

ALLETE

**Moderator: Al Hodnick
May 2, 2012
10:00 a.m. ET**

Operator: Good day, and welcome to the ALLETE first-quarter 2012 financial results call. Today's call is being recorded.

Certain statements contained in this conference call that are a not a description of historical facts are forward-looking statements, such as terms defined in the Private Securities Litigation Reform Act of 1995. Because such statements can include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause the results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to, those discussed in filings made by the Company with the Securities and Exchange Commission.

Many of the factors that will determine the Company's future results are beyond the ability of Management to control or predict. Listeners should not place undue reliance on forward-looking statements which reflect Management's view only as of the date hereof. The Company undertakes no obligation to revise or update any forward-looking statement or to make any other forward-looking statement, whether as the result of new information, future events, or otherwise.

For opening remarks and introductions, I would now like to turn the conference over to your host today, ALLETE Chairman, President and CEO, Mr. Al Hodnik. Sir, you may begin.

Al Hodnik: Good morning, and thank you for joining us. Mark Schober, ALLETE's Chief Financial Officer, is also with me today.

This morning we reported our first-quarter earnings results of \$0.66 per share. Other than a \$0.05 per share impact on our earnings due to the extremely mild winter weather we had in our region, the quarter's results were as we had anticipated. Mark will go through the financials shortly, but I want to point out that our 2012 earnings guidance remains unchanged. We expect to earn between \$2.45 and \$2.65 per share in 2012.

Before I turn to Mark, let me summarize some of the key events for the quarter. On March 1st, Minnesota Power received large power demand nominations for the May through August time period. They indicate our industrial customers plan to continue at near full production levels for the four-month period similar to the first four months of this year. As I mentioned during our last conference call, we assume continued strong production levels for our industrial customers for 2012.

With regard to new industrial development in our region, Essar Steel Minnesota, who is served by the City of Nashwauk, one of our municipal customers, continues to move forward with construction of its new 70 to 110 megawatt taconite mining and pellet plant production facility. Essar Steel has received all of their required permits to now produce seven million tons of taconite annually, and they are on track to begin operations in 2013.

Construction activities are also well underway for two new Magnetation facilities. The first of these two is now complete and is expected to be operational in May or June. The second, a joint venture between Magnetation and Steel Dynamics, the majority owner of Mesabi Nugget, called Mining Resources, is on schedule to be completed during the second half of this year. Both of these facilities are expected to require between five to seven megawatts each.

Turning to our capital investments, our two newest North Dakota wind projects, Bison 2 and Bison 3, are expected to be completed and fully operational by year end. Site preparation is currently underway, with about

135 construction workers on site. Total project costs are estimated to be approximately \$320 million combined, for both projects. And through the first quarter we have spent about \$65 million. We anticipate filing petitions with the Minnesota Public Utilities Commission during the first half of this year to establish customer billing rates for the approved cost recovery, which should begin during the second half of this year.

We have had a solid start to 2012, as we continue to make progress on our multifaceted, multi-year growth strategies. I will make some additional comments before we take your questions, but at this time I will turn the call over to Mark. Mark?

Mark Schober: Thanks, Al, and good morning, everyone.

Before I begin I would like to remind you that we filed our 10-Q this morning and I encourage you to refer to it for more details.

For the first quarter of 2012 ALLETE reported earnings per share of \$0.66 on net income of \$24.4 million and operating revenue of \$240 million compared to reported earnings per share of \$1.07 on net income of \$37.2 million and operating revenue of \$242.2 million in 2011.

Last year's first quarter included the reversal of a \$6.2 million, or \$0.18 per share, deferred tax liability related to a revenue receivable that Minnesota Power agreed to forego as part of a 2010 rate case stipulation and settlement agreement. Excluding this reversal the first quarter of 2012 earnings per share of \$0.66 and net income of \$24.4 million compares to earnings per share of \$0.89 and net income of \$31 million for the same period in 2011.

