



Otter Tail Corporation (OTTR)

Updated May 13th, 2023 by Samuel Smith

Key Metrics

Current Price:	\$77.7	5 Year CAGR Estimate:	9.1%	Market Cap:	\$3.2B
Fair Value Price:	\$94.0	5 Year Growth Estimate:	3.2%	Ex-Dividend Date:	08/12/23 ¹
% Fair Value:	83%	5 Year Valuation Multiple Estimate:	3.9%	Dividend Payment Date:	09/9/23 ²
Dividend Yield:	2.3%	5 Year Price Target	\$110	Years Of Dividend Growth:	10
Dividend Risk Score:	B	Retirement Suitability Score:	C	Rating:	Hold

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 generates over \$1 billion in annual revenue split between utility, manufacturing and plastics operations. Otter Tail has a \$3.2 billion market capitalization.

On May 2nd, 2023, Otter Tail Power reported Q1 results. The company reported GAAP EPS of \$1.49, surpassing expectations by \$0.45. Although revenue declined by 9.6% year-over-year, it still exceeded expectations by \$26.93 million. The company has updated its outlook for 2023 and increased its diluted earnings per share range to \$4.55 to \$4.85, compared to the initial guidance of \$3.76 to \$4.06. The consensus estimate was \$3.94. The updated guidance indicates that approximately 43% of earnings will come from the Electric segment, while the remaining 57% will come from the Manufacturing and Plastics segments, net of corporate costs. This deviation from the long-term expected earnings mix is due to the expectation of elevated earnings in the Plastics segment in 2023, which is higher than the company's anticipated normalized earnings for this segment.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$1.37	\$1.55	\$1.56	\$1.60	\$1.86	\$2.06	\$2.15	\$2.34	\$4.23	\$6.78	\$4.70	\$5.50
DPS	\$1.19	\$1.21	\$1.23	\$1.25	\$1.28	\$1.34	\$1.40	\$1.48	\$1.56	\$1.65	\$1.75	\$2.07
Shares³	36.3	37.4	38.0	39.4	39.6	39.7	40.2	41.5	41.6	41.6	41.7	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 3.2% going forward after a strong jump up in earnings from 2020 to 2022 and some expected normalization this year.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	21.1	18.8	18.2	20.2	22.1	22.2	24.2	17.4	17.5	8.1	16.5	20.0
Avg. Yld.	4.10%	4.20%	4.30%	3.90%	3.10%	2.90%	2.70%	3.60%	2.50%	2.8%	2.3%	2.0%

¹ Estimated

² Estimated

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 16.5 is below its recent historical norm of 20 and as such, we see the stock as undervalued. We think shares will return to a multiple of roughly 20 over time, producing a nice tailwind to total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	87%	78%	79%	78%	69%	65%	65%	63%	37%	24%	37%	38%

