Otter Tail Corporation (OTTR)

Updated March 11th, 2024 by Samuel Smith

Key Metrics

Current Price:	$83.1	**5 Year CAGR Estimate:**	-2.1%	**Market Cap:**	$3.6B
Fair Value Price:	$75.0	**5 Year Growth Estimate:**	-3.2%	**Ex-Dividend Date:**	5/14/24[1]
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Dividend Payment Date:**	6/8/24[2]
Dividend Yield:	2.3%	**5 Year Price Target**	$64	**Years Of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Rating:**	Sell

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 $3.6 billion market capitalization.

On February 12th, 2024, Otter Tail Power released its Q4 financial results. In comparison to the year ended December 31, 2022, the company experienced an 8% decrease in consolidated operating revenues, amounting to $1.3 billion. However, there was a 4% increase in consolidated net income, reaching $294.2 million, alongside a 3% rise in diluted earnings per share, which reached $7.00 per share. The corporation achieved a consolidated return on equity of 22.1% with an equity ratio of 61.4%. Notably, the corporation's board of directors announced an increase in the quarterly common stock dividend to $0.4675 per share, indicating an annual dividend rate of $1.87 per share in 2024, marking a 7% rise from $1.75 per share in 2023.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.55	$1.56	$1.60	$1.86	$2.06	$2.15	$2.34	$4.23	$6.78	$7.00	***$5.00***	***$4.25***
DPS	$1.21	$1.23	$1.25	$1.28	$1.34	$1.40	$1.48	$1.56	$1.65	$1.75	***$1.87***	***$2.40***
Shares[3]	37.4	38.0	39.4	39.6	39.7	40.2	41.5	41.6	41.6	41.7	***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 earnings per share declining at a 3.2% annualized pace 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	18.8	18.2	20.2	22.1	22.2	24.2	17.4	17.5	8.1	13.4	***16.6***	***15.0***
Avg. Yld.	4.1%	4.2%	4.3%	3.9%	3.1%	2.9%	2.7%	3.6%	2.5%	2.8%	***2.3%***	***3.8%***

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 16.6 is below its recent historical norm of 20

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[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.

and above our fair value estimate of 15, and as such, we see the stock as slightly overvalued. We think shares will return to a multiple of roughly 15 over time, producing a small headwind to total returns moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	78%	79%	78%	69%	65%	65%	63%	37%	24%	25%	**37%**	**56%**

