OTTER TAIL CORP
Form 10-Q
November 07, 2008

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 0-368

OTTER TAIL CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota	41-0462685
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
215 South Cascade Street, Box 496, Fergus Falls, Minnesota	56538-0496
(Address of principal executive offices)	(Zip Code)

866-410-8780
(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of Common Stock, as of the latest practicable date:

October 31, 2008 35,384,620 Common Shares ($5 par value)

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Otter Tail Corporation
Consolidated Balance Sheets
(not audited)
-Assets-

	September 30, 2008	December 31, 2007
	(Thousands of dollars)	
Current Assets		
Cash and Cash Equivalents	$ 17,862	$ 39,824
Accounts Receivable:		
Trade Net	171,681	151,446
Other	22,636	14,934
Inventories	111,042	97,214
Deferred Income Taxes	6,904	7,200
Accrued Utility and Cost-of-Energy Revenues	14,207	32,501
Costs and Estimated Earnings in Excess of Billings	60,616	42,234
Other	23,953	15,299
Total Current Assets	428,901	400,652
Investments	8,120	10,057
Other Assets	24,108	24,500
Goodwill	106,778	99,242
Other Intangibles Net	35,977	20,456
Deferred Debits		
Unamortized Debt Expense and Reacquisition Premiums	6,784	6,986
Regulatory Assets and Other Deferred Debits	41,024	38,837
Total Deferred Debits	47,808	45,823
Plant		
Electric Plant in Service	1,066,957	1,028,917
Nonelectric Operations	306,181	257,590
Total Plant	1,373,138	1,286,507
Less Accumulated Depreciation and Amortization	538,693	506,744
Plant Net of Accumulated Depreciation and Amortization	834,445	779,763
Construction Work in Progress	127,937	74,261
Net Plant	962,382	854,024
Total	$ 1,614,074	$ 1,454,754

See accompanying notes to consolidated financial statements

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Otter Tail Corporation
Consolidated Balance Sheets
(not audited)
-Liabilities-

	September 30, 2008	December 31, 2007
	(Thousands of dollars)	
Current Liabilities		
Short-Term Debt	$ 111,955	$ 95,000
Current Maturities of Long-Term Debt	3,389	3,004
Accounts Payable	128,547	141,390
Accrued Salaries and Wages	27,507	29,283
Accrued Taxes	10,248	11,409
Other Accrued Liabilities	14,284	13,873
Total Current Liabilities	295,930	293,959
Pensions Benefit Liability	39,537	39,429
Other Postretirement Benefits Liability	31,378	30,488
Other Noncurrent Liabilities	21,157	23,228
Deferred Credits		
Deferred Income Taxes	111,256	105,813
Deferred Tax Credits	17,527	16,761
Regulatory Liabilities	64,066	62,705
Other	330	275
Total Deferred Credits	193,179	185,554
Capitalization		
Long-Term Debt, Net of Current Maturities	340,667	342,694
Class B Stock Options of Subsidiary	1,255	1,255
Cumulative Preferred Shares Authorized 1,500,000 Shares Without Par Value; Outstanding 2008 and 2007 155,000 Shares	15,500	15,500
Cumulative Preference Shares Authorized 1,000,000 Shares without Par Value; Outstanding None		
Common Shares, Par Value $5 Per Share Authorized 50,000,000 Shares; Outstanding 2008 35,384,470 and 2007 29,849,789	176,922	149,249
Premium on Common Shares	240,996	108,885
Retained Earnings	257,327	263,332
Accumulated Other Comprehensive Income	226	1,181
Total Common Equity	675,471	522,647
Total Capitalization	1,032,893	882,096