Consolidated operating and maintenance expense increased by \$9.8 million compared to last year's first quarter. The key contributor to this increase is the timing of maintenance activities, which can vary year to year. While quarter-over-quarter comparisons will fluctuate due to these timing differences, we expect full-year consolidated operating and maintenance expense will be approximately five percent higher than in 2011. This increase includes higher salaries, pension expenses, and expenses at BNI Coal for 2012. These

increases were included in the original earnings guidance we made last December.

I will now highlight a few points from our Regulated Operations segment, which includes Minnesota Power, Superior Water Light & Power, and our investment in the American Transmission Company. Net income for this segment was \$24.4 million for the quarter compared to \$38.4 million for the same period in 2011. The decrease is due to the deferred tax reversal I just mentioned, lower kilowatt hour sales, higher costs under our Square Butte purchase power agreement, and higher operating and maintenance and depreciation expenses, partially offset by higher current cost recovery rider revenue.

Now, for some of the details for the quarter. Total Regulated Operations revenue decreased \$4.4 million, or two percent, from 2011. Fuel adjustment clause recoveries decreased \$5.4 million, or 20 percent, from 2011 due primarily to lower purchase power costs. Unseasonably warm weather negatively impacted sales primarily to our residential customers. Heating degree days in Duluth were approximately 25 percent lower than in the first quarter last year, and 20 percent below normal levels. However, these decreases were partially offset by increased sales to industrial customers. So, total kilowatt hour sales were down only about one percent from a year ago, despite the unusually warm weather.

Current cost recovery rider revenue increased by \$2.7 million, primarily due to higher capital expenditures related to our Bison projects. Current cost recovery rider revenue will grow in 2012 as our capital expenditure levels increase for the remainder of the year.

Regulated Operations operating and maintenance expense increased \$6.9 million, or 10 percent, over the same period in 2011. The increase reflects the timing difference I mentioned earlier, as well as higher salaries and benefit costs, property taxes, and transmission expenses. Depreciation expense increased \$2 million and interest expense was up \$1 million for the quarter, both directly attributable to the capital investment program at our regulated operations.

Earnings from our investment in ATC for the quarter were in line with 2011 results.

Income tax expense increased \$2 million, or 21 percent, from 2011 even though pretax income was lower. This was primarily due to the 2011 reversal of the \$6.2 million deferred tax liability.

The Investments and Other segment reported no net income for the quarter compared to a net loss of \$1.2 million in 2011. The improvement in 2012 was mainly due to lower state income tax and interest expense, partially offset by increased business development expenses.

Our consolidated effective tax rate for the first quarter of 2012 was 25.4 percent compared to 18.1 percent for the same period last year. Excluding the reversal of the \$6.2 million deferred tax liability from last year's taxes, the effective rate was 31.8 percent. We anticipate the effective tax rate for 2012 will be approximately 25 percent because of increased renewable tax credits as a result of our Bison projects.

An increase in the average number of common shares outstanding in 2012 from a year ago resulted in dilution of \$0.04 per share over the first quarter of 2011. Proceeds from our equity issuances are used to fund the capital investment program.

Our cash flow was strong for the quarter. As of March 31 we generated approximately \$69 million in cash from operating activities and carried a 44 percent debt-to-capital ratio.

In summary, we are satisfied with our financial results in the first quarter and we are confident in our prospects for the full year. Except for the approximate \$0.05 per share weather-related impact this quarter, results were consistent with our internal expectations.

Quarterly comparisons to 2011 results will fluctuate. For 2012 current cost recovery revenue will increase throughout the year as the Bison 2 and 3

projects progress. And, as I previously mentioned, the timing of operating and maintenance expenses can vary quarter to quarter.

Our earnings guidance for the full year remains unchanged. We continue to project that 2012 earnings per share will be within a range of \$2.45 to \$2.65 per share.

Al?

Al Hodnik: Thank you, Mark.

ALLETE is an energy company with a number of multifaceted and multi-year growth opportunities that we believe will materialize over the next decade. We are seeing the start of new organic revenue growth opportunities with the construction progress at Essar Steel in Nashwauk and with the twin Magnetation initiatives. When our Bison 2 and Bison 3 projects are completed at the end of this year we will have met a significant portion of the State of Minnesota's renewable energy mandate and, through current cost recovery, realized returns on our sizeable North Dakota investments.

