

Otter Tail Corp
Form 10-Q
November 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period September 30, 2012
ended

OR

☐ 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 0-53713

OTTER TAIL CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota 27-0383995
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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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.:

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

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

October 31, 2012 – 36,166,218 Common Shares (\$5 par value)

OTTER TAIL CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Otter Tail Corporation
Consolidated Balance Sheets
(not audited)

(in thousands)	September 30, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$--	\$ 14,652
Accounts Receivable:		
Trade—Net	133,674	116,522
Other	5,488	18,807
Inventories	73,430	77,983
Deferred Income Taxes	12,325	12,307
Accrued Utility Revenues	11,029	13,719
Costs and Estimated Earnings in Excess of Billings	23,900	67,109
Regulatory Assets	21,084	27,391
Other	17,766	21,414
Assets of Discontinued Operations	730	29,692
Total Current Assets	299,426	399,596
Investments	9,920	11,093
Other Assets	26,628	26,997
Goodwill	39,119	39,406
Other Intangibles—Net	14,549	15,286
Deferred Debits		
Unamortized Debt Expense	4,866	6,458
Regulatory Assets	117,537	124,137
Total Deferred Debits	122,403	130,595
Plant		
Electric Plant in Service	1,409,729	1,372,534
Nonelectric Operations	219,537	310,320
Construction Work in Progress	71,017	54,439
Total Gross Plant	1,700,283	1,737,293
Less Accumulated Depreciation and Amortization	642,402	659,744
Net Plant	1,057,881	1,077,549
Total Assets	\$1,569,926	\$ 1,700,522

See accompanying notes to consolidated financial statements.

Otter Tail Corporation
Consolidated Balance Sheets
(not audited)

(in thousands, except share data)	September 30, 2012	December 31, 2011
LIABILITIES AND EQUITY		
Current Liabilities		
Short-Term Debt	\$ 12,417	\$ --
Current Maturities of Long-Term Debt	173	3,033
Accounts Payable	103,108	115,514
Accrued Salaries and Wages	24,360	19,043
Accrued Taxes	10,359	11,841
Derivative Liabilities	18,869	18,770
Other Accrued Liabilities	6,923	5,540
Liabilities of Discontinued Operations	164	13,763
Total Current Liabilities	176,373	187,504
Pensions Benefit Liability	99,534	106,818
Other Postretirement Benefits Liability	49,876	48,263
Other Noncurrent Liabilities	21,806	19,002
Commitments and Contingencies (note 9)		
Deferred Credits		
Deferred Income Taxes	152,340	177,264
Deferred Tax Credits	31,822	33,182
Regulatory Liabilities	69,396	69,106
Other	449	520
Total Deferred Credits	254,007	280,072
Capitalization		
Long-Term Debt, Net of Current Maturities	421,725	471,915
Cumulative Preferred Shares		
Authorized 1,500,000 Shares Without Par Value;		
Outstanding 2012 and 2011 – 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, 2012—36,164,598 Shares; 2011—36,101,695 Shares	180,823	180,509
Premium on Common Shares	253,225	253,123
Retained Earnings	100,198	141,248
Accumulated Other Comprehensive Loss	(3,141)	(3,432)
Total Common Equity	531,105	571,448

Total Capitalization	968,330	1,058,863
Total Liabilities and Equity	\$ 1,569,926	\$ 1,700,522

See accompanying notes to consolidated financial statements.