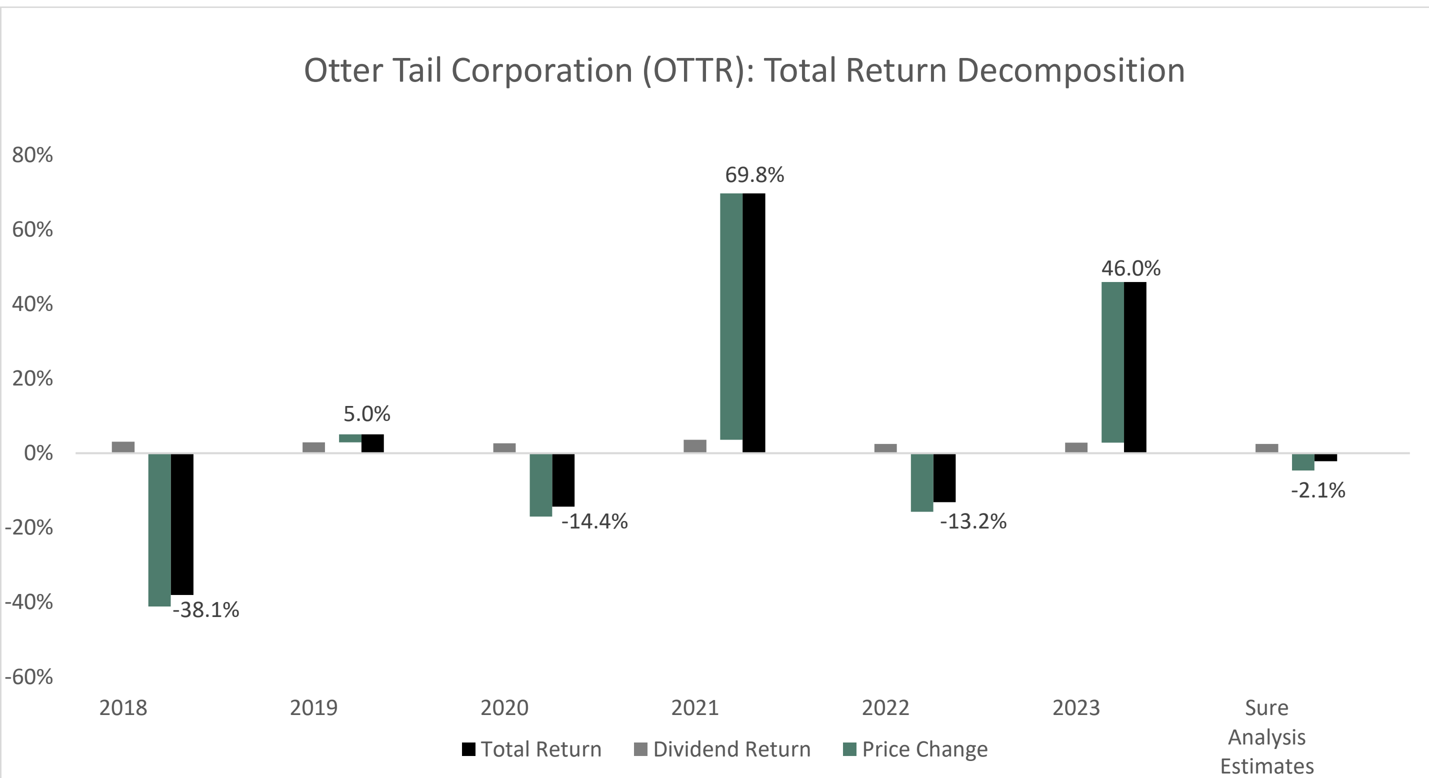
Otter Tail's payout ratio is generally around two-thirds of earnings and we don't expect that will change longer-term. However, bumper earnings this year has the payout ratio much lower temporarily. The company continues to boost its payout at roughly the same rate as earnings, so the dividend is quite 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 -2.1% annualized total return potential moving forward along with a safe 2.3% dividend yield that will grow slowly but steadily over time. As a result, it looks like an unattractive at the moment, making it a Sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	799	780	804	849	916	920	890	1,197	1,460	1,349
Gross Profit	216	223	243	261	271	280	302	424	570	565
Gross Margin	27.0%	28.6%	30.2%	30.8%	29.6%	30.4%	33.9%	35.4%	39.1%	41.9%
D&A Exp.	58	60	73	73	75	78	82	91	93	98
Operating Profit	100	109	112	127	124	131	144	248	392	389
Operating Margin	12.5%	14.0%	13.9%	14.9%	13.5%	14.2%	16.2%	20.7%	26.8%	28.8%
Net Profit	58	59	62	72	82	87	96	177	284	294
Net Margin	7.2%	7.6%	7.8%	8.5%	9.0%	9.4%	10.8%	14.8%	19.5%	21.8%
Free Cash Flow	(51)	(43)	2	41	38	(22)	(160)	59	218	117
Income Tax	17	22	20	27	15	17	20	36	73	69

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,741	1,819	1,912	2,004	2,053	2,274	2,578	2,755	2,902	3,243
Cash & Equivalents	-	-	-	16	1	21	1	2	119	230
Accounts Receivable	60	63	68	68	75	79	87	142	112	129
Inventories	85	85	84	88	106	98	92	148	146	150
Goodwill & Int. Ass.	43	55	53	51	50	49	48	47	46	44
Total Liabilities	1,168	1,214	1,242	1,307	1,324	1,492	1,707	1,764	1,684	1,800
Accounts Payable	107	89	89	85	96	121	121	135	104	94
Long-Term Debt	510	577	581	603	609	696	846	855	832	905
Shareholder's Equity	573	605	670	697	729	781	871	991	1,217	1,443
LTD/E Ratio	0.89	0.95	0.87	0.87	0.84	0.89	0.97	0.86	0.68	0.63

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.5%	3.3%	3.3%	3.7%	4.1%	4.0%	4.0%	6.6%	10.0%	9.6%
Return on Equity	10.4%	10.1%	9.8%	10.6%	11.6%	11.5%	11.6%	19.0%	25.7%	22.1%
ROIC	5.6%	5.2%	5.1%	5.7%	6.2%	6.2%	6.0%	9.9%	14.6%	13.4%
Shares Out.	37.4	38.0	39.4	39.6	39.7	40.2	41.5	41.6	41.6	41.7
Revenue/Share	21.75	20.70	20.75	21.37	22.97	23.01	21.76	28.62	34.82	32.09
FCF/Share	(1.39)	(1.13)	0.05	1.02	0.95	(0.56)	(3.90)	1.42	5.20	2.79

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