

## ELECTRIC



## PLASTICS



## MANUFACTURING



## HEALTH SERVICES

FOOD INGREDIENT  
PROCESSING

## OTHER BUSINESSES



## TO OUR SHAREHOLDERS

Our companies produced solid results in the third quarter, in line with expectations. In the electric segment, earnings were significantly lower from wholesale energy trading in comparison to the record levels of a year ago. We anticipated this as our power company participates in an energy market which has become much more efficient since its 2005 launch.

Our plastics segment continues to show exceptional performance with record third quarter earnings, and our manufacturing segment had marked improvements led by growth at DMI Industries, our wind tower business. In addition, performance at both of our construction companies improved. Higher operating costs continue to provide challenges in both the health services and food ingredient processing segments. We reaffirmed our 2006 earnings per share to be within our earnings guidance range of \$1.55 to \$1.75.

## FINANCIAL RESULTS AS OF SEPTEMBER 30, 2006

Otter Tail Corporation announced the following financial results for the third quarter of 2006:

- Consolidated net income from continuing operations was \$13.5 million compared with \$19.2 million for the third quarter of 2005.
- Total consolidated net income, which includes the results of discontinued operations, was \$13.5 million compared with \$17.6 million for the same period last year.
- Diluted earnings per share from continuing operations were \$0.45 compared with \$0.64 for the third quarter of 2005.
- Total diluted earnings per share, which includes the results of discontinued operations, were \$0.45 compared with \$0.59 a year ago.

## OPERATIONAL RESULTS

Operational results in each of the following segments are for the quarter ended September 30, 2006. These results and outlook references for each segment were announced in our third quarter earnings release on October 30, 2006, which is posted on [www.ottertail.com](http://www.ottertail.com).

## ELECTRIC

Net income in the electric segment was \$6.5 million compared with \$15.5 million for the same period a year ago. The decrease in net income between the periods primarily resulted from an \$8.4 million after-tax reduction in earnings from wholesale energy sales and trading activities and a \$1.1 million after-tax earnings decrease in retail electric revenues. The reduction in earnings from energy trading activities reflects adjustments in the Midwest Independent Transmission System Operator Day 2 energy markets as the market becomes more efficient in its second year of operations.

Due to the coal supply issues late in the first quarter and early second quarter of 2006, decreasing margins on wholesale energy sales involving the purchase and sale of electric energy contracts and increasing transmission and wage and benefit costs, we expect earnings in the electric segment in 2006 to be in a range of \$26.5 million to \$28.0 million, which is consistent with 2006 second quarter expectations.

## PLASTICS

The plastics segment produced another strong quarter, with net income of \$4.6 million compared with \$2.9 million in the third quarter of 2005. The increase in net income is primarily due to higher prices for PVC pipe between the quarters notwithstanding an 18% decrease in pounds sold between the quarters. We expect plastics segment earnings to be slightly higher in 2006 compared to 2005 levels due to the strong performance during the first nine months of 2006.

## MANUFACTURING

The manufacturing segment produced net income of \$2.5 million compared with \$0.9 million from the same quarter a year ago. DMI Industries, Inc. recorded an increase of \$1.4 million in net income between the quarters as a result of increased production and sales of wind towers. At BTD Manufacturing, Inc., net income increased \$0.4 million. Although sales were lower between the quarters at BTD, this was offset by improved productivity in the manufacturing process and from the sale of excess machining equipment that resulted in a net gain on the disposition of those assets. At ShoreMaster, Inc., the net loss increased slightly between the quarters reflecting higher commodity costs not passed through in pricing to customers. At T.O. Plastics, Inc., net income decreased \$0.1 million as a result of a reduction in gross profit margins due to material and production cost increases.

Forecasted 2006 net income from the manufacturing segment is in line with initial 2006 expectations. The improving economy, continued enhancements in productivity and capacity utilization, expanded markets, and expansion of production capacity with the opening of DMI's wind tower plant in Canada, are expected to result in increased net income.

