ALLETE

Moderator: Alan Hodnik
August 4, 2010
9:00 a.m. CT

Operator: Good day and welcome to the ALLETE second quarter financial results call. Today's call is being recorded. Certain statements contained in this conference call, that are not descriptions of historical fact, are forward-looking statements, such as terms defined in the Private Securities Litigation Reform Act of 1995. Because such statements can include risk 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. Investors should not place undo 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 statements, whether as a result of new information, future events or otherwise. For opening remarks and introductions, I'd like to now turn the conference over to ALLETE president and chief executive officer, Alan R. Hodnik. Please go ahead.

Alan Hodnik: Thank you. Good morning and thanks, everyone, for joining us today. With me is ALLETE's chief financial officer, Mark Schober. This morning we reported second quarter earnings per share of $0.57 compared with $0.29 a year ago. The year-over-year increase was driven by a number of factors, including a return to strong production levels by our taconite mining customers. Mark will go through the financial details in a few moments but first let me recap some of the highlights for the quarter.

Early this week we received demand nominations from our industrial customers for the last four months of 2010. The total nomination level is similar to that of the May through August time period and it indicates that total demand from our industrial customer class in 2010 will be quite a turnaround from 2009 levels. Turning to another topic, construction work is progressing nicely on the first portion of our North Dakota wind initiative, the 75-megawatt Bison I project. Located near the 250-kilovolt D.C. line we purchased in 2009, Bison I will consist of 33 wind turbines with the first half placed into service late this year. The total project is estimated to cost $177 million and as of June 30, we have spent about $63 million. On a related note, in July the Minnesota Public Utilities Commission approved our petition to begin billing customers for the project. Our retail rate increase request before the Minnesota Public Utilities Commission continues to proceed according to schedule.

As you may know, in April we filed our rebuttal testimony in which we lowered our increase request from $81 million to approximately $72 million due to adjustments for known and measurable events that occurred since the original filing. The largest of these adjustments relates to increased sales to our industrial customers. And, in addition, we lowered our return on equity request from 11.5 percent to 11.25 percent. In mid August, we expect a report and recommendation from the administrative law judge. The commission's oral deliberations should begin and be held some time in October, and the written order is due November 2. I will now ask Mark to provide the financial details for the quarter. Mark?

Mark Schober: Good morning. Before I begin, I encourage you to refer to the 10Q we filed this morning for complete details of our quarterly results. For the second quarter of 2010, ALLETE earned $0.57 per share on net income of $19.4 million compared to $0.29 per share on net income of $9.4 million in the second quarter of 2009. Last year's results included a $1.5 million after tax accrual, a rate refund related to the 2008 case. Excluding it, second quarter 2009 earned $0.34 per share, a net income of $10.9 million.

Our regulated operation, which includes Minnesota Power; Superior Water, Light and Power; and our investment in the American Transmission Company recorded net income of $18.2 million for the quarter compared to $10.7 million a year ago. As I mentioned, $1.5 million of the increase is due to the refund related to the 2008 rate case which was recorded in 2009. Retail and municipal kilowatt hour sales were 50 percent higher than last year's second quarter primarily due to a 98 percent increase in industrial sales. There was a corresponding decrease in sales to other power suppliers, which were 33 percent lower this quarter than in 2009. In total kilowatt hour sales were 17 percent higher in the second quarter of 2010 compared to 2009.

Last year sales were impacted by a dramatic downturn in production levels from our taconite mining customers. Total regulated operations revenue increased $49 million compared to last year, due to a number of factors including the significant increase in retail and municipal sales, authorized interim retail rates which are subject to refund pending a final order, the absence in 2010 of the 2008 interim rate refund accrual that occurred last year, higher fuel and purchased power recoveries, and increased transmission revenue related to the D.C. line we purchased in late 2009. Revenue from sales to other power suppliers decreased in 2010 versus 2009. Fuel and purchased power expense was $18 million higher than last year due to increased coal generation, higher coal prices and related transportation and increased kilowatt hour purchases combined with higher market prices.

The $12 million increase in regulated operating and maintenance expense reflected additional transmission expenses related to the D.C. line, higher generating plant operating and maintenance expenses, and increased employee benefit costs.

Depreciation expense increased four million dollars and interest expense one million dollars, both directly attributable to our capital investment program. Income from our investment in ATC was $100,000 higher this quarter than in the same period in 2009. In the second quarter, ALLETE's Investments and

Other segment earned $1.2 million this year versus a net loss of $1.3 million last year. The largest contributor to this increase was a result of a Minnesota income tax audit settlement and related interest from a previous year in the amount of $1.1 million. No land sales were made at ALLETE properties during the second quarter of either 2010 or 2009. And results at BNI Coal were similar to last year. ALLETE's quarterly earnings per share also included $0.04 of dilution due to the increased number of shares outstanding as we fund our capital investment program.

