



Otter Tail Corporation (OTTR)

Updated August 23rd, 2023 by Samuel Smith

Key Metrics

| | | | | | |
|-----------------------------|--------|--|-------|----------------------------------|-----------------------|
| Current Price: | \$81.6 | 5 Year CAGR Estimate: | 11.5% | Market Cap: | \$3.4B |
| Fair Value Price: | \$117 | 5 Year Growth Estimate: | 2.1% | Ex-Dividend Date: | 11/12/23 ¹ |
| % Fair Value: | 70% | 5 Year Valuation Multiple Estimate: | 7.5% | Dividend Payment Date: | 12/9/23 ² |
| Dividend Yield: | 2.1% | 5 Year Price Target | \$130 | Years Of Dividend Growth: | 10 |
| Dividend Risk Score: | B | Retirement Suitability Score: | C | Rating: | Buy |

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 \$3.4 billion market capitalization.

On August 1st, 2023, Otter Tail Power released its Q2 financial results. The company reported Q2 GAAP EPS of \$1.95, surpassing expectations by \$0.50. Despite a year-over-year decrease of 15.5% in revenue to \$338 million, the revenue still exceeded estimates by \$12.77 million. The company has revised its 2023 diluted earnings per share guidance upwards, now expecting a range of \$5.70 to \$6.00, compared to the previous range of \$4.55 to \$4.85, with consensus at \$4.74. The increase in earnings guidance is attributed to stronger-than-expected performance in the Plastics segment during the second quarter, which is anticipated to continue throughout the year. The company's earnings mix for 2023 is projected to be around 35% from the Electric segment and 65% from the Manufacturing and Plastics segments, adjusted for corporate costs, deviating from their long-term expected earnings mix due to the anticipated elevated earnings from the Plastics segment this year.

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 | \$5.85 | \$6.50 |
| DPS | \$1.19 | \$1.21 | \$1.23 | \$1.25 | \$1.28 | \$1.34 | \$1.40 | \$1.48 | \$1.56 | \$1.65 | \$1.75 | \$2.50 |
| 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 2.1% going forward after a strong jump up in earnings from 2020 to the present level.

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 | 13.9 | 20.0 |
| Avg. Yld. | 4.10% | 4.20% | 4.30% | 3.90% | 3.10% | 2.90% | 2.70% | 3.60% | 2.50% | 2.8% | 2.1% | 1.9% |

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

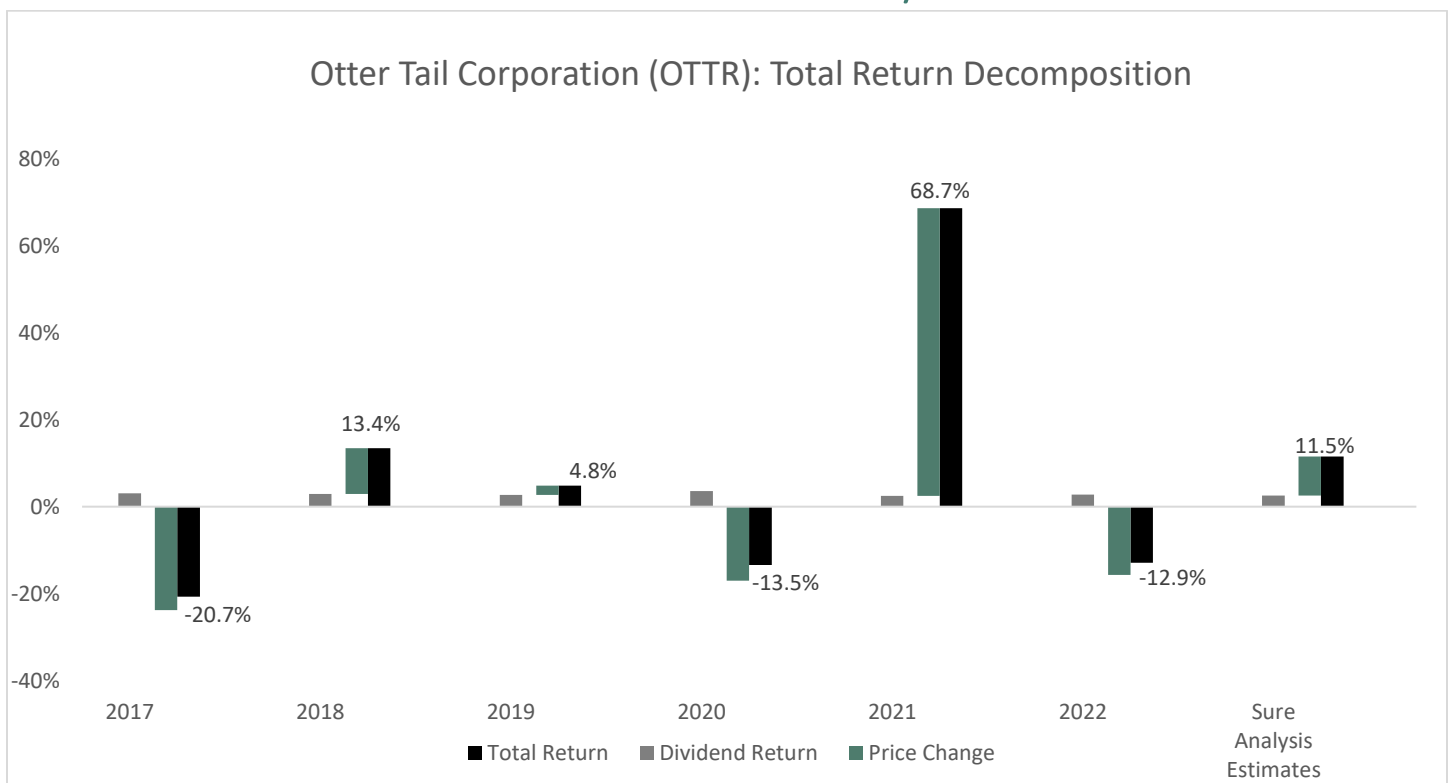
| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 87% | 78% | 79% | 78% | 69% | 65% | 65% | 63% | 37% | 24% | 30% | 38% |

Otter Tail's payout ratio is generally around two-thirds of earnings and we don't expect that will change longer-term. 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 11.5% annualized total return potential moving forward along with a safe 2.1% dividend yield that will grow slowly but steadily over time along with strong valuation multiple expansion potential. 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 | 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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