forward, and this would offset much of any potential ordinary gain.

Any losses for tax purposes are considered passive losses, not deductible from other ordinary income, and may be used only to offset any (future) income on the specific MLP from which the losses were generated. For a taxable investor, losses may not be aggregated among a group of MLPs.

In theory, investors must also file state income tax returns in states where the MLPs do business. In our experience to date, the MLPs we invest in have not shown positive “ordinary income” for state tax purposes. This could change over time, though the income actually categorized as ordinary income could be de minimis and may fall below the need to file returns in a given state. (Investors should consult a tax adviser or accountant. Our information is provided as a convenience to investors and should not be construed as tax or legal advice).

What Happens When MLPs Are Sold

When taxable investors sell MLP securities, the MLP, which keeps all partners’ records, provides the cost basis and gain/loss report. Miller/Howard and/or the custodian/broker would not generate this report.

Interestingly, as publicly traded securities, upon passing into an estate, an MLP’s tax basis is marked to the market on date of death just like any other security—thus any reduction in basis due to prior payouts is eliminated for beneficiaries.

TAX IMPLICATIONS FOR THE TAXABLE INVESTORS

Because MLPs are pass through entities, they generate annual K-1 reports for investors. These reports are used when filing taxes to report income, expenses, and other accounting details. Nearly all of the MLPs that we hold or have held in our portfolios make their K-1s available online by the beginning of March, in time for normal tax filing. In our experience the standard tax-preparation software packages can accommodate these securities and their reporting requirements.

The URL below is a link to **K-1 Tax Package Support Contacts**. It lists each MLP and their respective contact information. <https://www.taxpackagesupport.com>

TAX ISSUES FOR NON-TAXABLE INVESTORS

The primary issue for non-taxable investors is the possibility that MLPs may generate Unrelated Business Taxable Income, or “UBTI”, which would be subject to Unrelated Business Income Tax under the federal code. UBTI is not a transgression or rule violation, nor does it generate a penalty. UBTI does not include the entire cash distribution, only the portion designated as “ordinary income” after all normal expenses are taken into account—which often is a fraction of the total distribution. In our experience, the MLPs we use have not generated significant ordinary income. In any event the IRS provides for a \$1,000 annual exclusion of UBTI, and for this purpose the gains and losses of all MLPs held may be netted.

For a charitable organization or a pension fund, UBTI would be reported to the IRS on form 990T. For IRA holders, the situation is even simpler. The IRA trustee (custodian) is required to file form 990T if necessary, and to pay any tax due from the holder’s IRA account on the net income from aggregated MLP gains and losses. While the potential UBI tax due is remote, the IRA account holder needs to provide the custodian with a copy of all K-1s received.

TAX ADVANTAGES

- Considered pass-through entities by the IRS, MLPs do not pay tax at the corporate level and avoid the double taxation of most corporations.
- Most MLPs have more than 80% of their cash distributions allocated as “tax-deferred”.
- For example, assume an MLP with an 8% yield (e.g. \$0.80 distribution on \$10 unit price). If 80% is deferred income, only 20% (\$0.16 of the \$0.80 distribution) will be taxed at the ordinary income tax rate, the after tax yield is 7.4% (\$0.74/\$10).

PRO-FORMA AFTER TAX EXAMPLE	
MLP Unit Price	\$10
Distribution	\$0.80
Taxable Income	\$0.16
Tax-Deferred Income	\$0.64
Effective Yield	8.0%
Taxable Yield	1.6%
Tax-Deferred Yield	6.4%
Tax Owed (35% of \$0.16)	\$0.06
After Tax Distribution (\$0.80 minus \$0.06)	\$0.74
After Tax Yield	7.4%

Note: State taxes may apply and are not included in this example. The information and analyses contained herein are not intended as tax, legal or investment advice and may not be suitable for your specific circumstances; accordingly, you should consult your own tax, legal, investment or other advisors, at both the outset of any transaction and on an ongoing basis, to determine such suitability. Any investment returns, past, hypothetical or otherwise, are not indicative of future performance.

An example: Taking what is under present circumstances a worst-case scenario, let us assume that an organization had \$1,000,000 in MLP distributions. If 10% of that (\$100,000) were considered “ordinary income” net of any other MLP losses, the plan or fund would pay roughly \$35,000 in tax, reducing the total income to \$965,000. Considering the fact that the distribution *income-only* return was about 6% and the total returns (including appreciation) have been historically in excess of the broad market, we believe it is in the best interest of investors to consider any tax that might arise as a small cost of doing business.

Some observers have suggested avoiding use of MLPs in non-taxable accounts. We disagree with this view.

SUMMARY

MLPs, in our opinion, are an excellent way for investors to participate in the operation and growth of the US energy infrastructure. Since the entities do not pay corporate tax, there is more cash flow available to distribute to investors, and the units have the potential to offer higher yields and greater growth than competitive investments such as utilities or REITS, with advantageous tax treatment.

Though there is a slight burden of extra filing, we believe the investment results are well worth the minimal extra tax-preparation effort. For non-taxable investors there is a chance of generating UBTI with an associated tax. In the event that some UBTI is generated, we believe it warrants consideration as a normal business expense in the interest of participating in an investment area that has the potential to offer high income (net of any tax), high growth of income, and high total returns with low correlation to other assets.

PORTFOLIO TEAM

Lowell G. Miller, founder and CIO received a BS from Sarah Lawrence College and JD from New York University School of Law. He has continuously pursued the notion of disciplined investment strategies for over 30 years. He authored three acclaimed books on investing including the recently published *The Single Best Investment*, 2nd. Ed. (Print Project, 2006). Lowell has been responsible for portfolio construction since inception of the firm.

John E. Leslie III, CFA, research analyst and PM, received a BS in Finance from Suffolk University and an MBA from Babson College. He began his career in investments over twenty years ago and has focused on equity income stocks since 1987. Previously, John was a portfolio manager at Value Line Asset Management, M&T Capital Advisors Group (Division of M&T Bank), and Dewey Square Investors (Division of UAM). He brings expertise in both fundamental and quantitative research skills. John joined the portfolio team in 2004.

Bryan J. Spratt, CFA, research analyst and PM, earned a BA in Economics/Computer Science from Spring Arbor College (summa cum laude). He has worked as an analyst and portfolio manager since 1994. At Munder Capital (1994-2001) Bryan was a member of the Energy and Power Team that developed and managed the Munder Power Plus Fund, among other portfolio management responsibilities. He joined the portfolio team in 2004.

Roger G. Young, CFA, research analyst and PM, earned a BS in Economics from Wharton School, University of Pennsylvania; Bachelor of Foreign Trade, Spanish language, from Thunderbird School of Global Management; and an MBA from Michigan State University. Roger began his career in the investment industry 38 years ago. During his career, he started and managed the Transamerica Capital Appreciation Fund, which received a five star ranking by MorningStar. Roger joined the portfolio team in 2008.

FIRM BACKGROUND

Miller/Howard Investments, Inc., is an SEC registered employee-owned management firm with over 18 years experience managing portfolios for major institutions and individuals in disciplined dividend-focused investment strategies. We emphasize high quality stocks with high yield and strong dividend growth. We offer clients the opportunity for capital appreciation, current income, and growth of income. We have been investing in MLPs for over 10 years in our various investment portfolios.

Visit our website at www.mhinvest.com to view a variety of further information sources on MLPs.

IMPORTANT NOTES

This material was not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

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