

SPEAKING OF DIVIDENDS ■ by Shirley A. Lazo

Payout Partnership

One investment firm's take on the real measure of value

MILLER/HOWARD INVESTMENTS HAS crafted an insightful report on the upside of dividends. The 25-year-old independent employee-owned firm, whose focus is on high-quality dividend growth portfolios, believes the considerable hysteria about dividend reductions could be mollified by a diligent peek behind the headline numbers to see what is really happening.

While payout cuts and omissions have risen sharply, and the increase-to-decrease ratio has worsened, "the changes of late have been quite narrowly focused on financial companies, companies that rely on financing and companies that are sensitive to declines in economic activity." This applies to the big dividend cuts or payout omissions by money-center banks, insurance majors, General Motors, General Electric, Pfizer and Dow Chemical, to name a few.

At the same time, however, Miller/Howard, which is based in Woodstock, NY, is seeing dividend enhancements across all of its portfolios: "Sectors such as health, consumer nondurables, pipelines, telecommunications and utilities continue a regular course of dividend increases as though existing in a different world, a world of ample cash flow."

Historically, says Miller/Howard, dividend stocks have performed extremely well after bear markets in general and after recession-induced bear markets in particular. Therefore, investors should

strive to insure dividend stability in difficult times and seek dividend growth for long-term compounding.

Miller/Howard does that in several ways. With some exceptions, it likes to see cash flow cover a dividend by about 3-to-1. It prefers that interest charges are covered 4-to-1 by earnings before interest, taxes, depreciation and amortization. Except for utilities and a few others, it favors earnings at 2-to-1, relative to dividends. In the firm's view, it is also important to know the schedule of debt due and the current resources available to pay it. In addition, it is crucial to determine how sensitive a company is to economic conditions (does it make auto parts or sell groceries?). It recommends listening carefully to what management says, and being mindful of tax rulings that may influence how a company views its dividends.

Miller/Howard has five investment strategies: income-equity, rising dividend-plus, distribution/merging utilities, global utilities + infrastructure and MLP (master limited partnership) strategy.

In the income-equity with MLPs group, Colgate-Palmolive (ticker: CL) is, in the words of Miller/Howard, "a poster child for the kind of company we find most appealing at this point" – it sells popular disposables globally, markets its brands brilliantly, is a beneficiary of falling commodity prices and has a moderate valua-

tion, though "on the low side of our yield spectrum."

Miller/Howard said that for most of the first quarter, its returns in this portfolio "were far less negative than the broader market." A few of its other picks: CMS Energy (CMS), Northeast Utilities (NU), Abbott Labs (ABT), Genuine Parts (GPC), McCormick (MKC), Bristol-Myers Squibb (BMY), Thomson Reuters (TRI) and American Water Works (AWK).

Genuine Parts and McCormick sold off on weak earnings and guidance, but Miller/Howard continues "to place more credence in management's guidance through dividend increases than in the vacillating opinions of analysts and their penny-up-penny-down mentality."

As for the kinds of stocks it favors, the firm says, "We continue to believe that companies with a recurring business model, financial strength, protected and durable markets, and a continuing partnership with investors in the form of dividends are the right place to be in a world where certainty and visibility are, broadly speaking, as low as we can remember."

And it adds, "When a company raises dividends today, in an environment where there is so little competitive or peer pressure to raise, we think it speaks volumes about the company's true situation, its true prospects, its true view of shareholders, and the decisiveness and boldness of management." ■

This is a reprint of an article that appeared in Barron's on May 11, 2009. Opinions and estimates offered constitute the judgment of the author and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. Dividend yield is one component of performance and should not be the only consideration for investment. For more information, contact Miller/Howard Investments at (888)282-8845.

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