Total	$ 1,614,074	$ 1,454,754

See accompanying notes to consolidated financial statements

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Otter Tail Corporation
Consolidated Statements of Income
(not audited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
	(In thousands, except share and per share amounts)		(In thousands, except share and per share amounts)	
Operating Revenues				
Electric	$ 82,821	$ 72,052	$ 248,904	$ 232,403
Nonelectric	270,098	230,183	727,852	676,797
Total Operating Revenues	352,919	302,235	976,756	909,200
Operating Expenses				
Production Fuel Electric	18,732	16,994	53,444	47,496
Purchased Power Electric System Use	10,456	6,499	39,598	43,531
Electric Operation and Maintenance Expenses	33,091	27,212	87,591	80,738
Cost of Goods Sold Nonelectric (depreciation included below)	213,999	179,868	583,457	521,500
Other Nonelectric Expenses	37,222	30,211	108,211	92,346
Plant Closure Costs	883		2,295	
Depreciation and Amortization	16,563	13,366	47,600	39,406
Property Taxes Electric	2,227	2,538	7,414	7,591
Total Operating Expenses	333,173	276,688	929,610	832,608
Operating Income	19,746	25,547	47,146	76,592
Other Income	1,157	619	2,745	1,232
Interest Charges	7,269	4,927	21,023	14,821
Income Before Income Taxes	13,634	21,239	28,868	63,003
Income Taxes	4,003	7,907	7,490	23,160
Net Income	9,631	13,332	21,378	39,843
Preferred Dividend Requirements	184	184	552	552
Earnings Available for Common Shares	$ 9,447	$ 13,148	$ 20,826	$ 39,291
Earnings Per Common Share:				
Basic	$ 0.31	$ 0.44	$ 0.69	$ 1.33
Diluted	$ 0.31	$ 0.44	$ 0.69	$ 1.31
Average Number of Common Shares Outstanding:				

Basic	30,513,578	29,745,600	30,108,381	29,644,866
Diluted	30,817,013	29,995,660	30,398,235	29,887,510
Dividends Per Common Share	$ 0.2975	$ 0.2925	$ 0.8925	$ 0.8775

See accompanying notes to consolidated financial statements

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Otter Tail Corporation
Consolidated Statements of Cash Flows
(not audited)

	Nine months ended September 30, 2008	2007
	(Thousands of dollars)	
Cash Flows from Operating Activities		
Net Income	$ 21,378	$ 39,843
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	47,600	39,406
Deferred Tax Credits	(1,180)	(852)
Deferred Income Taxes	9,123	2,706
Change in Deferred Debits and Other Assets	(2,162)	(484)
Discretionary Contribution to Pension Plan	(2,000)	(4,000)
Change in Noncurrent Liabilities and Deferred Credits	1,795	6,116
Allowance for Equity (Other) Funds Used During Construction	(1,712)	
Change in Derivatives Net of Regulatory Deferral	(337)	(163)
Stock Compensation Expense	2,885	1,592
Other Net	580	(469)
Cash (Used for) Provided by Current Assets and Current Liabilities:		
Change in Receivables	(24,314)	(26,883)
Change in Inventories	(9,054)	7,779
Change in Other Current Assets	(8,165)	3,562
Change in Payables and Other Current Liabilities	4,997	(15,194)
Change in Interest and Income Taxes Payable	810	4,382
Net Cash Provided by Operating Activities	40,244	57,341
Cash Flows from Investing Activities		
Capital Expenditures	(172,237)	(99,433)
Proceeds from Disposal of Noncurrent Assets	7,446	8,297
Acquisitions Net of Cash Acquired	(41,674)	(6,750)
Increases in Other Investments	(393)	(5,824)
Net Cash Used in Investing Activities	(206,858)	(103,710)
Cash Flows from Financing Activities		
Net Short-Term Borrowings	16,955	39,881
Proceeds from Issuance of Common Stock	162,961	7,633
Common Stock Issuance Expenses	(6,136)	
Payments for Retirement of Common Stock	(91)	(305)
Proceeds from Issuance of Long-Term Debt	1,140	25,128
Short-Term and Long-Term Debt Issuance Expenses	(527)	(328)
Payments for Retirement of Long-Term Debt	(2,691)	(2,445)
Dividends Paid	(27,382)	(26,601)