## HEALTH SERVICES

Net income was \$0.3 million in the health services segment compared with \$1.1 million in the third quarter of 2005. Increases in equipment maintenance costs, unit rental costs and sublease costs contributed to the lower results. The health services segment is expected to have earnings in the range of \$1.7 million to \$2.3 million in 2006 due to the lower than expected results in the first nine months of the year.

## FOOD INGREDIENT PROCESSING

The food ingredient processing segment had a net loss of \$1.1 million compared with net income of \$0.3 million in the same period a year ago. The segment has been primarily impacted by raw potato supply shortages that caused production to be curtailed and led to higher than expected raw product costs resulting in a 49.6% increase in the

cost per pound of product sold between the quarters. Revenues per pound of product sold increased 17.2% while pounds of product sold showed a slight decrease between the quarters. We expect to record a net loss in the range of \$1.6 million to \$3.4 million from the food ingredient processing business in 2006, which is consistent with 2006 second quarter expectations.

### OTHER BUSINESS OPERATIONS

Other business operations had net income of \$0.7 million compared with a net loss of \$1.5 million a year ago. The improvement in net income between the periods was due to a \$1.3 million increase in net income at the construction companies and a \$0.9 million reduction in costs at the corporate level mainly related to a reduction of income tax liabilities as a result of closed income tax returns.

The other business operations segment is expected to show improved results over 2005, due to an improving economy and an increase in its backlog of construction contracts. An increase in wind energy projects activity is expected to have a positive impact on our electrical contracting business.

### DISCONTINUED OPERATIONS

Discontinued operations had no impact on results for the third quarter of 2006 and are included for comparisons between the third quarters of 2006 and 2005. The \$1.6 million net loss from discontinued operations in the third quarter of 2005 includes after-tax operating losses from Chassis Liner, St. George Steel and the gas marketing operations of OTESCO.

## BIG STONE II RECEIVES S.D. PERMITS

### Participants say region needs coal and wind

The permitting process is moving forward for Big Stone II, the proposed new power plant that will adjoin the existing Big Stone Plant in Milbank, S.D. Otter Tail Power Company and six other utilities will co-own Big Stone II, which is targeted to be operational for regional energy needs by mid-2011 to early 2012.

During this past summer, the Big Stone II Project Team secured the plant's solid waste, surface water and siting permits from the state of South Dakota. Air, groundwater and transmission route permit processes are underway in South Dakota, as are Certificate of Need proceedings in Minnesota for transmission lines to be located in the state. The permitting process for the Federal Environmental Impact Statement is also under review.



Otter Tail Corporation common stock (NASDAQ: OTTR) reached a quarterly high of \$30.80 and a low of \$26.50 for the three months ended September 30, 2006.

### FORWARD-LOOKING STATEMENTS

Forward-looking statements in this shareholder report are made under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to a number of factors including, but not limited to, government regulations and actions; weather conditions; MISO Day 2 electric markets and recovery of related costs; electric wholesale trading activities; reduced coal shipments to power plants due to rail transportation bottlenecks; continuation of production tax credits; federal and state environmental regulations; diversification efforts; competition; economic uncertainty; impact of volatile financial markets on access to capital markets, borrowing costs and pension plan expenses; the availability of off-grade potato supplies; foreign currency changes between Canada and the United States; natural gas prices; supply and cost of PVC resin; dealership arrangements and other agreements with Phillips Medical; and other factors discussed from time to time in reports the corporation files with the Securities and Exchange Commission.

With the addition of 630 megawatts from Big Stone II, the generating capacity of the Big Stone site will more than double. But emissions will be tightly controlled. Using new technologies in environmental protection equipment, emissions of sulfur dioxide, nitrogen oxides and mercury from the two coal-based plants will be as clean as, or cleaner than, they are now with a single plant. The new plant will emit 20% less carbon dioxide than the average of existing coal-fired power plants in the region.

An associated project, the Big Stone Transmission Project, calls for upgrading or adding to the transmission grid in order to deliver both the power generated by the new plant and power from other new generation, including renewable energy resources. Certain lines will have greater carrying capacity to allow for an additional 800 megawatts, which will potentially come from wind energy and other forms of renewable power.