Transmission investments in CapEx 2020, in the American Transmission Company, and in infrastructure designed to serve the Essar Steel facility are continuing. So, too, is developmental work on our exciting Manitoba Hydro transmission delivery opportunity.

Lastly, with the issuance by the EPA of new mercury rules, final engineering relative to our 585 megawatt Boswell Unit 4 is coming into focus. We have until 2015 to meet these new rules and are currently estimating that a \$300 million to \$400 million capital investment will be required.

We remain excited about our strategy and overall positioning. I look forward to reporting our progress in future calls. Before we take your questions, thank you once again for your investment in ALLETE.

At this time I will ask the Operator to open up the lines for your questions.

Operator: Thank you. Ladies and gentlemen, if you have a question at this time, please press star one on your touchtone telephone. If your question has been answered and you wish to remove yourself from the queue, please press the pound key.

Again, if you have a question, please press star then one. Our first question comes from Larry Solow of CJS Securities. Your line is open.

Arnie Ursaner: It's actually Arnie Ursaner, backing up Larry Solow at CJS Securities. Two questions if I can – one is, we're hearing a lot of comments about the resurgence of industrial activity in the Midwest and wouldn't mind if you would comment on how you see that impacting your business over the next several years, whether in fact you think that is correct and how it could change the way you manage your business.

Al Hodnik: Well, there's no doubt that there's a resurgence in manufacturing in the Midwest or, if nothing else, a recovery from the '08, '09 period. But beyond the recovery I think there is a resurgence in manufacturing in the Midwest. Of course, our customers are largely mining customers and mineral customers. And most of the product that they produce, or all the product they produce, stays domestic and is used in the processing, if you will, or finishing of steel, steel products and all the things that would go into a surge, if you will, in sort of metals-related manufacturing.

And beyond that we're very excited about the expansion prospects that they've already – sort of have underway or have announced that they intend to pursue further, both on the ferrous mining side, the traditional mining side up here, and also on the nonferrous mining side, PolyMet Mining, Twin Metals, and other companies that are exploring copper, nickel, platinum, and palladium opportunities on the eastern end of the Mesabi Iron Range. So those projects are a little bit further downstream with regards to permitting. But, nonetheless, those companies are continuing to pursue opening up those mines and providing those kinds of critical vital natural resources not only domestically here, but overseas where their applications make sense.

So we're excited about that. We see prospects for load growth in our region here, if all of this came to pass, at anywhere from 300 to 600 megawatts. And so for us that is a tremendous load growth prospect, some of which, again, with Essar Steel as I described earlier are already coming to pass.

And so for us it's an exciting time, both on organic revenue growth prospects, opportunities for capital investment maybe down the road and new generation if that was necessary to serve the load, and just economic prosperity here in the region in terms of secondary suppliers to these industries expanding their businesses as well.

Operator: Brian Russo; Ladenburg Thalmann.

Brian Russo: Could you just update us on the status of the pension tracker filing? And also, what is the impact of the incremental pension expense in 2012?

Mark Schober: Brian, that continues to move forward. As you're aware, we filed earlier in the year to – recovery on our pension expenses that are over and above what's in our last rate case. That continues to move forward. We anticipate that will be in front of the Commission sometime probably later this summer. Comments have come in from other parties to date and certainly that's more information that the Commission will consider.

The overall impact on the Company for 2012 is probably in the range of \$4 million to \$5 million.

Brian Russo: OK, and that's captured in the five percent increase in year-over-year O&M?

Mark Schober: Yes.

Brian Russo: OK. Has staff filed comments yet?

Mark Schober: No, they have not.

Brian Russo: When can we expect that?

Mark Schober: I would anticipate that sometime within the next quarter, sometime you'll see that.

Brian Russo: OK, great. And it's my understanding that Essar Steel is also contemplating up to 300 – a steel mill that would require up to 300 megawatts of load in the 2015 timeframe. Any update you can give us on the development of that? And would you need to build a gas plant to serve that load?