Otter Tail Corporation
Consolidated Statements of Income
(not audited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except share and per-share amounts)	2012	2011	2012	2011
Operating Revenues				
Electric	\$88,518	\$85,118	\$257,365	\$254,622
Nonelectric	188,625	197,255	581,076	560,197
Total Operating Revenues	277,143	282,373	838,441	814,819
Operating Expenses				
Production Fuel - Electric	20,622	19,080	48,501	55,737
Purchased Power - Electric System Use	8,138	7,488	34,624	27,759
Electric Operation and Maintenance Expenses	28,717	27,323	91,137	84,718
Cost of Goods Sold - Nonelectric (excludes depreciation; included below)	158,703	171,157	489,305	490,737
Other Nonelectric Expenses	16,438	19,114	51,118	49,204
Asset Impairment Charge	--	--	46,005	--
Exit and Disposal Costs – DMI Industries, Inc.	4,400	--	4,400	--
Depreciation and Amortization	15,951	17,604	50,122	52,262
Property Taxes - Electric	2,833	2,601	8,120	7,427
Total Operating Expenses	255,802	264,367	823,332	767,844
Operating Income	21,341	18,006	15,109	46,975
Loss on Early Retirement of Debt	13,106	--	13,106	--
Interest Charges	7,904	8,696	24,997	27,310
Other Income	689	408	2,423	1,544
Income (Loss) from Continuing Operations Before Income Taxes	1,020	9,718	(20,571)	21,209
Income Tax (Benefit) Expense – Continuing Operations	(858)	2,382	(15,054)	3,535
Net Income (Loss) from Continuing Operations	1,878	7,336	(5,517)	17,674
Discontinued Operations				
(Loss) Income - net of Income Tax (Benefit) Expense of (\$2), (\$307), \$571, and \$261 for the respective periods	(5)	(514)	821	420
(Loss) Gain on Disposition - net of Income Tax (Benefit) Expense of \$0, (\$302), (\$169), and \$3,213 for the respective periods	--	(454)	(3,544)	12,798
Net (Loss) Income from Discontinued Operations	(5)	(968)	(2,723)	13,218
Net Income (Loss)	1,873	6,368	(8,240)	30,892
Preferred Dividend Requirements and Other Adjustments	183	184	551	874
Earnings Available for Common Shares	\$1,690	\$6,184	\$(8,791)	\$30,018
Average Number of Common Shares Outstanding—Basic	36,061,002	35,933,003	36,043,276	35,911,993
Average Number of Common Shares Outstanding—Diluted	36,252,765	36,171,555	36,043,276	36,150,545
Basic Earnings Per Common Share:				
Continuing Operations	\$0.05	\$0.20	\$(0.17)	\$0.48
Discontinued Operations	--	(0.03)	(0.07)	0.36
	\$0.05	\$0.17	\$(0.24)	\$0.84

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Diluted Earnings Per Common Share:

Continuing Operations	\$0.05	\$0.20	\$(0.17) \$0.47
Discontinued Operations	--	(0.03	) (0.07	) 0.36
	\$0.05	\$0.17	\$(0.24) \$0.83

Dividends Declared Per Common Share	\$0.2975	\$0.2975	\$0.8925	\$0.8925
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See accompanying notes to consolidated financial statements.

Otter Tail Corporation
Consolidated Statements of Comprehensive Income
(not audited)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Income (Loss)	\$1,873	\$6,368	\$(8,240)	\$30,892
Other Comprehensive Income (Loss):				
Unrealized Gain on Available-for-Sale Securities:				
Gain (Loss) Arising During Period	72	(3)	180	11
Income Tax Expense	(29)	1	(72)	(5)
Unrealized Gain on Available-for-Sale Securities – net-of-tax	43	(2)	108	6
Foreign Currency Translation Adjustment:				
Unrealized Net Change During Period	--	--	--	303
Reversal of Previously Recognized Gains Realized on the Sale of Idaho Pacific Holdings, Inc. (IPH)	--	--	--	(6,068)
Income Tax Benefit	--	--	--	1,788
Foreign Currency Translation Adjustment – net-of-tax	--	--	--	(3,977)
Pension and Postretirement Benefit Plans:				
Actuarial Loss -- Regulatory Allocation Adjustment (ESSRP)	--	--	--	(1,621)
Amortization of Unrecognized Postretirement Benefit Losses and Costs	101	79	305	963
Income Tax (Expense) Benefit	(41)	(32)	(122)	263
Pension and Postretirement Benefit Plans – net-of-tax	60	47	183	(395)
Total Other Comprehensive Income (Loss)	103	45	291	(4,366)
Total Comprehensive Income (Loss)	\$1,976	\$6,413	\$(7,949)	\$26,526