The project participants are committed to substantially increasing renewable energy sources within their respective generation resource mixes. In total, they have proposed to own or purchase the output of 850 megawatts of wind energy by 2015 plus an additional 100 megawatts of other renewable sources. In addition, they have collectively saved 560 megawatts through programs emphasizing energy conservation and efficiencies and anticipate saving 240 megawatts more with these programs during the next few years.

We realize that laying the groundwork for greater energy demand doesn't exclude one energy solution over another, such as coal versus wind. It will take coal and wind—along with other traditional and renewable resources, effective pollution-control technology and conservation measures—to keep clean and cost-effective electricity readily available.

## OTTER TAIL RECOGNIZED AMONG 40 BEST ENERGY COMPANIES

In its September issue, leading trade publication *Public Utilities Fortnightly* compiled a financial ranking of the 40 top-performing electric and gas utilities (including diversified utilities such as our organization), pipelines and distribution companies in the United States.

Otter Tail Corporation is recognized as 27<sup>th</sup> on the 2006 list of energy leaders. The ratings were based on profitability, dividend yield, cash flow, return on equity, return on assets and sustainable growth for the three-period from 2003 to 2005. Otter Tail Corporation also appeared on this list in 2005, the first year it was compiled. We are pleased to again be included in this annual compilation of excellent performers.

## PEOPLE MAKE THE DIFFERENCE

When I attended the recent ribbon-cutting event at the DMI wind tower plant in Fort Erie, Ontario, I could see the high level of pride and dedication that our newest employees bring to their work. (For more about DMI's successful expansion into Canada, see page 4.) I also attended an event in October to celebrate another successive year of safety at ShoreMaster's plastics division in Fergus Falls, Minn. At Otter Tail Corporation, we talk about working together to grow our companies. We realize this growth wouldn't be possible without the exceptional efforts of the 3,500 people who work at all of our companies.

On behalf of all the employees at the Otter Tail companies, we are grateful for your continued support and we will work hard to provide our shareholders with a strong and reliable investment.

Sincerely,

John Erickson  
President and CEO

**CONSOLIDATED STATEMENTS OF INCOME**
**Three months ended September 30,**
**Nine months ended September 30,**

<i>(in thousands, except share and per-share amounts) (not audited)</i>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Operating revenues</b>				
Electric	\$ 71,206	\$ 85,770	\$ 227,308	\$ 233,403
Plastics	45,941	45,462	136,731	113,621
Manufacturing	76,667	59,803	226,555	183,190
Health services	35,432	30,653	100,341	89,775
Food ingredient processing	11,474	9,808	30,635	27,297
Other business operations	40,739	30,805	99,397	78,781
Intersegment eliminations	(917)	(1,114)	(2,714)	(2,997)
Total operating revenues	280,542	261,187	818,253	723,070
<b>Operating expenses</b>				
Production fuel	15,846	14,485	42,108	40,211
Purchased power - system use	8,590	13,295	44,990	44,737
Other electric operation and maintenance expenses	26,433	23,383	77,889	72,635
Cost of goods sold (excludes depreciation; included below)	161,148	135,662	449,905	372,894
Other nonelectric expenses	29,543	26,428	85,097	74,712
Depreciation and amortization	12,552	11,720	37,155	34,658
Property taxes - electric operations	2,260	2,735	7,429	7,816
Total operating expenses	256,372	227,708	744,573	647,663
<b>Operating income (loss)</b>				
Electric	11,647	25,788	35,658	49,717
Plastics	7,792	5,175	24,046	14,065
Manufacturing	5,944	2,739	19,793	13,944
Health services	749	2,087	2,693	5,860
Food ingredient processing	(1,602)	558	(4,792)	2,216
Other business operations	(360)	(2,868)	(3,718)	(10,395)
Total operating income	24,170	33,479	73,680	75,407
<b>Other income</b>	1,060	1,071	2,147	1,472
<b>Interest charges</b>	5,078	4,633	14,622	14,007
<b>Income from continuing operations before income taxes</b>	20,152	29,917	61,205	62,872
<b>Income taxes - continuing operations</b>	6,676	10,749	21,737	21,676
<b>Net income from continuing operations</b>	13,476	19,168	39,468	41,196
<b>Discontinued operations</b>				
(Loss) Income from discontinued operations net of taxes of \$0; (\$391); \$28 and (\$161) for the respective periods	—	(589)	26	(252)
Goodwill impairment loss	—	(1,003)	—	(1,003)
Net gain on disposition of discontinued operations - net of taxes of \$0; \$17; \$224 and \$5,786 for the respective periods	—	27	336	9,937
<b>Net income from discontinued operations</b>	—	(1,565)	362	8,682
<b>Net income</b>	13,476	17,603	39,830	49,878
<b>Preferred dividend requirements</b>	183	185	551	552
<b>Earnings available for common shares</b>	\$ 13,293	\$ 17,418	\$ 39,279	\$ 49,326
<b>Average number of common shares outstanding—basic</b>	29,412,526	29,245,640	29,377,158	29,176,625
<b>Average number of common shares outstanding—diluted</b>	29,805,897	29,441,410	29,764,752	29,289,438
<b>Basic earnings per common share:</b>				
Continuing operations (net of preferred dividend requirement)	\$ .45	\$ .65	\$ 1.33	\$ 1.39
Discontinued operations	\$ —	\$ (.05)	\$ .01	\$ .30
	\$ .45	\$ .60	\$ 1.34	\$ 1.69
<b>Diluted earnings per common share:</b>				
Continuing operations (net of preferred dividend requirement)	\$ .45	\$ .64	\$ 1.31	\$ 1.39
Discontinued operations	\$ —	\$ (.05)	\$ .01	\$ .29
	\$ .45	\$ .59	\$ 1.32	\$ 1.68
<b>Dividends per common share</b>	\$ .2875	\$ .2800	\$ .8625	\$ .8400

