

ALLETE

**Moderator: Al Hodnik
October 31, 2012
10:00 a.m. ET**

Operator: Good day Ladies and gentlemen, and welcome to the ALLETE third quarter 2012 financial results call.

At this time, all participants are in a listen only mode. Later, we will conduct a question and answer session and instructions will follow at that time. If any one should require assistance during the conference, please press star then zero on your touchtone telephone. As a reminder, this conference call is being recorded.

Certain statements contained in this conference call that are 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 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 statements or to make any

other forward-looking statement, whether as the result of new information, future events, or otherwise.

I would now like to turn the conference over to your host, Mr. Al Hodnik, Chairman, President and Chief Executive Officer. You may begin.

Al Hodnik: Good morning everyone. Mark Schober, ALLETE's Chief Financial Officer, is with me, and will be providing quarterly financial details in a few moments. For the third quarter, ALLETE reported earnings per share of \$0.78. The quarterly results were consistent with our expectations as has been the case each quarter throughout this year. Given our year to date results and the fact that our industrial customers have demand nominations at full capacity through the end of the year, we have narrowed our year end earnings per share guidance to \$2.50 to \$2.60 per share.

Before I turn the call over to Mark, I would like to give you a status update on some of our projects, as well as those of potential new customers in our region. Let me begin with the new customers. Essar Steel Minnesota has nearly \$700 million invested in their project to date and has hired over 85 employees so far. About 150 contractors are currently working on the site. Large concentrator grinding mills have begun arriving and will be assembled and then set onto concrete mill pedestals yet this year.

The coarse crusher has been set in place and building walls completed with only the roof installation left before winter. Essar's first rotary blast hole drill has also been constructed and is expected to begin drilling soon in preparation for an initial blast. In addition, construction of the balling and filtering building for the power plant is also well underway. So as you can see, Essar has made significant progress as they proceed toward a 2013 startup of their facility. At full production levels, we anticipate Essar will require about 120 megawatts of electricity.

During our last call, I reported that another new customer, Magnetation, had started up a new 5 to 7 megawatt facility in our region. Magnetation has experienced much success and recently begun an expansion of this plant, which will feature new equipment installations at the site in two stages in

2013. Once the expansion is completed, the load for this facility will grow to 12 to 15 megawatts. In addition, their new 5 to 7 megawatt Magnetation facility, this one in partnership with Steel Dynamics of Indiana, has recently come online and is ramping up towards full production, which is expected before year end.

Turning toward our capital investments, please know that our Bison 2 and Bison 3 wind generating facilities in North Dakota are nearing completion. All turbines are up in the air and are now in the startup and final commissioning phase. These facilities will be operational by year end and meet the production tax credit deadline. The Minnesota Power total generation supply will be approximately 20 percent renewable as we head off into 2013. We are proud of the nearly \$550 million Bison investment and it reflects our shared purpose, growing ALLETE while answering the call to transform the nation's energy landscape.

Earlier this year, we announced an environmental upgrade project at Minnesota Power's Boswell Unit Four. This \$350 million to \$400 million project is scheduled to be completed in 2015. On August 31st, Minnesota Power filed its Mercury Emission reduction plan for Boswell Four with the Minnesota Public Utility Commission and the Minnesota Pollution Control Agency. Project engineering is in progress and we expect groundbreaking and overall construction work to begin at Boswell in 2013.

I will make some additional comments, but before I do, I will now turn the call over to Mark. Mark?

Mark Schober: Thank you, 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 third quarter, ALLETE reported earnings of \$0.78 per share on net income of \$29.4 million and revenue of \$248.8 million. In the same period a year ago, ALLETE earned \$0.57 per share on net income of \$20.5 million and revenue of \$226.9 million.

Earnings from our Regulated Operations segment, which includes Minnesota Power, Superior Water, Light & Power, and our investment in the American Transmission Company improved approximately 23 percent from \$23.8 million in 2011 to \$29.3 million in 2012. Minnesota Power recorded higher sales, cost recovery rider revenue, and renewable tax credit, as well as increased operating and maintenance expenses and depreciation on interest expense associated with our ongoing capital investments.

Total regulated operations revenue was \$19 million or 19 percent more than in 2011 due to a number of factors. First, a 1.3 percent increase in total kilowatt-hour sales resulted in an additional \$4.7 million of revenue compared to last year. The increase in kilowatt-hour sales was primarily due to higher sales to retail and municipal customers, partially offset by lower sales to other power suppliers. Electric sales to retail and municipal customers were up 3.8 percent compared to last year. Sales to our industrial customers remained strong, increasing 3.5 percent over the same quarter last year.