Our earnings expectation for 2010 remains at $2.05 to $2.35 per share, excluding the $0.12 per share charge related to the healthcare act in the first quarter. Our guidance provides for a range of potential regulatory outcomes and takes into account the recent demand nominations from our industrial customers. For the second half of the year we expect increasing operating and maintenance expenses in part due to a planned maintenance outage at the Boswell 4 unit. In addition, we expect increasing depreciation and interest expenses as a direct result of our ongoing capital investment program. Our investment balance in ATC is expected to grow by five million dollars over last year and we continue to expect that ALLETE properties will record a net loss of about five million dollars in 2010. Al?

Alan Hodnik: Thanks, Mark. I'm very pleased how the company has performed both financially and operationally through the first half of 2010. We've made progress with the beginning phase of our North Dakota wind initiative and we are certainly encouraged to see our industrial customers' production levels rise from the dreadful conditions they faced in 2009. As Mark mentioned, we are on track to meet our earnings expectations for the year. We are also on track with our capital investment program, a combination of base capital costs and expenditures to meet renewable mandates.

We are in a good position with our cash balance and our debt to capital ratio is a strong 42 percent. ALLETE is an energy company committed to earning a financial return that rewards our shareholders, allows for reinvestment in our businesses, and sustains growth. We will take actions necessary to earn our allowed rate of return in our regulated businesses while we pursue longer term growth initiatives in renewable energy, transmission and other energy-centric businesses. And, I'm enthused about our prospects for the future. At this time I will ask the operator to open the lines for your questions.

Operator: Thank you, ladies and gentlemen, if you have a question at this time please press star then one on your touchtone telephone. If your question has been answered and you wish to remove yourself from the queue you may press the pound key. Again ladies and gentlemen, if you have a question please press star then one at this time. Our first question comes from Larry Solow with CJS Securities.

Larry Solow: Hi, good morning.

Alan Hodnik: Good morning, Larry.

Mark Schober: Good morning, Larry.

Larry Solow: Notwithstanding the several variables that go into your guidance, which I know are moving around constantly. Based on the strong performance in the quarter and nominations looking pretty good or as good as this prior four-month period, is it fair to say you are tracking toward the high end of your guidance? Any reason why you'd leave such a wide gap especially considering it looks like things are relatively positive?

Mark Schober: Larry, our guidance remains the same at $2.05 to $2.35. As we issued that guidance and as we reaffirmed that guidance coming out of Q1, we expected nominations to be strong through the remainder of the year. So the fact that nominations came in near full production levels for the remainder of the year, that's not going to change our guidance. The big drivers as we look towards the end of the year, and we have kind of touched on those during the call here, that we expect O&M expense to be back ended this year, so you'll see a significant ramp up, primarily driven by our Boswell 4 outage, and also increasing costs at our Boswell 3 Unit due to the new scrubber that we put in there and continuing increases in depreciation expense and interest expense because of the capital spend. So really no surprises, those are all factored into the guidance and then ultimately the big one is where we end up in this rate case and that's why we are maintaining the guidance with such a wide range.

Larry Solow: Right. And with the rate case itself, in terms of – what is in your guidance for the rate case? I mean you won't get the approval – assuming things go without a hitch, it wouldn't happen until, I guess, November, right? So is that – your guidance assumes interim rates for November/December period, too? Or do you assume you'd get a little bit ...

Mark Schober: Yes. Nothing has changed since when we issued guidance in November of last year.

Larry Solow: Right.

Mark Schober: So guidance provides for a range of regulatory outcomes. We do expect the commission to have an order issued in November and we do anticipate recording that order in 2010 business. So that again is why the range remains so wide.

Larry Solow: Okay. And I guess in terms of milestones to look for, so the ALJ report comes out – is that a specific date for that or is it just around mid August?

Alan Hodnik: We are just thinking it will be around mid August at this point.

Larry Solow: Okay, so there's no actual drop-dead deadline or whatever where it has to be submitted or what have you?

Alan Hodnik: No.

Larry Solow: And correct me if I'm wrong, but I believe they usually kind of – these are obviously – for the people or for the government, so it's generally more of a critical Devil's advocate point of view versus not necessarily the final outcome. It's more of a conservative view?

Alan Hodnik: It's a view, Larry. It's a recommendation by the ALJ based on their analysis of the record at that point in time to the MPUC.

Larry Solow: Right. So I mean I know you don't want to comment on it, but qualitatively, generally speaking, it doesn't necessarily (sic) they are the final decision. I mean there are some gives and takes there, and I believe, in your last rate case, the ALJs was lower than you actually ended up getting, is that right?

Alan Hodnik: That's correct for the last rate case. But again, it's a recommendation to the MPUC and I'm not going to (inaudible).

Larry Solow: (Inaudible). I fully understand that. Okay. Great. Thanks, I appreciate it, guys.

Alan Hodnik: All right. Thanks, Larry.

Mark Schober: Thanks, Larry.

Operator: Our next question comes from James Bellessa from D.A. Davidson.

James Bellessa: Good morning.

Mark Schober: Good morning, Jim.

Alan Hodnik: Good morning, Jim.

James Bellessa: The Boswell 4 outage, when does that occur and how long will it be out?

Alan Hodnik: Boswell 4 outage begins in the middle of August here and it's currently scheduled to be about an eight or nine week outage, Jim.

