Otter Tail Corporation (OTTR)

Updated March 1st, 2021 by Samuel Smith

Key Metrics

Current Price:	$40.5	**5 Year CAGR Estimate:**	10.0%	**Market Cap:**	$1.7B
Fair Value Price:	$50.0	**5 Year Growth Estimate:**	2.7%	**Ex-Dividend Date[1]:**	02/12/21
% Fair Value:	81%	**5 Year Valuation Multiple Estimate:**	4.2%	**Dividend Payment Date[2]:**	03/11/21
Dividend Yield:	3.9%	**5 Year Price Target**	$57	**Years Of Dividend Growth:**	8
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	5.4%

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 $960 million in annual revenue split between utility, manufacturing and plastics operations. Otter Tail has a $1.7 billion market capitalization.

Otter Tail reported Q4 fiscal 2020 earnings on 02/14/21. Consolidated operating revenues decreased to $890.1 million from $919.5 million year-over-year and consolidated net income increased 10.4% to $95.9 million. Diluted earnings-per-share grew 7.8% to $2.34 year-over-year. Meanwhile, the company's quarterly common stock dividend increased by 5.4% to $0.39 year-over-year. Otter Tail also expects 2021 diluted earnings per share between $2.39 to $2.54.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$0.45	$1.05	$1.37	$1.55	$1.56	$1.60	$1.86	$2.06	$2.15	$2.34	***$2.49***	***$2.84***
DPS	$1.19	$1.19	$1.19	$1.21	$1.23	$1.25	$1.28	$1.34	$1.40	$1.48	***$1.56***	***$1.82***
Shares[3]	36	36	36	37	38	39	40	40	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. We see average growth of 2.7% 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 prior quarters 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.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	47.5	21.7	21.1	18.8	18.2	20.2	22.1	22.2	24.2	17.4	***16.3***	***20.0***
Avg. Yld.	5.6%	5.2%	4.1%	4.1%	4.3%	3.9%	3.1%	2.9%	2.7%	3.7%	***3.9%***	***3.2%***

[1] Estimate

[2] Estimate

[3] In millions

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.

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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 16.3 is well below its recent historical norm of 20 and as such, we see the stock as undervalued.

We think shares will remain around a multiple of 20 over time, causing a modest tailwind to total returns moving forward. The yield should remain near where it is today between 3%-4% as dividend increases keep pace with earnings-per-share growth, and Otter Tail remains a decent income stock choice among utilities.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	113%	87%	78%	79%	78%	69%	65%	65%	64%	***63%***	***64%***

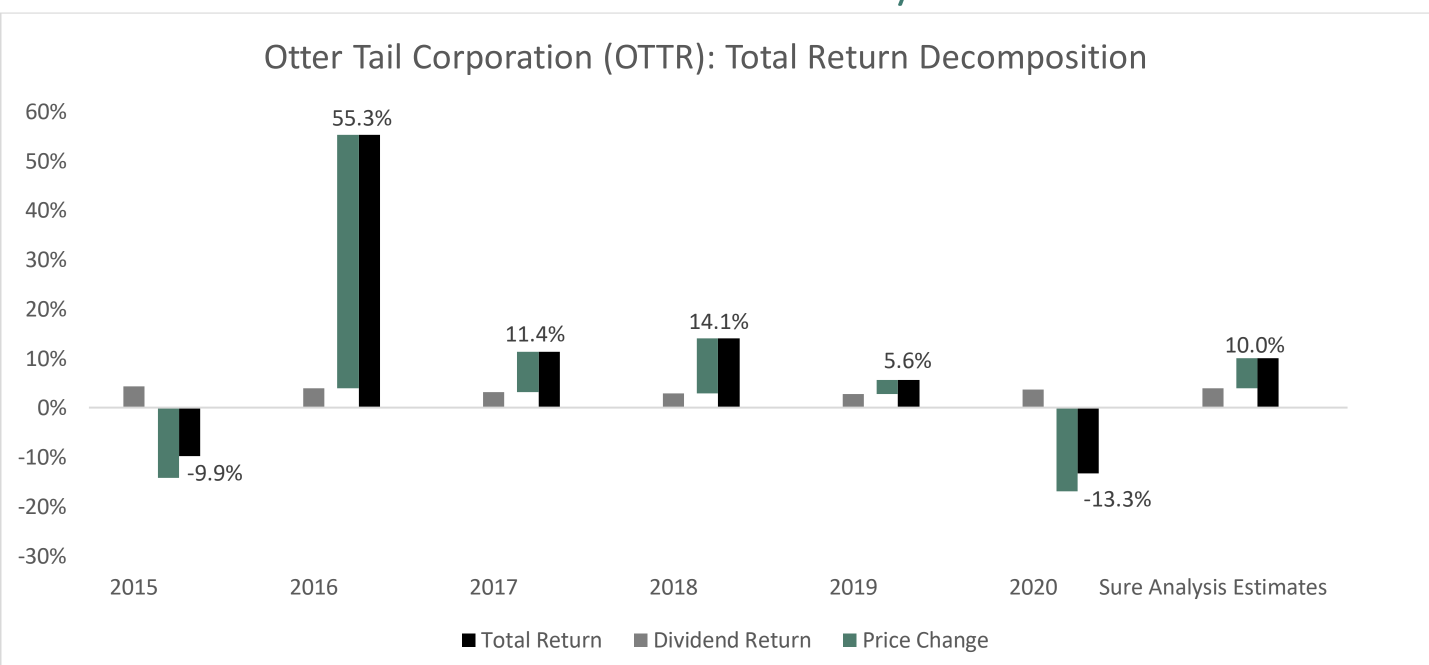
Otter Tail's payout ratio remains around two-thirds of earnings and we don't expect that will change. The company continues to boost its payout at roughly the same rate as earnings, so the dividend is quite safe and should continue to move higher over time.