Net Cash Provided by Financing Activities		144,229		42,963
Effect of Foreign Exchange Rate Fluctuations on Cash		423		(2,681)
Net Change in Cash and Cash Equivalents		(21,962)		(6,087)
Cash and Cash Equivalents at Beginning of Period		39,824		6,791
Cash and Cash Equivalents at End of Period	$	17,862	$	704

See accompanying notes to consolidated financial statements

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OTTER TAIL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(not audited)

In the opinion of management, Otter Tail Corporation (the Company) has included all adjustments (including normal recurring accruals) necessary for a fair presentation of the consolidated results of operations for the periods presented. The consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes as of and for the years ended December 31, 2007, 2006 and 2005 included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007. Because of seasonal and other factors, the earnings for the three-month and nine-month periods ended September 30, 2008 should not be taken as an indication of earnings for all or any part of the balance of the year.

The following notes are numbered to correspond to numbers on the notes included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

1. Summary of Significant Accounting Policies

Revenue Recognition

Due to the diverse business operations of the Company, revenue recognition depends on the product produced and sold or service performed. The Company recognizes revenue when the earnings process is complete, evidenced by an agreement with the customer, there has been delivery and acceptance, and the price is fixed or determinable. In cases where significant obligations remain after delivery, revenue recognition is deferred until such obligations are fulfilled. Provisions for sales returns and warranty costs are recorded at the time of the sale based on historical information and current trends. In the case of derivative instruments, such as the electric utility s forward energy contracts, marked-to-market and realized gains and losses are recognized on a net basis in revenue in accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended and interpreted. Gains and losses on forward energy contracts subject to regulatory treatment, if any, are deferred and recognized on a net basis in revenue in the period realized.

For the Company s operating companies recognizing revenue on certain products when shipped, those operating companies have no further obligation to provide services related to such product. The shipping terms used in these instances are FOB shipping point.

Some of the operating businesses enter into fixed-price construction contracts. Revenues under these contracts are recognized on a percentage-of-completion basis. The Company s consolidated revenues recorded under the percentage-of-completion method were 34.6% for the three months ended September 30, 2008 compared with 33.3% for the three months ended September 30, 2007 and 32.3% for the nine months ended September 30, 2008 compared with 29.5% for the nine months ended September 30, 2007. The method used to determine the progress of completion is based on the ratio of labor hours incurred to total estimated labor hours at the Company s wind tower manufacturer, square footage completed to total bid square footage for certain floating dock projects and costs incurred to total estimated costs on all other construction projects. If a loss is indicated at a point in time during a contract, a projected loss for the entire contract is estimated and recognized.

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The following table summarizes costs incurred and billings and estimated earnings recognized on uncompleted contracts:

(in thousands)	September 30, 2008	December 31, 2007
Costs Incurred on Uncompleted Contracts	$ 518,863	$ 286,358
Less Billings to Date	(528,496)	(292,692)
Plus Estimated Earnings Recognized	63,801	38,275
	$ 54,168	$ 31,941

The following amounts are included in the Company s consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts are included in Accounts Payable:

(in thousands)	September 30, 2008	December 31, 2007
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts	$ 60,616	$ 42,234
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	(6,448)	(10,293)
	$ 54,168	$ 31,941

Sales of Receivables

In March 2008, DMI Industries, Inc. (DMI), the Company s wind tower manufacturer, entered into a three-year $40 million receivable purchase agreement whereby designated customer accounts receivable may be sold to General Electric Capital Corporation on a revolving basis. Accounts receivable totaling $90.9 million have been sold in 2008. Discounts of $0.5 million for the nine months ended September 30, 2008 were charged to operating expenses in the consolidated statements of income. In compliance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, sales of accounts receivable are reflected as a reduction of accounts receivable in the consolidated balance sheets and the proceeds are included in the cash flows from operating activities in the consolidated statements of cash flows.