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
(in thousands)	2012	2011
Cash Flows from Operating Activities		
Net (Loss) Income	\$(8,240)	) \$30,892
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Net Loss (Gain) from Sale of Discontinued Operations	3,544	(12,798)
Income from Discontinued Operations	(821)	) (420)
Depreciation and Amortization	50,122	52,262
Asset Impairment Charge	46,005	--
Premium Paid for Early Retirement of Long-Term Debt	12,500	--
Deferred Tax Credits	(1,568)	) (1,834)
Deferred Income Taxes	(3,513)	) 10,117
Change in Deferred Debits and Other Assets	16,493	11,976
Discretionary Contribution to Pension Plan	(10,000)) --
Change in Noncurrent Liabilities and Deferred Credits	7,129	1,690
Allowance for Equity (Other) Funds Used During Construction	(518)	) (576)
Change in Derivatives Net of Regulatory Deferral	752	(177)
Stock Compensation Expense – Equity Awards	930	1,760
Other—Net	821	1,107
Cash (Used for) Provided by Current Assets and Current Liabilities:		
Change in Receivables	(3,815)	) (36,575)
Change in Inventories	4,552	(11,866)
Change in Other Current Assets	43,202	10,225
Change in Payables and Other Current Liabilities	2,748	6,472
Change in Interest and Income Taxes Receivable/Payable	(12,263)	) 280
Net Cash Provided by Continuing Operations	148,060	62,535
Net Cash Provided by Discontinued Operations	1,322	17,837
Net Cash Provided by Operating Activities	149,382	80,372
Cash Flows from Investing Activities		
Capital Expenditures	(96,548)	) (60,431)
Proceeds from Disposal of Noncurrent Assets	5,478	1,859
Net (Increase) Decrease in Other Investments	(1,385)	) 334
Net Cash Used in Investing Activities - Continuing Operations	(92,455)	) (58,238)
Net Proceeds from Sale of Discontinued Operations	24,278	84,330
Net Cash Used in Investing Activities - Discontinued Operations	(11,705)	) (15,875)
Net Cash (Used in) Provided by Investing Activities	(79,882)	) 10,217
Cash Flows from Financing Activities		
Change in Checks Written in Excess of Cash	4,402	(8,464)
Net Short-Term Borrowings (Repayments)	12,417	(40,415)
Payments for Retirement of Common Stock and Common Stock Issuance Expenses	(291)	) (152)
Proceeds from Issuance of Long-Term Debt	--	2,007
Short-Term and Long-Term Debt Issuance Expenses	(14)	) (1,577)
Payments for Retirement of Long-Term Debt	(53,051)) (368)
Premium Paid for Early Retirement of Long-Term Debt	(12,500)) --

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Dividends Paid and Other Distributions	(33,033)	(33,011)
Net Cash Used in Financing Activities - Continuing Operations	(82,070)	(81,980)
Net Cash Used in Financing Activities - Discontinued Operations	(1,409)	(1,681)
Net Cash Used in Financing Activities	(83,479)	(83,661)
Net Change in Cash and Cash Equivalents - Discontinued Operations	(673)	921
Effect of Foreign Exchange Rate Fluctuations on Cash – Discontinued Operations	--	(324)
Net Change in Cash and Cash Equivalents	(14,652)	7,525
Cash and Cash Equivalents at Beginning of Period	14,652	--
Cash and Cash Equivalents at End of Period	\$--	\$7,525

See accompanying notes to consolidated financial statements.

OTTER TAIL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(not audited)

In the opinion of management, Otter Tail Corporation (the Company) has included all adjustments necessary for a fair presentation of the condensed consolidated financial statements for the periods presented. The condensed 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, 2011, 2010 and 2009 included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Because of seasonal and other factors, the earnings for the three and nine month periods ended September 30, 2012 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 of the notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

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 Otter Tail Power Company (OTP) forward energy contracts, marked-to-market and realized gains and losses are recognized on a net basis in revenue in accordance with the Financial Accounting Standards Board Accounting Standards Codification (ASC) 815, Derivatives and Hedging. 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 in the Company's Wind Energy, Manufacturing and Construction segments enter into fixed-price construction contracts. Revenues under these contracts are recognized on a percentage-of-completion basis. 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 and costs incurred to total estimated costs on all other construction projects.