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 expected for a pure utility. That will likely 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 and is trading well below fair value. We see the stock providing 10% annualized total returns moving forward along with a safe 3.9% dividend yield that will grow with inflation over time. As a result, it is a solid holding for conservative dividend growth investors, and we rate it a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	840	710	743	799	780	804	849	916	920	890
Gross Profit	190	204	203	216	223	243	261	271	280	302
Gross Margin	22.6%	28.7%	27.4%	27.0%	28.6%	30.2%	30.8%	29.6%	30.4%	33.9%
D&A Exp.	58	58	58	58	60	73	73	75	78	82
Operating Profit	72	95	94	100	109	117	132	129	135	148
Operating Margin	8.6%	13.3%	12.7%	12.5%	14.0%	14.5%	15.6%	14.1%	14.7%	16.6%
Net Profit	(13)	(5)	51	58	59	62	72	82	87	96
Net Margin	-1.6%	-0.7%	6.8%	7.2%	7.6%	7.8%	8.5%	9.0%	9.4%	10.8%
Free Cash Flow	37	119	(12)	(51)	(43)	2	41	38	(22)	(160)
Income Tax	4	7	13	17	22	20	27	15	17	20

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	1,701	1,602	1,596	1,741	1,819	1,912	2,004	2,053	2,274	2,578
Cash & Equivalents	16	52	2	-	-	-	16	1	21	1
Accounts Receivable	93	91	58	60	63	68	68	75	79	87
Inventories	69	69	73	85	85	84	88	106	98	92
Goodwill & Int. Ass.	54	53	44	43	55	53	51	50	49	48
Total Liabilities	1,114	1,065	1,061	1,168	1,214	1,242	1,307	1,324	1,492	1,707
Accounts Payable	80	88	96	107	89	89	85	96	121	131
Long-Term Debt	472	422	441	510	577	581	603	609	696	846
Shareholder's Equity	571	522	535	573	605	670	697	729	781	871
D/E Ratio	0.80	0.78	0.82	0.89	0.95	0.87	0.87	0.84	0.89	0.97

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	-0.8%	-0.3%	3.2%	3.5%	3.3%	3.3%	3.7%	4.1%	4.0%	4.0%
Return on Equity	-2.2%	-1.0%	9.6%	10.4%	10.1%	9.8%	10.6%	11.6%	11.5%	11.6%
ROIC	-1.2%	-0.5%	5.3%	5.6%	5.2%	5.1%	5.7%	6.2%	6.2%	6.0%
Shares Out.	36	36	36	37	38	39	40	40	40	40
Revenue/Share	23.29	19.60	20.45	21.75	20.70	20.75	21.37	22.97	23.01	21.76
FCF/Share	1.03	3.29	(0.33)	(1.39)	(1.13)	0.05	1.02	0.95	(0.56)	(3.90)

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