Otter Tail Corporation (OTTR)

Updated February 20th, 2019 by Josh Arnold

Key Metrics

Current Price:	$50	**5 Year CAGR Estimate:**	4.9%	**Volatility Percentile:**	18.5%
Fair Value Price:	$44	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	83.5%
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Growth Percentile:**	34.3%
Dividend Yield:	2.8%	**5 Year Price Target**	$56	**Valuation Percentile:**	30.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	23.0%

Overview & Current Events

Otter Tail Corporation goes back to 1907 with its electric utility, which was founded in Fergus Falls, MN. The company eventually expanded into metal fabrication and plastics manufacturing and today, it has about $950 million in annual revenue split between utility, manufacturing and plastics operations. Otter Tail has a $2 billion market capitalization.

Otter Tail reported Q4 earnings on 2/18/19 and results were okay, capping a good year for 2018. Total revenue was up 7% in Q4 thanks to continued rate base growth from the Otter Tail Power Company. The company also continues to achieve strong results from its manufacturing and plastics businesses, which are seeing steady demand and better margins. This helped offset some headwinds from the company's power generation business given that 2018 was a particularly warm year, leading to fewer heating days, which reduces demand.

The company received approval for a revenue increase in North Dakota, as well as an interim increase in South Dakota that should be resolved fully for 2020. Also, the Big Stone South-Ellendale line, a 345-kilovolt regional transmission project Otter Tail co-owns with another utility, was energized in February 2019, subsequent to the end of the quarter.

In total, earnings-per-share for Q4 fell from 46 cents to 35 cents year-over-year. The decline was due to much higher operating and maintenance expenses, as well as higher depreciation from the year-ago period. This led to significantly lower earnings for the plastics and manufacturing segments, respectively, while earnings from the power business were fractionally lower.

Management offered up guidance for 2019 of $2.10 to $2.25 in earnings-per-share; our initial estimate for this year is the midpoint of that range at $2.18.

The company also raised its dividend by 4.5% to $1.40 per share annually.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.71	$0.38	$0.45	$1.05	$1.37	$1.55	$1.56	$1.60	$1.86	$2.06	***$2.18***	***$2.78***
DPS	$1.19	$1.19	$1.19	$1.19	$1.19	$1.21	$1.23	$1.25	$1.28	$1.34	***$1.40***	***$1.80***
Shares	36	36	36	36	36	37	38	39	40	40	***40***	***42***

Otter Tail's earnings-per-share history has been fairly strong in the last decade, as earnings bottomed in 2010 and have grown every year since. Guidance for this year is for ~$2.18 and we see average growth of 5% going forward. Otter Tail will achieve this growth via revenue increases from its utility business – which is looking stronger now that North Dakota and South Dakota have approved rate increases – as well as continued strong performances in its other two, non-utility lines of business. It continues to increase margins as well and the diversification it offers over other utilities is certainly a strength that is showing its value. The company's manufacturing and plastics businesses have benefited from higher order rates as well as a lower income tax rate, while seeing gross margins tick higher over time. The higher operating expenses seen in Q4 are uncharacteristic for Otter Tail, so we don't see any long-term impairment just yet. We see all of these factors as continuing until further notice and as a result, earnings should grow steadily in the coming years. Otter Tail's full rate case in South Dakota is still pending, but the company has a favorable relationship with its regulators, so we are optimistic that Otter Tail will continue to receive the rate increases it needs to grow revenue.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Otter Tail Corporation (OTTR)

Updated February 20th, 2019 by Josh Arnold

The dividend was stagnant from 2008 to 2013 as Otter Tail was not able to cover the payout with earnings. However, that situation has rectified itself as the company has managed to produce some robust earnings growth and as a result, the dividend is being raised again. This is an important factor for the stock and we see modest payout growth ahead.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	31.2	55.1	47.5	21.7	21.1	18.8	18.2	20.2	22.1	22.2	***23.2***	***20.0***
Avg. Yld.	5.4%	5.7%	5.6%	5.2%	4.1%	4.1%	4.3%	3.9%	3.1%	2.9%	***2.8%***	***3.2%***

The stock's price-to-earnings multiple has moved significantly lower in recent years after being artificially inflated due to low earnings-per-share from 2008 to 2011. However, today's multiple of 23.2 is in excess of its recent historical norm of 20 and as such, we see the stock as overvalued here. We think shares will drift back towards a multiple of 20 over time, causing a modest 2.9% headwind to total returns. The yield should remain near where it is today at 2.8% as dividend increases keep pace with the stock and Otter Tail remains a decent income stock choice among utilities.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	--	--	--	113%	87%	78%	79%	78%	69%	65%	***64%***	***65%***