James Bellessa: So it will stretch into the next quarter, from the third into the fourth quarter.

Alan Hodnik: Right, and when you include start-up issues always following a big outage like that, yes.

James Bellessa: You indicated that you had a state income tax audit refund. Did you say $1.1 million?

Mark Schober: Yes, that's an audit that we completed this quarter, Jim. And we recorded the fact that we completed and the benefit was $1.1 million. Yes.

James Bellessa: And that's about $0.03 a share. Would that be about right?

Mark Schober: That's about right, $0.03 to $0.04, yes.

James Bellessa: We see evidently in the ALLETE Properties, you received a property and you must have put that back on your books as a gain, right?

Mark Schober: Yes, what happened at ALLETE Properties, we had a note receivable with a customer that has gone through bankruptcy. What we did was take that property back on to our books. So when you look at the numbers in the 10Q that show the units and acreages, that's what it is. It's simply taking that property back on our books. And you're right. When you take that property back on, you take it on at fair market value. We had that real estate appraised and we recognized a gain in that transaction at ALLETE Properties in the amount of about $700,000.

James Bellessa: And if I heard in the narrative correctly, in Minnesota you received a June decision that allows you to start collecting on Bison I. Are you already collecting or will you be collecting?

Mark Schober: Bison I, we just received the commission approval to do that here in July. So those billings, or those costs will start appearing on customer bills here August 1.

James Bellessa: Thank you very much.

Alan Hodnik: Bison I was a current cost recovery rider-eligible project.

James Bellessa: Thank you.

Alan Hodnik: Thanks, Jim.

Mark Schober: Thanks, Jim.

Operator: Again ladies and gentlemen, if you have a question please press star then one on your touchtone telephone. Our next question comes from Brendan Naeve with Levin Capital.

Neil Stein: Hi, it's actually Neil Stein from Levin Capital. How are you this morning?

Mark Schober: We're good.

Alan Hodnik: Hi, Neil.

Neil Stein: The question I had is, just looking at the level of taconite sales, and the recovery there has been really impressive, but I was wondering how that compares to what you filed in your rate case and might you need to make an amendment to that filing to take up that level or will the commission take into account to the level of sales?

Mark Schober: We've already made that adjustment, Neil, to our rate case. If you recall, when we filed, we originally filed for about $81 million back in November of 2009. Earlier this year we adjusted that amount down to $72 million, and the biggest driver of that was the increase in the sales to our industrial customers so we captured that in the rate case already. And yes, the commission will look at that as we move forward in the process.

Neil Stein: It's somewhat confusing, the model on a quarter to quarter basis. But how do we think about the margin associated with selling to these taconite customer versus if you didn't have that demand and you were selling into the market. I imagine it varies quarter to quarter?

Mark Schober: If we don't sell to our taconite customers, it will vary substantially quarter to quarter. As we've discussed, we are confident we can take that power to market. It's really a volume hedge but it's not a price hedge. So those margins could and do change dramatically based on market prices at the time we take it to market.

Neil Stein: In the third quarter are you able to satisfy this incremental demand with your own generation or do you actually need to go into the market to buy power to satisfy the incremental taconite demand?

Alan Hodnik: No, we are able to satisfy this increased demand with our existing generating suite.

Neil Stein: Okay. I guess though, maybe on a year-over-year basis, the opportunity cost of not selling in the market is may be a bit higher if that's the way to think about it? Lower end in the shoulder quarters so you're – it's much better maybe to sell to the taconite customers maybe but to the extent prices are much higher in the third quarter is would have better to sell into the market? Is that a way to think about it?

Mark Schober: Again, it comes back to the what those market prices are.

Neil Stein: Yes.

Mark Schober: And those market prices have been soft for the past several months. We would much rather have the certainty of selling to our taconite customers versus having to take that power to the market.

Neil Stein: And then maybe just a bigger picture question, how sustainable is this taconite demand? Is this just temporary inventory restocking and thing we're going to see sort of fade away or fade back to where it was or do you think it's a little bit more a sign that we should expect to last?

Alan Hodnik: Well, as we have said a good proxy to watch or look at, and one that we look at is the blast furnace utilization rates in the Great Lakes. And of course that rises and falls also with the U.S. economy and so depending on your views of the U.S. economy and where it's at on recovery mode here, and where that utilization rate is, you can kind of predict on your own where taconite might be at. We're encouraged where they are today, we're encouraged with our nominations here for the next four months and we're not going to try to predict necessarily where 2011 and 2012 might be going.

Neil Stein: Okay. Thanks very much.

Alan Hodnik: Thanks, Neil.

Mark Schober: Thanks, Neil.

Operator: I'd like to turn the conference back over to Alan Hodnik for closing comments.

Alan Hodnik: Well, that concludes our call for today. I look forward to announcing third quarter results this fall. Thanks for joining us this morning, and I wish everyone listening an enjoyable rest of the summer.

Operator: Thank you, ladies and gentlemen, and thank you for your participation in today's conference. This does conclude the conference and you may disconnect. Good day.

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