ALLETE

Moderator: Al Hodnik
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10:00 a.m. ET

Operator: Good day, and welcome to the ALLETE Second Quarter 2012 Financial Results call. Today's 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.

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.

Alan Hodnik: Thank you for joining us this morning. With me is ALLETE's Chief Financial Officer, Mark Schober.

Today, we are pleased to report second quarter earnings per share of 39 cents, which was in line with our expectations. Mark will go through the financial details of the quarter in a few moments. But before he does, let me say that despite having a 5 cent per share impact on our first quarter results, due to extremely mild winter weather, our year-to-date earnings are basically where we had originally anticipated when we first gave guidance last December.

Yesterday, Minnesota Power received large power demand nominations for the final four months of 2012. They indicate our industrial class customers, of which taconite producers are the largest segment, will operate at near full production levels for the remainder of the year. Our taconite producers primarily serve the domestic steel makers, who are currently experiencing strong demand from automobile manufacturers and other United States-based industries. So, as a result, our full year earnings guidance remained unchanged and we continue to expect to earn between $2.45 and $2.65 per share in 2012.

Solid organic growth continues in our region, as two industrial projects continue to make construction progress. First, the Essar Steel Minnesota taconite facility, which will be served by one of our municipal customers, the City of Nashwauk, is moving forward. The first mine blast is scheduled for September to be followed by production rock stripping activities. Essar is on track to begin start-up in the spring of 2013. They already have 85 employees on the payroll and have spent about $500 million on the project to-date. This classic taconite facility will require more than 100 megawatts once it reaches full production.

The second is Magnetation, which began the year with plans to construct two new five to seven megawatt facilities in our service territory. The first became operational in May and now has 110 employees working at the site. The second is a joint venture with Steel Dynamics called Mining Resources. And it is due to begin operations in late summer.

North Dakota continues to be good for our business, as our Bison 2 and Bison 3 wind construction generation – construction projects proceed on schedule. To the second quarter, we have spent about $224 million out of the approximately $320 million of capital expenditures planned for these projects this year. These low cost renewable projects are anticipated to be in-service by year-end and well before an expected production tax credit PTC Expiration. The completion of Bison 2 and 3 will bring Minnesota Power's renewable percentage up to 20 percent, well on its way to meeting Minnesota's renewable mandate of 25 percent by the year 2025.

Earlier this year, we informed you about plans to construct a new 500 kV transmission line that will deliver hydroelectric energy from Manitoba Hydro into Minnesota's Iron Range by 2020. We have now given that line a name, the Great Northern Transmission Line. Total project costs, size and cost allocations are still to be determined and we will keep you posted on the developments as we go forward.

As part of the Great Northern Transmission Line, Minnesota Power and ATC are evaluating joint development of 345 kV transmission line from the Iron Range to Duluth, with an in-service date of approximately 2020. This in addition to assessing transmission alternatives in Wisconsin that would allow for movement of more renewable energy in the Midwest, while at the same time strengthening electric reliability in the region.

MISO planners are presently evaluating the merits of these projects. Total project costs, ownership shares and cost allocation are still to be determined with these lines as well. We will provide more detail when it becomes available.

I will provide some additional comments in a few moments, but at this time I will 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 second quarter 2012, ALLETE reported earnings per share of 39 cents on net income of $14.4 million and operating revenue of $216.4 million compared to reported earnings per diluted share of 48 cents on net income of $17 million and operating revenue of $219.9 million in 2011.

Last year's second quarter included the recognition of a $2.9 million, or $0.08 per share, income tax benefit. This benefit resulted from the Minnesota Public Utility Commission's approval of our request to defer the retail portion of a 2010 income tax charge related to the Patient Protection and Affordable Care Act. Excluding this item, second quarter of 2011 earnings per share was 40 cents on net income of $14.1 million.

I will now highlight results 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 $14.4 million for the quarter compared to $18.3 million for the same period in 2011. Most of the difference from the same quarter last year is explained by the income tax benefit I just mentioned.

Kilowatt-hour sales to Minnesota Power's retail and municipal customers increased 1.9 percent over the same quarter last year, primarily due to a 3.4 percent increase in sales to industrial customers. However, total electric sales were lower by 2.3 percent from the second quarter a year ago to a 19.9 percent decrease in sales to other power suppliers.

You may have noticed with our earnings press release that in response to your requests, we now include a breakdown of revenue by customer class. Total regulated operations revenue decreased $4.8 million due to a number of factors and I will list the major items. First, the 2.3 percent reduction in total kilowatt hour sales resulted in a revenue decrease of about $5 million. Also, revenue from municipal customers decreased $3.4 million due to a period over period fluctuation and a true up for actual cost provisions of the contracts.

Current cost recovery rider revenue increased by $6.1 million, primarily due to higher capital expenditures related to our Bison projects. In addition, transmission revenue increased $1.9 million from our ongoing investment in

CAPEX 20/20. Current cost recovery rider revenue will increase as our capital expenditure levels rise for the remainder of the year.

There was a decrease of fuel adjustment cost recovery of $3.5 million or 18 percent primarily due to lower fuel and purchase power costs attributable to retail and municipal customer sales.

Turning to the expense side, regulated operations, operating, and maintenance expense was down $1.1 million or 1 percent from the same period in 2011. The decrease is primarily due to lower purchase gas cost at Superior Water, Light, & Power. Operations and maintenance expense levels for the remainder of 2012 should be similar to last year in total. Depreciation expense increased $2.5 million and interest expense was up $800,000 for the quarter, both directly attributable to the capital investment program at our regulated operations segment.

Earnings from our investment in ATC were slightly higher than the same quarter of 2011. Regulated operations income tax expense increased $1.6 million or 29 percent from 2011, primarily due to last year's recognition of the $2.9 million tax benefit I mentioned earlier. This was partially offset by higher renewable tax credits in 2012. The Investment and Other segment reported no net income for the quarter compared to a net loss of $1.3 million in 2011. The improvement in 2012 was primarily due to lower interest and state income tax expenses.

Our effective tax rate for the second quarter of 2012 was 25 percent, compared to 18 percent for the same period last year. Excluding the income tax benefit, last year's rate would have been 32 percent. We anticipate the effective tax rates for 2012 will be approximately 25 percent, primarily due to increased renewable tax credits. Our cash flow this quarter was strong once again, year-to-date through June 30th we generated $128.1 million in cash from operating activities and carried 44 percent debt-to-capital ratio. As we expected, our cash balance at the end of the quarter was lower than the first quarter, as we funded our capital investment program. The cash balance increased again on July 2nd as we issued $160 million of first mortgage bonds.

In summary, we are satisfied with our financial results in the second quarter and we are confident in our prospects for the full year. Our second quarter results were consistent with our internal expectations and we reaffirm our full year guidance range of $2.45 to $2.65 per share. Al?

Alan Hodnik: Thank you, Mark. ALLETE is an energy company with a number of multi-year and multi-faceted growth opportunities ahead of us. Regional growth, especially industrial expansions continue. Already this year we have seen the opening of one new 5 to 7 megawatt Magnetation facility with another scheduled to be completed very soon. The Essar Steel Minnesota project continues on schedule and is slated to begin mining activities in the first half of 2013. The already fully permitted US Steel Keetac expansion continues to be evaluated in Pittsburg. And last but not least, the exciting PolyMet and Twin Metals non-ferrous mining initiatives continue to advance with PolyMet's environmental impact statement expected out early next year.

Relative to our renewable energy initiatives, the Bison 2 and 3 projects will be completed by year-end. We will see an increase in current cost recovery revenue throughout the remainder of this year and we will get the full impact from these new facilities in 2013.

Regarding our transmission strategy, investments in CAPEX 2020, in the American Transmission Company, and in infrastructure designed to serve Essar Steel all continue to progress. Meanwhile, developmental work continues on our proposed great Northern Transmission Line, as well as reliability related prospects that would require an upgrade of our North Dakota to Duluth DC line.

Turning to environmental upgrade investments, we previously announced our intent to retrofit our largest generating unit, Boswell Unit 4. We anticipate investing between $350 million and $400 million over the next two years as we upgrade this unit to further reduce emissions by helping to ensure competitively priced energy for decades to come. We will file a petition seeking regulatory approval of this project this month.

Finally, the United States energy sector continues to evolve through a very transformative time. We believe there are and will be significant energy infrastructure or energy infrastructure services investment opportunities resulting from this transformation. Accordingly, our business development initiatives focusing on transmission, renewable, shale gas related or other cleaner energy forms continue. An example of which is our lead clean energy subsidiary, which is actively working to develop and/or acquire projects that create energy solutions and future earnings via wind, solar, biomass, hydro, natural gas and liquids and shale resources.

This is a dynamic time at ALLETE. I'm pleased with our progress so far this year and look forward to the successful execution of our strategy, a strategy designed to deliver results to you, our valued investors.

At this time I will ask the operator to open up the line for your questions.

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

Our first question comes from Brian Russo of Ladenburg Thalmann. Please go ahead.

Brian Russo: Hi good morning.

Mark Schober: Good morning, Brian.

Brian Russo: I guess, the lower O&M in the second half of the year kind of keeps the 2012 O&M relatively flat to 2011, is that kind of trend that we would expect to continue post-2012.

Mark Schober: Just to back up Brian, O&M will be flat for the next two quarters. But as we look at 2012 O&M versus 2011, it will be up probably 3 percent to 5 percent year-over-year.

Brian Russo: OK.

Mark Schober: And then as we look forward into 2013, we will certainly give you that information as we provide guidance later this year. So, we are in the process of looking at 2013 and developing the budgets for that as we speak.

Brian Russo: OK, and in terms of the average annual earnings growth, are you guys still projecting at least 5 percent.

Mark Schober: That 5 percent is our target. So, that's average annual growth off of the 2010 base, and some years we will do better than that and some will do worse but that's the company's objective long term.

Brian Russo: OK and remind me, but as the pension tracker filing is that off the table now, was it denied by staff and the commission or is it still pending an outcome?

Mark Schober: It's still pending an outcome in front of the commission. We should probably know something here in the next quarter or so, is what we are estimating.

Brian Russo: OK and when might we expect you to file your next general rate case in Minnesota Power?

Mark Schober: We look at rate cases on a regular basis. Right now Brian we have no plans to file a general rate case, but we'll certainly keep you apprised as we move forward, but it's something we are looking at on an ongoing basis, and at this point don't feel the need to do it in the short term.

Brian Russo: OK, then just lastly, the 3 percent increase in industrial sales, 3.4 percent, I'm just trying to understand the dynamic there. When the industrial customers submit their demand nominations, they are required to pay demand or capacity charge for that and that's where Minnesota Power derives the margin. But if they exceed their demand nomination, does Minnesota also charge them an additional energy charge so that the margin on that customer actually expands if they exceed their nomination?

Mark Schober: Yes. That's exactly what happens. So, as we look forward, if they operate above that, the prices for that power tend to be higher than if they nominated. So they are – our customer is certainly incented to give us an accurate reflection of the power take they expect over the upcoming quarter.

Brian Russo: OK. Thanks a lot.

Mark Schober: You bet.

Alan Hodnik: Thanks, Brian.

Operator: Ladies and gentlemen, if you have a question at this time, please press star then one on your touch-tone telephone. One moment while we wait for additional questions.

Our next question comes from Chris Ellinghaus of Williams Capital. Please go ahead.

Chris Ellinghaus: Hey guys. How are you?

Mark Schober: Hi, Chris.

Alan Hodnik: Hi, Chris.

Chris Ellinghaus: Can you talk a little bit – give us a little color on ALLETE Clean Energy. Have you guys got anything tangible in the pipeline at this point?

Alan Hodnik: Well, ALLETE Clean Energy of course is about one year old. As you know, we announced ALLETE Clean Energy about a year ago at this time, and they've continued to study and advance discussions if you will in the wind and solar and other renewable activities, including looking at North Dakota, but in terms of sort of an ability to announce something today, no, we don't have anything today.

Chris Ellinghaus: OK. And the transmission development with ATC, can you infer from that that the purpose is to off take some of Manitoba's capacity or imports into Wisconsin, is that what that additional line's purpose would be?

Alan Hodnik: I think the line has two purposes – or our view is the line has two purposes; one is to bolster upper Midwest regional reliability. As we think about Wisconsin and Michigan and total other Northern half of the country, the transmission infrastructure is somewhat weaker than other parts of the country as it exists today.

Secondly, when you look at the advancing environmental regulations that are likely to impact coal fire generation and perhaps take some facilities out of service, there is an issue of reliability associated with the generation supply or existing assets that are in place and may be their final disposition.

And then, yes, lastly, Manitoba Hydro has an interest in moving carbon free energy into the United States, so where Minnesota Power would be an off-taker. As you know, they are also looking at setting up or trying to construct deals with other off-takers in the upper Midwest.

Chris Ellinghaus: And how would that ownership split? Has that been decided yet?

Alan Hodnik: It has not been decided yet. There are a couple lines in discussion. Of course, there is a line that we're building or would need to build to bring in our 250 megawatt PPA into the Iron Range from Manitoba. The Wisconsin outcomes with ATC and some of that dialog is still in formation. We don't have any sort of further word on that today, Chris.

Chris Ellinghaus: OK. Is it possible that the Great Northern Transmission Line might have something similar to CAPEX 2020 in terms of participants?

Alan Hodnik: Well, again, it's hard to say how the deal structure could look at, but we could see a situation where there would be more partners than one and that's all being worked out at this point in time. Some of its related to who is an off-taker perhaps of Manitoba Hydro. Of course, ATC is just in transmission building on their own and so yeah there could be multiple partnerships.

Chris Ellinghaus: OK, great. Thank you very much.

Alan Hodnik: Thank you.

Mark Schober: Thanks, Chris.

Operator: Our next question comes from James Bellessa of D.A. Davidson & Company. Please go ahead.

James Bellessa: Good morning.

Mark Schober: Good morning, Jim.

James Bellessa: The Great Northern Transmission Line that you've named today, is that the one that comes from Canadian border down to the Iron Range?

Alan Hodnik: Yes.

James Bellessa: And then you don't have a name for the joint developments line that you may have with ATC from the Iron Range down to Duluth?

Alan Hodnik: Well, that entire corridor from the sort of International Falls or the international boundary between Canada and the US down to Duluth will have sort of one permit corridor. That whole permit corridor will be known as the Great Northern. But the actual deal structure, if you will, in terms of the deal configuration with ATC or with other partners may look differently on the portion from the Iron Range to Duluth. But from a permitting corridor, think about that whole corridor being the Great Northern.

James Bellessa: And on your business that's Investments and Other for two quarters in a row, you haven't have any losses or earnings and that's due to this income tax credits that you've received. Can you go through that and how long those credits will last and is this a pattern of breakeven going go-forward or is it just the near-term event?

Alan Hodnik: Jim, when you look at that segment, what's in there is what you've mentioned, but what's also included in there is BNI and also our real estate group, so those two entities will certainly drive earnings in that segment. When you're looking at it this year, there is a couple of things going on. One is interest expense. As we look at our interest expense and as the rate base at Minnesota Power grows, you will see more interest expense charged to the regulated utility. So that reduces the remainder that gets left in the Investment and Other segment. So that's a big piece of it.

And then the other piece is investment tax credits through – primarily in the State of North Dakota that we're recognizing those this year. And you'll see those continue to grow through this year, but they will taper off looking out into 2013, 2014 so that the bulk of them will be this year.

James Bellessa: Thank you very much.

Alan Hodnik: Thanks, Jim.

Operator: I'm showing no further questions at this time and would like to turn the conference back over to Mr. Al Hodnik for any closing remarks.

Alan Hodnik: Well, thanks again for joining us this morning. I hope you enjoy the rest of the summer season and Mark and I look forward to speaking with you again when we report our third quarter results. Thank you, and have a great day.

Operator: Ladies and gentlemen, this does conclude today's conference. You may all disconnect and have a wonderful day.

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