**CONSOLIDATED BALANCE SHEETS**

<i>(in thousands) (not audited)</i>	<b>September 30, 2006</b>	<b>December 31, 2005</b>	<b>September 30, 2006</b>	<b>December 31, 2005</b>
<b>ASSETS</b>			<b>LIABILITIES AND EQUITY</b>	
<b>Current assets</b>			<b>Current liabilities</b>	
Cash and cash equivalents	\$ 7,999	\$ 5,430	Short-term debt	\$ 54,037
Accounts receivable, net	140,020	129,586	Current maturities of long-term debt	3,087
Inventories	106,601	88,677	Accounts payable	115,118
Deferred income taxes	6,967	6,871	Income taxes payable	2,108
Accrued utility revenues	20,091	22,892	Other accrued taxes	10,008
Costs and estimated earnings in excess of billings	41,733	21,542	Other accrued liabilities	41,932
Other	14,360	16,476	Liabilities of discontinued operations	187
Assets of discontinued operations	409	13,701	Total current liabilities	226,477
Total current assets	338,180	305,175	<b>Pension benefit liability</b>	24,397
<b>Investments and other assets</b>			<b>Other postretirement benefits liability</b>	28,033
Goodwill—net	36,992	33,824	<b>Other noncurrent liabilities</b>	17,137
Other intangibles—net	98,110	98,110	<b>Deferred credits</b>	
Deferred debits	20,360	21,160	Deferred income taxes	112,351
	23,452	26,136	Deferred investment tax credit	8,467
<b>Plant</b>			Regulatory liabilities	65,343
Electric plant in service	921,642	910,766	Other	1,430
Nonelectric operations	235,893	228,548	Total deferred credits	187,591
Total plant	1,157,535	1,139,314	<b>Capitalization</b>	
Less accumulated depreciation and amortization	472,876	459,438	Long-term debt, net of current maturities	256,223
Plant—net of accumulated depreciation and amortization	684,659	679,876	Class B stock options of subsidiary	1,258
Construction work in progress	37,042	17,215	Cumulative preferred shares	15,500
Net plant	721,701	697,091	Common shares	147,495
Total	\$ 1,238,795	\$ 1,181,496	Premium on common shares	98,124
			Unearned compensation	—
			Retained earnings	242,392
			Accumulated other comprehensive loss	(5,832)
			Total common equity	482,179
			Total capitalization	755,160
			Total	\$ 1,238,795
				\$ 1,181,496