The Company has a standard quarterly Estimate at Completion (EAC) process in which management reviews the progress and performance of the Company's contracts accounted for under percentage-of-completion accounting. As part of this process, management reviews include, but are not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities, and the related changes in estimates of revenues and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule, technical requirements and other contract requirements. Management must make assumptions regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract, and performance by subcontractors, among other variables. Based on this analysis, any adjustments to net sales, costs of sales, and the related impact to operating

income are recorded as necessary in the period they become known. These adjustments may result from positive program performance and an increase in operating profit during the performance of individual contracts if management determines it will be successful in mitigating risks surrounding the technical, schedule, and cost aspects of those contracts or realizing related opportunities. Likewise, these adjustments may result in a decrease in operating profit if management determines it will not be successful in mitigating these risks or realizing related opportunities. Changes in estimates of net sales, costs of sales, and the related impact to operating income are recognized using a cumulative catch-up, which recognizes, in the current period, the cumulative effect of the changes on current and prior periods based on a contract's percent complete. A significant change in one or more of these estimates could affect the profitability of one or more of the Company's contracts. If a loss is indicated at a point in time during a contract, a projected loss for the entire contract is estimated and recognized.

Following are the percentages of the Company's consolidated revenues recorded under the percentage-of-completion method:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
Percentage-of-Completion Revenues	34.5	%	39.0	%	34.3	%	37.6	%

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

(in thousands)	September 30, 2012	December 31, 2011
Costs Incurred on Uncompleted Contracts	\$ 448,039	\$ 583,346
Less Billings to Date	(454,803)	(550,070)
Plus Estimated Earnings Recognized	17,091	24,478
Net Costs Incurred in Excess of Billings and Accrued Revenues on Uncompleted Contracts	\$ 10,327	\$ 57,754

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, 2012	December 31, 2011
Costs and Estimated Earnings in Excess of Billings	\$ 23,900	\$ 67,109
Billings in Excess of Costs and Estimated Earnings	(13,573)	(9,355)
Net Costs Incurred in Excess of Billings and Accrued Revenues on Uncompleted Contracts	\$ 10,327	\$ 57,754

Included in Costs and Estimated Earnings in Excess of Billings are the following amounts at DMI Industries, Inc. (DMI), the Company's wind tower manufacturer:

(in thousands)	September 30, 2012	December 31, 2011
Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts - DMI	\$ 17,609	\$ 54,541

These amounts are related to costs incurred on wind towers in the process of completion on major contracts under which the customer is not billed until towers are completed and ready for shipment.

Warranty Reserves

The Company establishes reserves for estimated product warranty costs at the time revenue is recognized based on historical warranty experience and additionally for any known product warranty issues. Certain Company products carry one to fifteen year warranties. Although the Company engages in extensive product quality programs and processes, the Company's warranty obligations have been and may in the future be affected by product failure rates, repair or field replacement costs and additional development costs incurred in correcting product failures.

(in thousands)

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Warranty Reserve Balance, December 31, 2011	\$ 3,170
Provision for Warranties Issued During the	
Year	761
Settlements Made During the Year	(880)
Adjustments to Warranty Estimates for Prior	
Years	(71)
Warranty Reserve Balance, September 30, 2012	\$ 2,980

Expenses associated with remediation activities in the Wind Energy segment could be substantial. The potential exists for multiple claims based on one defect repeated throughout the production process or for claims where the cost to repair or replace the defective part is highly disproportionate to the original cost of the part. If the Company is required to cover remediation expenses in addition to regular warranty coverage, the Company could be required to accrue additional expenses and experience additional unplanned cash expenditures which could adversely affect the Company's consolidated results of operations and financial condition.

Retainage

Accounts Receivable include the following amounts, billed under contracts by the Company's subsidiaries, that have been retained by customers pending project completion:

(in thousands)	September 30, 2012	December 31, 2011
Accounts Receivable Retained by Customers	\$ 13,224	\$ 13,526

Sales of Receivables

DMI previously was a party to a \$40 million receivables sales agreement whereby designated customer accounts receivable were sold to General Electric Capital Corporation (GECC) on a revolving basis. This agreement was terminated effective April 26, 2012. In compliance with guidance under ASC 860-20, Sales of Financial Assets, 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.

Following are the amounts of accounts receivable sold under DMI's receivables sales agreement with GECC:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Accounts Receivable Sold	\$-	\$20,662	\$32,115	\$48,802

Fair Value Measurements

The Company follows ASC 820, Fair Value Measurements and Disclosures, for recurring fair value measurements. ASC 820 provides a single definition of fair value, r