Utilities Plus

QUARTERLY REPORT 4Q 2024

AFTER FOUR CONSECUTIVE QUARTERS OF positive performance and their best quarter in over 20 years, utilities stalled late in the fourth quarter. Interest rate headwinds resurfaced as the yield on the 10-year Treasury increased roughly 80 basis points in the quarter. While the Federal Reserve continued to cut rates, in December, the Fed indicated that it expected fewer rate cuts in 2025 amid higher-than-anticipated inflation. Utilities outperformed the broad market through the first three quarters of 2024 before losing ground through year end. Despite the disappointing conclusion, utilities recorded their strongest calendar year performance since 2019.

Within the group, independent power producers (IPPs) finally took a breather amid lingering uncertainty around co-location. Top performers generally had more idiosyncratic drivers like strategic actions, positive regulatory developments, or strengthening growth profiles. Water utilities and renewable developers lagged the group on interest rate sensitivity and concerns that the Inflation Reduction Act could be modified in 2025.

Looking Ahead

Utilities' unique regulatory structure is designed to provide a reasonable and consistent return on investment. It therefore seems intuitive that their earnings would be easier to project, particularly when looking out more than one year. The difference between actual EPS and two-year forward consensus estimates corroborates this idea. Over the last 20 years, reported EPS for the S&P 500 Index and utilities were above/below the two-year estimate a similar number of times. However, the standard deviation of this difference was nearly 3x higher for the S&P 500 compared to utilities. Current two-year forward EPS estimates suggest the broad market's growth will exceed utilities' growth by 2% per year. We question this excess growth in the context of the higher forecasting error for the S&P 500—with limited visibility into inflation, interest rates, and policy changes.

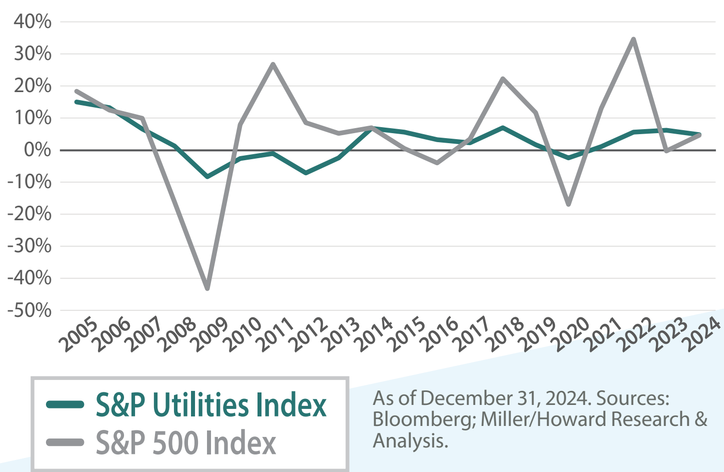
Despite a host of reasons to feel more confident in their EPS forecasts, utilities trade at greatly discounted levels to the market based on forward price-to-earnings ratio (20%), creating a constructive backdrop for risk-adjusted returns in our view (a topic discussed in our 2Q 2024 Quarterly Report). We continue to believe that 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, 10 of our 32 holdings announced dividend increases with an average increase of approximately 20%—including a 150% increase declared by **PG&E Corp. (PCG).**
- **Risk management:** We trimmed our position in **Vistra Corp. (VST)** after a period of continued outperformance. VST was the second-best performing name in the S&P 500 this year, as the company is a key beneficiary of growing electricity demand from data center and artificial intelligence (AI) trends. Despite trimming the name in both the first and second quarters, VST was our highest weight at the time of the trim.
- **Increased conviction:** We added to our position in **PG&E Corp. (PCG)** and expect it to benefit from peer-leading EPS growth and a discounted valuation.

Utilities Have Lower Forecasting Error

Actual vs 2-Year Forward EPS Estimates



As of December 31, 2024. Sources: Bloomberg; Miller/Howard Research & Analysis.

Miller/Howard INVESTMENTS

Utilities Plus Leaders and Laggards

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LEADERS ◊

Vistra: VST raised 2024 and 2025 guidance. The company continued to benefit from data center and AI trends based on its market exposures and fuel diversity (nuclear and natural gas).

Entergy: Increased its capex and long-term EPS growth guidance due to higher-than-expected load growth stemming from META's (not held) plans to build a $10B AI data center in northeast Louisiana.

NiSource: NI initiated in line 2025 guidance and raised its capex plan. NI highlighted that its long-term EPS compound annual growth rate (CAGR) of 6%-8% does not include upside from data center opportunities.

MDU Resources: MDU completed the spinoff of its construction services subsidiary, increased earnings guidance for its regulated businesses, and announced a higher capital investment plan for 2025-2029.

CenterPoint Energy: CNP initiated 2025 guidance slightly above expectations, raised its 10 year capital plan, and made progress on normalizing its regulatory relationships in the aftermath of Hurricane Beryl.

LAGGARDS ◊

Constellation Energy: CEG raised 2024 EPS guidance and reaffirmed its long-term growth rate. Lingering uncertainty around colocation weighed on the name.

NextEra Energy: 3Q results beat and included strong renewable backlog additions. Renewable developers came under pressure on concerns the Inflation Reduction Act could be modified.

AES Corp: 3Q results were messy and included a reduction in 2024 EBITDA (w/o tax credits) guidance. Renewable developers also faced pressure from concerns that the Inflation Reduction Act could be modified.

American Electric Power: AEP provided mixed guidance with lower-than-expected 2025 EPS but a higher long-term growth target. AEP increased its 5-year capex plan which left questions on the company's equity and/or asset monetization plans.

Southern Co: SO raised 2024 guidance. While SO has several opportunities to increase rate base growth, its own sensitivity analysis highlighted it was going to take a lot to move the needle given the company's current size. Hurricane Helene was the most destructive storm in Georgia Power's history.

◊ By contribution to return. To obtain our methodology for calculating the best- and worst-performing securities, as well as a list of the contribution to performance of each security listed, please call us at 845.679.9166. The holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. This list is not a recommendation to buy, sell, or hold these securities.

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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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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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