ALLETE, Inc.

Moderator: Al Hodnik
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Operator: Good day, and welcome to the ALLETE Third Quarter 2010 Financial Results call. Today's call is being recorded. Certain statements contained in the 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 include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements.

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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 reflects management's views as the date here of. 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.

I would now like to turn the conference over to your host for today, Mr. Al Hodnik, president and CEO. Sir, you may begin.

Alan Hodnik: Good morning, everyone, and thank you for joining us. With me on the call today is ALLETE's Chief Financial Officer, Mark Schober.

I'm pleased to report that ALLETE recorded quarterly earnings per share of 56 cents, compared with 49 cents last year. Year to date ALLETE has earned $1.93 per share, excluding a 12 cent one-time item. Mark will go over the financial details shortly. Before he does that, I would like to update you on some significant events that occurred during the quarter.

I mentioned it on the last call, but I think it's worth repeating. In early August, Minnesota Power received demand nominations for the last four months of 2010 from (its) industrial customers. The total nomination level was similar to the preceding four-month period, which is near full capacity. Our industrial customers have had quite a turnaround in 2010 compared to 2009. We are pleased that economic improvement was seen by our customers this year, which is not only good for them, but for the entire Northeastern Minnesota region.

On the renewable energy front, we continue to make progress with our North Dakota wind initiative, as construction has been completed on the first phase of our Bison 1 Wind project. The first 16 wind turbines are now in position and will be phased into service through the end of this year. The remaining turbines will be installed in 2011.

In addition, we have completed construction of a 22 mile, 230 kilovolt transmission line that not only physically connects the Bison I Wind farm, but also broader areas of these lands we hold that are part of our wind development strategy to the DC line we purchased late last year. The total project is estimated to cost $177 million, and through September 30, we have spent $101 million. The Minnesota Public Utilities Commission has already approved our petition to begin billing our customers for this project effective August 1.

Minnesota Power's retail rate increase request also continues to progress. On September 29th, the Minnesota Public Utilities Commission considered and decided upon over 50 different issues contained in the request. We estimate that the Minnesota Public Utilities Commission will order an overall retail electric rate increase of approximately $54 million when it issues a formal written order by November 2.

The Minnesota Public Utilities Commission approved a 10.38 percent return on equity and a 54.29 percent equity ratio. We will continue to collect interim rates from our customers until the new rates go into effect, which will be after a reconsideration period has expired and after all compliance filings are completed and accepted. We estimate the new rates will go into effect early next year.

Last spring, I announced our plans to participate in additional phases of CapEx 2020, a Minnesota initiative to ensure electric transmission reliability well into the future. We initially intend to invest between $100 million and $125 million through 2015 for transmission lines between Fargo, North Dakota, and Monticello, Minnesota, as well as between Bemidji and Grand Rapids, Minnesota.

The first segment, a line between Monticello and St. Cloud, Minnesota, was granted a route permit from the Minnesota Public Utilities Commission in July. Construction of this line is expected to be complete by late 2011. And yesterday, the Minnesota Public Utilities Commission approved the route permit for the Bemidji to Grand Rapids line. We expect construction of that line will begin some time in 2011.

CapEx 2020 project costs are eligible for current cost recovery, and we have petitioned the Minnesota Public Utilities Commission to recover the cost under a rider. CapEx 2020 participants are also currently researching and studying additional reliability upgrades.

ALLETE continues to make progress as we pursue our various energy-centric initiatives. I look forward to sharing additional updates with you as we move forward. At this time, I will ask Mark to go through the financial details, and then I will provide a few more comments before we take your questions. Mark?

Mark Schober: Good morning. Before I begin, I encourage you to refer to the 10-Q we filed this morning for complete details of our quarterly results.

For the third quarter of 2010 ALLETE earned 56 cents per share on net income of $19.6 million, compared to 49 cents per share on net income of $16 million in the third quarter of 2009; our regulated operations, which includes Minnesota Power; Superior Water, Light and Power, and our investment in the American Transmission Company; recorded net income of $22.1 million for the quarter, compared to $16.6 million a year ago.