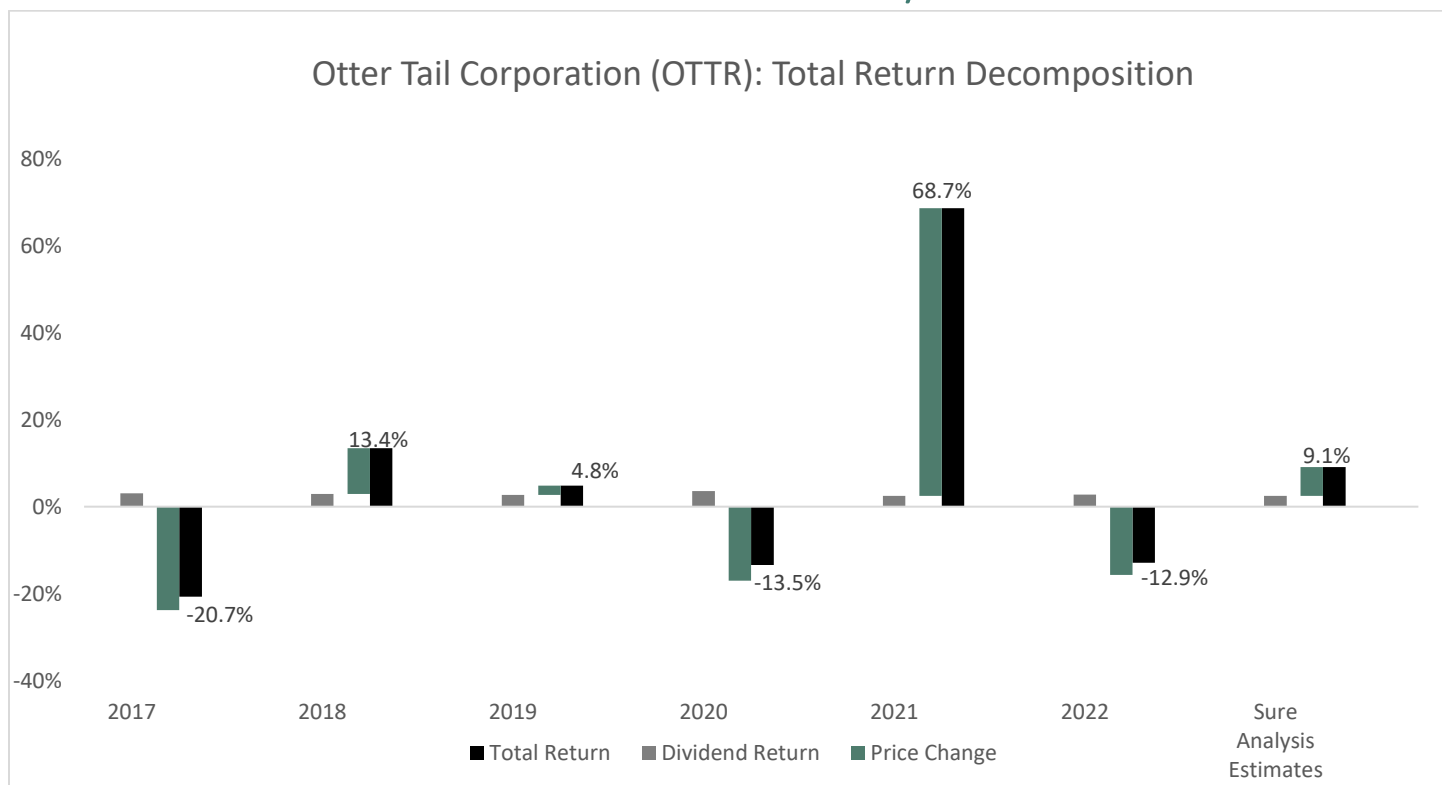
Otter Tail's payout ratio is generally around two-thirds of earnings and we don't expect that will change. However, bumper earnings this year has the payout ratio much lower temporarily. The company continues to boost its payout at roughly the same rate as earnings, so the dividend is quite safe and 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 offers 9.1% annualized total return potential moving forward along with a safe 2.3% dividend yield that will grow slowly but steadily over time along with decent valuation multiple expansion potential. As a result, it is a solid holding for conservative dividend growth investors, and we rate it a Hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	743	799	780	804	849	916	920	890	1,197	1,460
Gross Profit	203	216	223	243	261	271	280	302	424	570
Gross Margin	27.4%	27.0%	28.6%	30.2%	30.8%	29.6%	30.4%	33.9%	35.4%	39.1%
D&A Exp.	58	58	60	73	73	75	78	82	91	93
Operating Profit	94	100	109	117	132	129	135	148	250	390
Operating Margin	12.7%	12.5%	14.0%	14.5%	15.6%	14.1%	14.7%	16.6%	20.9%	26.7%
Net Profit	51	58	59	62	72	82	87	96	177	284
Net Margin	6.8%	7.2%	7.6%	7.8%	8.5%	9.0%	9.4%	10.8%	14.8%	19.5%
Free Cash Flow	(12)	(51)	(43)	2	41	38	(22)	(160)	59	218
Income Tax	13	17	22	20	27	15	17	20	36	73

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,596	1,741	1,819	1,912	2,004	2,053	2,274	2,578	2,755	2,902
Cash & Equivalents	2	-	-	-	16	1	21	1	2	119
Accounts Receivable	58	60	63	68	68	75	79	87	142	112
Inventories	73	85	85	84	88	106	98	92	148	146
Goodwill & Int. Ass.	44	43	55	53	51	50	49	48	47	46
Total Liabilities	1,061	1,168	1,214	1,242	1,307	1,324	1,492	1,707	1,764	1,684
Accounts Payable	96	107	89	89	85	96	121	121	135	104
Long-Term Debt	441	510	577	581	603	609	696	846	855	832
Shareholder's Equity	535	573	605	670	697	729	781	871	991	1,217
LTD/E Ratio	0.82	0.89	0.95	0.87	0.87	0.84	0.89	0.97	0.86	0.68

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.2%	3.5%	3.3%	3.3%	3.7%	4.1%	4.0%	4.0%	6.6%	10.0%
Return on Equity	9.6%	10.4%	10.1%	9.8%	10.6%	11.6%	11.5%	11.6%	19.0%	25.7%
ROIC	5.3%	5.6%	5.2%	5.1%	5.7%	6.2%	6.2%	6.0%	9.9%	14.6%
Shares Out.	36.3	37.4	38.0	39.4	39.6	39.7	40.2	41.5	41.6	41.6
Revenue/Share	20.45	21.75	20.70	20.75	21.37	22.97	23.01	21.76	28.62	34.82
FCF/Share	(0.33)	(1.39)	(1.13)	0.05	1.02	0.95	(0.56)	(3.90)	1.42	5.20

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

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