Marketing and Sales Incentive Costs

ShoreMaster, Inc. (ShoreMaster), the Company s waterfront equipment manufacturer, provides dealer floor plan financing assistance for certain dealer purchases of ShoreMaster products for certain set time periods based on the timing and size of a dealer s order. ShoreMaster recognizes the estimated cost of projected interest payments related to each financed sale as a liability and a reduction of revenue at the time of sale, based on historical experience of the average length of time floor plan debt is outstanding, in accordance with Emerging Issues Task Force Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of a Vendor s Products)*. The liability is reduced when interest is paid. To the extent current experience differs from previous estimates the accrued liability for financing assistance costs is adjusted accordingly. Financing assistance costs of $98,000 for the three months ended September 30, 2008 and $338,000 for the nine months ended September 30, 2008 were charged to revenue.

Supplemental Disclosures of Cash Flow Information

(in thousands)	Nine Months Ended September 30, 2008	2007
Increases (Decreases) in Accounts Payable and Other Liabilities Related to Capital Expenditures	$(21,117)	$ 1,631
Cash Paid During the Period for:		
Interest (net of amount capitalized)	$ 19,925	$11,899
Income Taxes	$ 1,779	$18,896

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Fair Value Measurements

Effective January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements*, for recurring fair value measurements. SFAS No. 157 provides a single definition of fair value and requires enhanced disclosures about assets and liabilities measured at fair value. SFAS No. 157 establishes a hierarchal framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value. The three levels defined by the SFAS No. 157 hierarchy and examples of each level are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reported date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices, such as equities listed by the New York Stock Exchange and commodity derivative contracts listed on the New York Mercantile Exchange.

Level 2 Pricing inputs are other than quoted prices in active markets, but are either directly or indirectly observable as of the reported date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, such as treasury securities with pricing interpolated from recent trades of similar securities, or priced with models using highly observable inputs, such as commodity options priced using observable forward prices and volatilities.

Level 3 Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those with inputs requiring significant management judgment or estimation, such as the complex and subjective models and forecasts used to determine the fair value of financial transmission rights.

The following table presents, for each of these hierarchy levels, the Company s assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2008:

(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investments for Nonqualified Retirement Savings Retirement Plan:				
Money Market and Mutual Funds and Cash	$ 1,049			$ 1,049
Cash Surrender Value of Life Insurance Policies		$ 9,211		9,211
Cash Surrender Value of Keyman Life Insurance Policies Net of Policy Loans		10,235		10,235
Forward Energy Contracts		4,922		4,922
Investments of Captive Insurance Company:				
Corporate Debt Securities	3,707			3,707
U.S. Government Debt Securities	1,323			1,323
Total Assets	$ 6,079	$ 24,368		$ 30,447
Liabilities:				
Forward Energy Contracts		$ 3,427		$ 3,427
Forward Foreign Currency Exchange Contracts	$ 114			114
Total Liabilities	$ 114	$ 3,427		$ 3,541
Net Assets	$ 5,965	$ 20,941		$ 26,906

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Inventories

Inventories consist of the following:

(in thousands)	September 30, 2008	December 31, 2007
Finished Goods	$ 45,492	$ 38,952
Work in Process	11,044	5,218
Raw Material, Fuel and Supplies	54,506	53,044
	$ 111,042	$ 97,214

Goodwill and Other Intangible Assets

As a result of the acquisition of Miller Welding & Iron Works, Inc. (Miller Welding) by BTD Manufacturing, Inc. (BTD) in May 2008, Goodwill increased $7,986,000, Covenants Not to Compete increased by $100,000, Customer Relationships increased by $16,100,000 and Brand/Trade Name increased by $400,000. In the second quarter of 2008, ShoreMaster eliminated $282,000 of fully amortized Covenants Not to Compete. As a result of the sale of certain imaging assets and routes in the Health Services segment in the third quarter of 2008, Goodwill was reduced by $450,000 and $200,000 of fully amortized Covenants Not to Compete were eliminated.

The following table summarizes the components of the Company s other intangible assets at September 30, 2008 and December 31, 2007:

	September 30, 2008	December 31, 2007