Secondly, cost recovery rider revenue was up \$7.1 million due to higher capital expenditures, primarily related to our Bison projects. Also, transmission revenue grew by \$3.6 million, largely because of Midwest Independent System Operator, or MISO revenue, resulting from our investment in CAPX2020. And finally, fuel adjustment cost recoveries increased \$4 million from 2011 due to higher fuel and purchase power costs attributable to our retail and municipal customers.

On the expense side, fuel and purchase power rose \$4.7 million or six percent from 2011, primarily due to increased purchase power expenses, coal prices, and costs under our Square Butte Purchase Power Agreement. Regulated operations operating and maintenance expense increased \$6 million or nine percent from 2011, mostly due to increased salary, benefits, and MISO transmission expenses. Benefit expenses increased largely because of higher pension expense, resulting from lower discount rates. Depreciation expense increased \$2.1 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 for the same quarter. Income tax expense increased slightly this quarter because of higher pretax income, which was partially offset by higher renewable tax credits. The investments and other segment reported a net income of \$100,000 compared to a net loss of \$3.3 million in the same quarter of 2011. State income tax expense was lower in 2012, primarily due to North Dakota income tax credits attributable to our North Dakota capital investment and recognizable as a result of ALLETE generating future taxable income and access of that generated by our regulated operations. The lower tax expense was partially offset by higher business development expenses.

Our consolidated effective tax rate for the third quarter of 2012 was 25.9 percent, compared to 38.2 percent for the same quarter in 2011. We anticipate that the effective tax rate for the full year will be approximately 25 percent. Finally, additional common stock issuances related to funding our capital expenditures had a dilutive impact of \$0.04 per share for the quarter.

In summary, we're pleased with our results in the third quarter and year to date. Our cash flow was strong once again this quarter. Year to date through September 30th, we generated \$195.5 million in cash from operating activities and carried a 47 percent debt to capital ratio, which includes \$67 million of debt due next year.

Al?

Al Hodnik: Thanks, Mark. Heading into the final two months of 2012, I am pleased with our performance to date, which has been consistent with our expectations when we first issued earnings guidance last December. Over the next few months, you can expect to hear more from us as we continue to execute our multi-year, multi-faceted growth strategy. Around December 1st, we will issue an 8-K to disclose large power demand nominations for January through April 2013. Sometime during mid-December, we will initiate our 2013 earnings guidance and further detail associated assumptions.

We will also inform you when the Bison 2 and Bison 3 wind facilities begin operations. And of course, if there should be any other material developments

relative to organic growth, renewable energy, transmission, or environmental investments, or other energy centric investment growth opportunities in front of us, we will be sure to let you know.

Thank you for your interest and your investment in ALLETE. At this time, the operator will please 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 Paul Ridzon of Keybanc. Your line is open.

Paul Ridzon: Good morning. Can you hear me?

Al Hodnik: Hi, Paul.

Paul Ridzon: I had three quick questions. One is, any update from U.S. Steel on their expansion? The second is how you foresee the ramp up of Essar in 2013, whether that's going to come on midyear, later in the year, or just kind of how to model that. Then lastly, other investment this year, a decent – relative to last year, decent results. Whether any of these benefits are going to be ongoing or how to think about those.

Al Hodnik: Well, I'll take maybe the steel related questions and Mark can take the last question I guess. We did not learn anything new necessarily from U.S. Steel regarding their Keewatin Taconite expansion decision. It's in the boardroom level, if you will. They have received permits from Minnesota, as you know, and those permits are still good to early next year sometime. So we don't have any additional information on U.S. Steel Keetac.

With respect to Essar Steel, Essar Steel's construction continues to go well, but like any construction initiative of this size, things ebb and flow. I'm thinking, we're thinking that construction will carry on through much of the first half of the year and that startup will be sometime in the later spring or early summer.

Now, there will be some blasting and drilling, and other things going on with respect to the pit itself and preparing crude ore or taconite, if you will, for processing. But we're expecting sort of a ramp up coming from the summer months heading off into the later part of the year. Mark?

Mark Schober: And just to follow-up on Essar, Paul, is we issue guidance for 2013 here in mid-December. We'll look at giving you some incremental information as far as how to look at Essar in 2013. As far as in the other investments segment, the driver there is, as you're aware, is the investment tax credits that we have in the state of North Dakota. The majority of those have been recognized or will be recognized in 2012, but there will be some ongoing benefit going into 2013 and future years based on the outlook for earnings in the state of North Dakota.

Paul Ridzon: Thank you very much.

Al Hodnik: Thanks, Paul.

Operator: Again, if you have a question at this time, please press star then one.

Our next question comes from Brian Russo of Ladenburg Thalmann. Your line is open.

Brian Russo: Hi. Good morning.

Al Hodnik: Morning Brian.

Brian Russo: Could you just comment on your general rate case strategy, when you might file next.

Mark Schober: Brian, we don't have any immediate plans to file a rate case. We certainly look at it on a regular base. As we've chatted in the past, the majority of our capital that we're investing in the last couple of years and as we go forward is eligible for current cost recovery for riders is either that renewable or the large environmental projects that we're looking at.