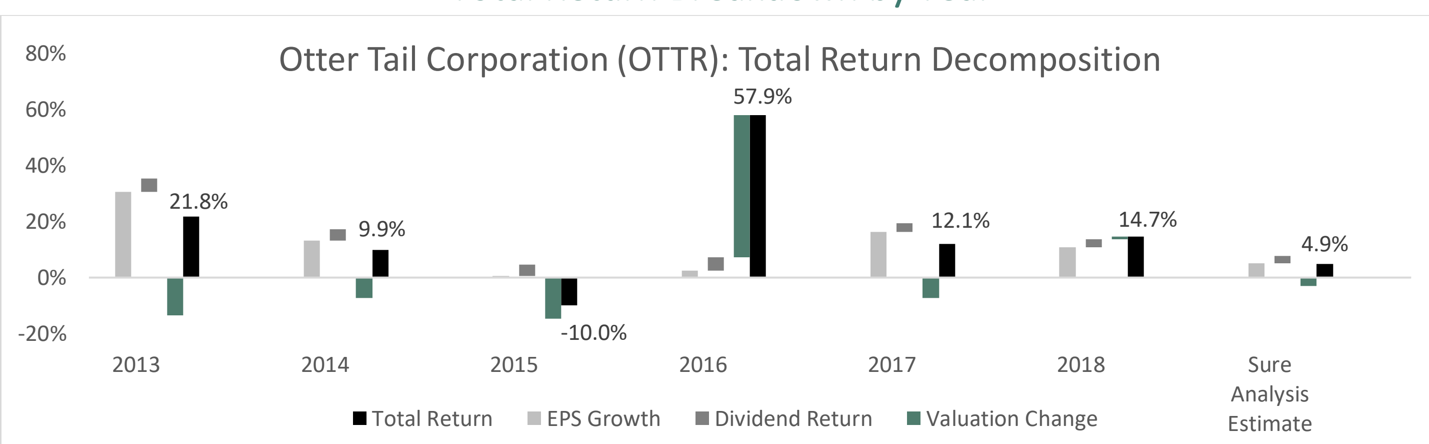
Otter Tail's payout ratio remains around two-thirds of earnings and we don't expect that will change. The company continues to boost its payout at roughly the same rate as earnings, so the dividend is quite safe and should continue to move higher over time.

Otter Tail's competitive advantage of having a diversified business model is also its disadvantage during recessions. The non-utility businesses are providing strong growth today but during the last recession, earnings fell much more than you'd expect for a pure utility. That will happen next time there is a downturn, so investors should keep this in mind.

Final Thoughts & Recommendation

We see Otter Tail as a stock that has a relatively strong growth outlook compared to its peers, but also one that is trading in excess of fair value. Growth levers with all three of its businesses are apparent but the stock's strong returns in the past three years have left it overvalued. We see total returns of 4.9% annually moving forward, consisting of the current 2.8% yield, 5% earnings-per-share growth and a 2.9% headwind from the lower valuation. Given these low projected returns, Otter Tail Corporation earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Otter Tail Corporation (OTTR)

Updated February 20th, 2019 by Josh Arnold

Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1040	718	840	710	743	799	780	804	849	916
Gross Profit	236	132	141	163	163	170	183	199	214	220
Gross Margin	22.7%	18.3%	16.8%	23.0%	22.0%	21.3%	23.5%	24.7%	25.2%	24.0%
D&A Exp.	74	58	58	58	58	58	60	73	73	75
Operating Profit	45	65	72	95	94	100	109	111	126	124
Operating Margin	4.4%	9.0%	8.6%	13.3%	12.7%	12.5%	14.0%	13.8%	14.9%	13.5%
Net Profit	26	-1	-13	-5	51	58	59	62	72	82
Net Margin	2.5%	-0.2%	-1.6%	-0.7%	6.8%	7.2%	7.6%	7.8%	8.5%	9.0%
Free Cash Flow	-14	47	37	119	-12	-51	-43	2	41	38
Income Tax	-5	3	4	7	13	17	22	20	27	15

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1755	1771	1701	1602	1596	1741	1819	1912	2004	2053
Cash & Equivalents	4	0	16	52	2	0	0	0	16	1
Accounts Receivable	107	95	93	91	58	60	63	68	68	75
Inventories	87	72	69	69	73	85	85	84	88	106
Goodwill & Int. Ass.	141	56	54	53	44	43	55	53	51	50
Total Liabilities	1068	1123	1129	1080	1061	1168	1214	1242	1307	1324
Accounts Payable	84	103	80	88	96	107	89	89	84	96
Long-Term Debt	503	513	472	422	441	510	577	581	603	609
Shareholder's Equity	671	632	571	522	535	573	605	670	697	729
D/E Ratio	0.73	0.79	0.83	0.81	0.82	0.89	0.95	0.87	0.87	0.84

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	1.5%	-0.1%	-0.8%	-0.3%	3.2%	3.5%	3.3%	3.3%	3.7%	4.1%
Return on Equity	3.9%	-0.2%	-2.2%	-1.0%	9.6%	10.4%	10.1%	9.8%	10.6%	11.6%
ROIC	2.2%	-0.1%	-1.2%	-0.5%	5.3%	5.6%	5.2%	5.1%	5.7%	6.2%
Shares Out.	36	36	36	36	36	37	38	39	40	40
Revenue/Share	29.10	19.93	23.29	19.60	20.45	21.75	20.70	20.75	21.37	22.97
FCF/Share	-0.40	1.30	1.03	3.29	-0.33	-1.39	-1.13	0.05	1.02	0.95

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.