Al Hodnik: Well, the communications that we've had with Essar Steel, Brian, indicate that the direct reduced iron (and) steelmaking facilities are in their sort of long-term plans, so they are definitely contemplating them. I think they have indicated that they would have to take a look at the markets, both in India in terms of their needs there and also sort of North American needs before they would move forward with that project. I think their focus right now is to complete the taconite facility which, as I said earlier, has been permitted now to a seven million ton capacity. So it's certainly sized for what it is they're looking at, not only for pellet production but long-term steel making. And we'll just have to wait and see as to how that materializes. It would be roughly a 300 megawatt load if it came to pass and they did build it in that 2015/2016 timeframe.

And for us, given the nature of that type of load – steelmaking is a little bit more cyclical up and down, if you will, by just the way they produce steel compared to taconite, which is sort of a 24-hour day, round the clock concentrating crushing and grinding operation. We probably would need some different type of an asset to serve that anyway. And as I've said on prior calls, that next asset is likely to be some form of a gas combustion turbine.

Brian Russo: OK. So I guess in summary, it's early on in that process and we should look for developments maybe after they complete the taconite expansion?

Al Hodnik: That would be my sense. I think they'll focus now as much as they're able to get the taconite facility up and running in 2013. And then once they sort of shake that out and understand where they're at there, then take a look at the next steps.

Brian Russo: OK. And then lastly, when might we expect you to file your next general rate case in Minnesota?

Mark Schober: That's something we look at, Brian, on a regular basis. And at this point in time there is no date out there when we're planning on filing. So we'll look at our results and our plans for 2013/2014 and if there's drivers there to push us in – pension could be one of them. But at this point in time there's nothing firm that we have to file a rate case.

Brian Russo: OK. Then just back on the pension tracker, have you had – is there precedent for this type of filing, meaning have you experienced higher pension expense and rates and got a tracker for it?

Mark Schober: Yes. I believe there's precedence in other states, Brian. But I don't think there is in Minnesota.

Brian Russo: OK, great. Thank you very much.

Operator: Thank you. Again, if you have a question at this time, please press star one on your touch tone telephone.

Our next question comes from James Bellessa of D.A. Davidson. Your line is open.

James Bellessa: You indicated that O&M perhaps might be up five percent in 2012 versus 2011. By my arithmetic that puts it at about \$400 million. Is that what you're talking about?

Mark Schober: No. When we look at O&M on a – for the full year, consolidated O&M, Jim, we anticipate a five percent increase. And that's overall about an \$18 million increase in O&M then.

James Bellessa: Yes, that's –

Mark Schober: OK? And that's split, then. About half of that is going to be on the Regulated side of the business and the other half will be on the Investment and Other. And that's primarily increases at BNI Coal. And you've already seen some of that in Q1 here.

- James Bellessa: The most recent quarter was almost \$100 million in O&M. So your average quarterly rate will be at this speed, it sounds like. Now –
- Mark Schober: No, that –
- James Bellessa: Now, the utility O&M was \$78 million in the most recent quarter. Is that the high for the year for the utilities side or is there another higher quarter?
- Mark Schober; Jim, we don't give quarter-to-quarter guidance, but when you look at the number that we'd given you and the five percent consolidated – and you look where the (regulated) O&M is for the full – for the remainder of the year for 2011 regulated utility O&M should be pretty consistent with where it was for 2011 for the remaining three quarters. You will see some quarter-to-quarter fluctuations, but when we come in at the end of the year it will be up about five percent. And most –
- James Bellessa: I was understanding that last year O&M in the regulated business was back-end loaded. This year it's front-end loaded. Is that a correct understanding or am I wrong?
- Mark Schober: No, that's correct. So that's why –
- James Bellessa: Thank you very much.
- Mark Schober: Yes, that's why you see the quarter-to-quarter variance. You got it.
- Al Hodnik: Thanks, Jim.
- Operator: Thank you. I'm showing no further questions in the queue at this time. I'll hand the call back to Al Hodnik for closing remarks.
- Al Hodnik: Well, thank you everyone for your questions and mostly for your continued support for ALLETE. Mark and I look forward to visiting with you directly along the way the rest of the year. And thank you again for participating in the call.
- Operator: Thank you. Ladies and gentlemen, this concludes the conference for today. You may all disconnect and have a wonderful day.

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