Retail and municipal kilowatt-hour sales were 48 percent higher than last year's third quarter, primarily due to an 83 percent increase in industrial sales. Offsetting the increase in industrial sales was a 40 percent decrease in sales to other power suppliers compared to the same quarter in 2009. In total, regulated utility kilowatt-hour sales were 16 percent higher in the third quarter of 2010 compared to 2009. Last year's sales were impacted by a dramatic drop in production levels by our taconite mining customers.

Total regulated operations revenue increased $45 million compared to third quarter last year due to the significant increase in retail and municipal kilowatt-hour sales; authorized interim retail rates, which are subject to refund pending the final order; higher fuel and purchase power recoveries; and an increase in transmission revenue related to the DC transmission line we purchased last December. The increase in revenue from industrial sales was partially offset by lower sales to other power suppliers in 2010 versus 2009.

Fuel and purchase power expense was $9 million higher than last year due to increased coal generation, higher coal prices and related transportation, and increased kilowatt-hour purchases partially offset by lower market prices. Regulated operations operating and maintenance expense increased $20 million or 40 percent over 2009.

The increase reflects higher reagent and contractor expenses at our power plants of $8 million, increased labor and benefit costs of $5 million, and $3 million additional MISO expenses related to the DC transmission line. Depreciation expense increased $4 million, and interest expense was up $1 million, both directly attributable to the capital investment program at our regulated operations.

Income from our investment and ATC was $100,000 higher this quarter than in the same period in 2009. ALLETE's "investments in other" segment reported a net loss of $2.5 million in the third quarter, compared to a net loss of $600,000 last year. The increased loss was primarily due to higher nonregulated operating and maintenance expenses compared to the third quarter of 2009. Also contributing to the increased loss was the impact of transferring a small generating facility to regulated operations in November of 2009. No land sales were made at ALLETE Properties during the third quarter of either 2010 or 2009, and results of BNI coal were similar to last year.

ALLETE's quarterly earnings per share also included 4 cents of dilutions due to the increased number of shares outstanding as we fund our capital investment program. We expect 2010 earnings to come in between $2.25 and $2.35 per share, excluding the 12 cents per share non-recurring charge we took in the first quarter as a result of Patient Protection and Affordable Care Act.

As mentioned in past quarters, we anticipate increasing operating and maintenance expenses and higher depreciation and interest expenses into the end of the year. Our investment balance in ATC is expected to grow by $5 million over last year, and we continue to expect that ALLETE Properties will record a net loss of about $5 million in 2010. Al?

Alan Hodnik: Thank you, Mark. This year we have decided to hold off issuing our 2011 earnings guidance until mid-December for a couple of reasons. First, we have not yet received the formal written order from the Minnesota Public Utilities Commission for our retail rate increase request, and we are unable to predict if there will be any reconsideration requests. We will have more clarity on that issue toward the end of this year. And secondly, we prefer to wait until we receive our industrial customers' demand nominations, which are due on December 1.

When we provide guidance, it will take into account a number of assumptions that include our expectations for final rates and industrial customer demand in 2011. In addition, our guidance will include the expectation of continued progress with our investments in wind generation in North Dakota and transmission expansion in Minnesota through our participation in CapEx 2020. Our investment balance in ATC will continue to grow and lastly, as Mark mentioned earlier, we also expect continued increases in O&M, depreciation and interest expenses.

Now I will ask the operator to open the lines, and Mark and I can take your questions.

Operator: Certainly. Ladies and gentlemen, if you have a question or a comment at this time, please press star then one on our touchtone telephone. If your question has been answered or you wish to remove yourself from the queue at time, please press the pound key. Again, if you do have a question, please press star then one at this time. One moment, while we wait for questions to queue. And our first question comes from the line of Larry Solow from CJS Securities.

Larry Solow: Good morning.

Alan Hodnik: Good morning, Larry.

Mark Schober: Good morning, Larry.

Larry Solow: Mark, you – in terms of your guidance, I guess the variance, is that – obviously you've narrowed it a lot, but it’s still 10 cents for the last quarter. I mean, variances, is that mostly just how much you ramp up on the O&M expenses?

Mark Schober: Well, it would be a combination of things, