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Q1 2019 ALLETE Inc Earnings Call

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Vedula Murti

PRESENTATION

Operator

Good day and welcome to the ALLETE First Quarter 2019 Financial Results Call. Today's call is being recorded. Certain statements contained in this conference call that are not descriptions 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 views only as 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 now like to turn the conference over to ALLETE [Chairman] (corrected by company after the call) and Chief Executive Officer, Alan R. Hodnik. Please go ahead.

Alan R. Hodnik ALLETE, Inc. - Chairman & CEO

Well, good morning everyone and thanks for joining us today. With me are ALLETE's President, Bethany Owen; Senior Vice President and Chief Financial Officer, Bob Adams and ALLETE's Vice President, Controller and Chief Accounting Officer, Steve Morris.

Today, we are pleased to report strong first quarter 2019 financial results of \$1.37 per share on net income of \$70.5 million. These solid earnings were consistent with our expectations and support our full year 2019 earnings guidance range of \$3.50 per share to \$3.80 per share. This guidance range, originally issued in February, included the expected gain from the recent sale of U.S. Water Services. In addition to strong financial results for the quarter, I'm very pleased with the significant strategic accomplishments made during the quarter, such as the closing of the sale of U.S. Water Services, while setting the stage with renewable energy partners for future investments in clean energy.

ALLETE is well positioned for meaningful growth in the years to come and has talented employees at all business units, remain focused on delivering strong values-based operational and financial support of ALLETE's shared purpose, answering the call to transform the nation's energy landscape.

In terms of that strong Q1 operational and financial performance, it gives me great pleasure to turn the call over to ALLETE's President, Bethany Owen. Bethany?

Bethany M. Owen ALLETE, Inc. - President

Thanks Al. Good morning, everyone. Before Steve and Bob go through the financial details for the quarter, I'd like to share my thoughts on our outlook and significant updates on what matters most, our execution.



ALLETE's vision and strategy remain highly focused on the accelerating need for cleaner and more efficient energy sources. We are perfectly suited to continue to meet the challenges these transformational changes require, on behalf of all of our stakeholders, customers, employees and investors. Sustainability, whether it is measured in terms of the environment, our communities or our governance, has been and will always be a major part of who we are, our values, and our success. As we move forward, sustainability will also be an even greater differentiator of ALLETE's growth.

I want to turn to our execution, beginning with our regulated business segment. Minnesota Power has continued to make great progress on its energy forward initiatives. We are proud to report that approximately 45% of the energy that Minnesota Power sources will come from renewables by 2025. This percentage significantly exceeds the current Minnesota renewable electricity standard of 25% by 2025.

As we continue adding renewable resources, natural gas is a necessary component of this energy mix in order to ensure reliability and affordability for Minnesota Power's customers. The NTEC Project is advancing with final approvals expected from the Public Service Commission of Wisconsin during the second quarter of next year. NTEC not only enable us to reliably provide additional renewable energy resources, it will also be a vital system back-stop when extreme weather events, such as last winter's polar vortex, have the potential to disrupt the reliability of power supply. Especially given the challenging winters in our region, safety and quality of life are dependent on an appropriate energy mix that also balances affordability and reliability.

The recently approved 250 megawatt Nobles 2 project is moving forward and is scheduled to begin providing carbon-free wind energy in 2020. This exciting project not only provides least cost renewable energy to Minnesota Power's customers, it also provides ALLETE with a unique \$190 million investment as part of our partnership with Tenaska Energy.

Another significant Minnesota Power energy forward initiative, the Great Northern Transmission Line, is on budget and on schedule. The GNTL will support delivery of 250 megawatts of carbon-free hydro energy from Canada, scheduled to be completed in 2020. Minnesota Power's total investment in this project is approximately \$325 million. These transformative projects represent Minnesota Power's ongoing commitment to cleaner and more sustainable energy. They also represent significant growth for the company and we anticipate additional opportunities in the future.

As promised, we concluded the sale of U.S. Water Services during the first quarter, which resulted in approximately \$265 million of cash. We plan to redeploy this significant capital into clean energy growth initiatives at both our regulated and non-regulated businesses.

At ALLETE Clean Energy, we have advanced a multitude of major initiatives. First, a reminder that late last year, the company acquired additional PTC safe harbor turbines, extending the opportunity for PTC-qualified new wind projects through 2022. ALLETE Clean Energy with approximately 550 megawatt -- 555 megawatts of its own wind generation also completed PTC re-qualification work at its 50-megawatt Condon wind facility in Oregon and extended its Storm Lake II contract with Alliant Energy into mid-2020.

Second, ALLETE Clean Energy is ramping up for a record year of renewable construction activity. In addition to robust turbine refurbishment activities at existing facilities, the new South Peak and Glen Ullin wind projects, totaling almost \$250 million of our planned capital spend for 2019, will be built and placed into service by the end of the year.

Third, ALLETE Clean Energy continues to optimize its existing carbon-free renewable generation, while preparing for significant expansion and scaling over the next 24 to 36 months. ALLETE Clean Energy's strong internal capabilities include back office, origination, permitting and contracting expertise, now with an employee count of almost 100 talented individuals and growing.

Fourth, regarding new project origination, ALLETE Clean Energy has a valuable investment in PTC-qualified turbines. Between new wind project developments and acquisitions of existing projects, we remain confident in ALLETE Clean Energy's ability to invest in one to two additional projects per year. As a result, we have set our sights on establishing a high quality, well diversified, long PPA duration portfolio with at least 1,500 megawatts by 2023.

Finally, ALLETE Clean Energy's strong pipeline of potential new opportunities is expected to provide significant ongoing growth for the company. In fact, the company is currently in advanced negotiations on safe harbor PTC projects, and upon closing, anticipates making

related announcements.

I will provide additional comments on our closing remarks, but first I'll ask Steve and Bob to go through the first quarter financial details. Steve?

Steven Wayne Morris ALLETE, Inc. - VP, Controller & CAO

Thanks, Bethany, and good morning everyone. I would like to remind you that we filed our 10-Q this morning and encourage you to refer to it for more details on our first quarter results.

For the first quarter of 2019, ALLETE reported earnings of \$1.37 per share on net income of \$70.5 million. Earnings for the same quarter in 2018 were \$0.99 per share on net income of \$51 million. First quarter earnings this year included \$0.19 per share for the gain on the sale of U.S. Water Services. A few details from our business segments. ALLETE's Regulated Operations segment, which includes Minnesota Power, Superior Water, Light and Power and the Company's investment in the American Transmission Company, recorded net income of \$51.5 million, an increase of \$7.6 million over the first quarter of 2018.

Net income at Minnesota Power was higher than in 2018, primarily due to lower operating and maintenance and property tax expense, increased cost recovery rider revenue and higher sales to residential customers resulting from cooler weather conditions than in the first quarter of 2018. These increases were partially offset by lower industrial sales and the timing of fuel adjustment clause recoveries. Net income at Superior Water, Light and Power increased over last year due to higher rates implemented the first quarter of this year and lower operating and maintenance expense. ALLETE's earnings in the American Transmission Company were higher than in 2018, primarily due to additional equity investments.

Earnings at ALLETE Clean Energy decreased \$2.3 million from 2018, primarily due to poor wind resources and extreme weather conditions, which negatively impacted wind production by 20% as compared to the same period last year. This decrease was partially offset by higher production tax credits generated during the quarter, as ALLETE Clean Energy continues to execute on its refurbishment strategy.

Corporate and Other, which includes BNI Energy and ALLETE Properties, recorded net income of \$14.3 million for the quarter, compared to net income of \$400,000 in 2018. Net income in the first quarter of 2019 included the gain on sale of U.S. Water Services of approximately \$10 million after tax. Net income in 2019 also included additional income tax benefit to record income taxes at the estimated annual effective tax rate.

ALLETE's financial position is supported by a strong balance sheet that includes a significant cash balance of \$353 million, due to proceeds from the sale of U.S. Water Services, and our debt to capital ratio was 41% as of March 31, 2019.

I'll now hand it off to Bob for additional comments on our financial outlook. Bob?

Robert J. Adams ALLETE, Inc. - Senior VP & CFO

Thanks, Steve, and good morning everyone. As Al mentioned, our year-to-date financial results are well in line with our expectations and support our full year earnings guidance of \$3.50 per share to \$3.80 per share, which includes \$0.20 per share gain from the sale of U.S. Water Services. As I mentioned in our February conference call, the cash proceeds from U.S. Water Services sale are being targeted towards new clean energy effectively offsetting any significant equity issuances that may otherwise be required in our current forecast. Indeed, our strong balance sheet and overall liquidity position provides us with significant dry powder to support our growth aspirations.

I am particularly pleased how the aforementioned clean energy investments and the laser focus on efficiency and effectiveness by the management teams in all of our operations are fundamentally changing the performance and growth profile of this organization. This disciplined and effective execution ensures we will continue to meet our evolving customer expectations, while at the same time, provide a highly attractive value proposition for our shareholders.

From a growth standpoint, we are now on a high confidence track to achieve the higher end of our 5% to 7% long-term average annual

growth objective. In fact, 2019 is a record construction year of renewable energy infrastructure for ALLETE's businesses. Our 5-year base CapEx plan, which represents only known and approved projects, is already in excess of \$1.8 billion. Moreover, the vast majority of that amount will be deployed into projects that support clean energy transformation. Al?

Alan R. Hodnik ALLETE, Inc. - Chairman & CEO

Thank you for the financial updates Steve and Bob. I will make a few comments on Large Power customers, before Bethany closes and we address your questions.

Strong economic conditions and trade policies that effectively address unfairly traded steel, continue to benefit Northeastern Minnesota mineral mining. Cleveland-Cliffs, United States Steel and ArcelorMittal continue to operate at full production levels and we remain optimistic on the long-term outlook of Minnesota Power's mining customers. Significant capital investments made in their own operations, especially in enhanced pellet products designed for use in expanding HBI production in Toledo, Ohio are clear indications that the Northeast Minnesota mineral district remains the nation's preferred supplier of iron units for steel making.

Minnesota Power's natural resource-based commercial and industrial customers provide opportunity for long-term organic growth through needed infrastructure investment and additional load that will benefit Minnesota Power. Beyond iron ore, a clean energy economy, being promoted by federal and state policy makers, requires a clean source of copper, nickel and other precious metals. PolyMet Mining received its final required permit in March of this year and has moved to the construction finance stage. This project will mine one of the richest ore bodies in the world to serve the increasing global demand for precious metals used to power electric vehicles, solar and wind generators, data centers and the multiple digital devices we all hold in our hands. The PolyMet project will provide significant load growth to Minnesota Power, resulting in a new customer requiring 45 to 50 megawatts of power under a long-term power supply contract that is effective with the startup of mining operations.

I'll now turn it over to Bethany for some closing comments. Bethany?

Bethany M. Owen ALLETE, Inc. - President

Thanks Al. ALLETE's family of businesses is well positioned as a premier energy supplier to meet the increasing clean energy goals well underway in many states. We believe our geographic positioning is a differentiator, by virtue of the relationship, land rights and optionality that we have in connection with our transmission assets.

In addition to the Great Northern Transmission Line, which provides access to carbon-free hydro power from Canada, we are now moving forward with a modernization and capacity upgrade of our 500 mile DC transmission line to wind-rich North Dakota. This project represents approximately \$300 million in total investment and more than 200 megawatts of additional capacity.

While we are excited about new opportunities in the Midwest, we are working to expand our presence in other areas of the country and in other customer markets, including the rapidly growing commercial and industrial segment. These moves will not only provide added growth, they will also increase the overall diversity of our portfolio.

A constructive regulatory environment is invaluable in this time of energy transformation. At the Minnesota Public Utilities Commission, we look forward to working with new Commissioner Valerie Means and new Chair Katie Sieben, as well as commissioners Lipschultz, Tuma and Schuerger. We are also looking forward to continuing our close work with our customers, as well as other state leaders and stakeholders on energy policies for the future.

Also, on the regulatory front, Minnesota Power anticipates filing for a general rate review later this year. The filing is needed, primarily due to significant reductions in revenue, associated with expiring power sales contracts and lower transmission revenues. At this time, we anticipate filing with the MPUC in early November with a 2020 test year.

I look forward to sharing more with you in the coming quarters as we continue to execute on our growth initiatives. Thank you for your

time and for your investment in ALLETE.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from Chris Ellinghaus from Williams Capital.

Christopher Ronald Ellinghaus *The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas*

Bethany, you mentioned some advanced discussions for ACE projects, is that multiple projects?

Bethany M. Owen *ALLETE, Inc. - President*

It is Chris, thank you, yes multiple projects, advanced discussions, but not ready to announce anything just yet.

Christopher Ronald Ellinghaus *The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas*

Okay. Multiple is more than adequate. Steve, the tax benefit in the quarter, I assume that's just accrual timing. Can you talk about how you expect that to even out over the year?

Steven Wayne Morris *ALLETE, Inc. - VP, Controller & CAO*

Yeah, it's about \$3 million, we expect it to -- by the end of the year obviously that will work its way out, Chris. It's hard to tell you exactly how that will work its way out, but for now I'd spread it out evenly.

Christopher Ronald Ellinghaus *The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas*

Okay. Also O&M was down a lot. Can you sort of discuss the O&M pattern for the year?

Steven Wayne Morris *ALLETE, Inc. - VP, Controller & CAO*

Yes, so you see on the regulatory side, O&M was down approximately \$8 million pre-tax and we signaled in our guidance O&M would be down roughly 10%. So think about there about \$15 million to \$20 million on a year-over-year basis. So you saw the \$8 million. And it isn't going to be even. The fourth quarter last year we had higher expenses. I expect a similar variance for the fourth quarter of roughly \$8 million or so. Second quarter, I think would be roughly \$2 million down or so. Third quarter, I'd expect it to be flat, of course, all dependent on when we -- actual results will differ from budget. But that's our expectations right now.

Christopher Ronald Ellinghaus *The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas*

Great. That helps a lot. The other thing, could you just talk about the weather impact in terms of -- you had a benefit on the residential side, plus you had the offset with the negative impact on ACE. Can you just sort of talk about how you thought of the weather in overall versus normal?

Steven Wayne Morris *ALLETE, Inc. - VP, Controller & CAO*

Yes, right. So versus our expectations, you can see that ACE was down substantially because of the weather, probably about 25% from our expectations. And you've seen that a lot throughout the industry this year. (inaudible) so you're down in revenue, plus we're down in PTCs generated, that combined for a total of about \$0.08 variance from our expectations. And as you mentioned, that was offset by better results from the regulated utility, because of cooler weather by about \$0.04. Net-net, we're down about \$0.04 from expectations.

Operator

Our next question is from Vedula Murti from Avon Capital.

Vedula Murti

I'm wondering if you can maybe qualitatively describe a little further the multiple advanced discussions underway?

Robert J. Adams ALLETE, Inc. - Senior VP & CFO

Murti, could you repeat that? This is Bob.

Vedula Murti

I was wondering if you could maybe more qualitatively describe the multiple advanced discussions currently underway.

Robert J. Adams ALLETE, Inc. - Senior VP & CFO

Oh, sure, sure. Okay. Yes, so it's an exciting time for ACE, for sure. We've been working these particular opportunities for quite a while. As I have expressed to you and others repeatedly, we have a lot of discipline we're applying to these projects to make sure they achieve our return expectations, et cetera. And we're at a very good spot. So these negotiations are taking a little bit longer to get us where we want them to be. So I will tell you that. So qualitatively, these projects will line up very well with regard to things we've been trying to do, which is increase the length of our portfolio of PPA periods. These will be projects that actually meet and/or exceed our return expectations and they are with solid counterparties.

Vedula Murti

Okay. And also can you update us on, I think you'd indicated on the February 14 call about various requests for proposals on which you would be actively participating and kind of status of those and when we might hear some outcomes?

Robert J. Adams ALLETE, Inc. - Senior VP & CFO

Sure. I'm assuming you're talking about ACE again. So ACE is participating in RFPs as well that -- they do that from time-to-time. They've been -- in addition to the RFPs that they participate in, they've been very successful and actually by virtue of relationships of not having to participate in RFPs. So we're getting quite a bit of -- with the scaling of the business, the reputation of the business, we're actually getting quite a number of inbound calls directly to the company, where we don't -- we have an opportunity to do exclusive deals without getting involved with RFPs.

Vedula Murti

I understand that. And that's actually, probably, quite preferable, but are there any RFPs that you can specifically point to that we might want to pay attention to that -- where we may hear something, say, prior to 2Q's next call?

Robert J. Adams ALLETE, Inc. - Senior VP & CFO

Nothing that we would be prepared to disclose at this time.

Operator

Thank you. (Operator Instructions) At this time, I'm showing no further questions. I would like to turn the call back over to Bethany Owen, President, for closing remarks.

Bethany M. Owen ALLETE, Inc. - President

Steve, Bob, Al and I thank you again for being with us this morning and for your interest in ALLETE.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect.



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