O&M costs, we continue to look at those, especially where discount rates are, and our pension, and medical, and employee expenses. But at this point in time, we don't see the need to file a rate case in the immediate future, but we certainly look at it on a regular basis and are ready to file if we need to.

Brian Russo: OK, and on the Boswell environmental upgrade, when will spending ramp up there and just kind of add some color on how those costs recovered and the recovery rider? Are they recovered as they are spent or is there some sort of lag?

Mark Schober: As we outlined in our Q and I think Al mentioned too, we're in the process of design and engineering of that project currently and that will continue on through 2013. That ramp up in spend then will really pick up in 2014, 2015. That's when you'll see the majority of the dollars.

As far as – so we recognize AFUDC on those dollars as we spend them. The process that we go through then is we need approval from the Minnesota Pollution Control Agency. That will happen hopefully by midyear in 2013 and then we'll get approval from our regulators to recover it through rates. That probably won't happen until some time at the end of next year, early 2014, and that's when you'll see the actual cash flow will start then in 2014. From an income statement standpoint, though, we'll be recognizing the revenue through AFUDC.

Brian Russo: OK, great. And I may have missed this earlier, but is there any update on the clean energy subsidiary? Anything in the pipeline that you guys can discuss?

Al Hodnik: Nothing that we can discuss right now. We continue to focus on energy centric investments, both with ALLETE clean energy and with our business development team. We like energy, as you know, and we're focused on energy exclusively, or energy infrastructure at least related to energy. And so nothing new to report right now, Brian, but we continue to actively pursue opportunities.

Brian Russo: OK, one last question. On – how do you manage your guidance and the sensitivities to uncertain changes in the industrial nominations? Meaning, I think 40 million tons is kind of the benchmark at full production. If by chance

that was to decrease by, say, five percent, is there margin sensitivity there? Or are you able to offset that with off-system sales and cost cutting?

Mark Schober: So as we look at our guidance for 2013 that we'll issue here in December, Brian, that will give you the metrics on what we anticipate production from our taconite customers will be. And you're right, full production is right around that 41 million tons level plus or minus. So we certainly look at our expectations for the year and we build in some potential for some short-term swings in production in our guidance. If there's a shut down or a slowdown in the five percent range, certainly there would be some margin pressure. We could take some cost out. We'd take that active power to market, but we're all well aware where wholesale prices are very soft and we would not be able to replicate all of those margins. But we anticipate that would be relatively short-term. It would not have a material impact on the Company long-term.

Brian Russo: OK. Thank you very much.

Al Hodnik: Thanks, Brian.

Operator: Thank you. Again, if you have a question at this time, please press star then one.

Our next question comes from Bernard Horn of Polaris. Your line is open.

Bernard Horn: Good morning. I was wondering if you could comment on – I know that in the first part of the year you had lower sales due to a mild winter, and it seems like the third quarter was a little bit more normal. I'm just curious if as you look forward for the next six months or so, and this relates to the kind of gas versus coal question, is there any price sensitivity among your customers that there would be some price elasticity such that you're seeing any increase or changes in behavior as far as electricity consumption is concerned with respect to the prices that they're paying?

Al Hodnik: No, we're not anticipating a lot of change on the residential or commercial side of the business in terms of their usage or consumption relative to that. And likewise, with the taconites, they continue to signal strong operations at

least through the end of this year. So we don't see any sort of material change in behaviors by residential or commercial customers.

Bernard Horn: OK, and as far as the spreads are concerned over coal, and coal prices, and so forth, are you – in terms of what you have bought, and inventories and so forth, do you – would you expect the spreads that you're going to earn over the next six months or so to be any different from what they were the first nine months?

Mark Schober: No, not from a fuel standpoint. Bernie, again, it's important to remember that here in Minnesota we have a fuel adjustment clause. I know you passed that through, but yes, so it doesn't have a significant impact. We are seeing some softness in coal prices, but certainly those benefits then roll through to our customers.

And on the margin standpoint around the weather, too, it's important to remember that Minnesota Power is not real weather sensitive. As we've discussed, the vast majority or 50 percent plus of our revenues come from our industrial customers that run and are not really impacted by weather. So what happened in the first and into the second quarter here was unusual. We usually don't have – not real impacted by different patterns in weather.

Bernard Horn: OK, great. Thanks. That's all I had.

Operator: Again, if you have a question at this time, please press star then one.

And I'm showing no questions in the queue at this time. I'll hand the call back to management for closing remarks.

Al Hodnik: Well, thank you again, everyone, for joining us this morning. We look forward to meeting with a number of you at our upcoming EEI Financial Conference, interface with you all, and want to thank you again for your investment in ALLETE. Have a good day.

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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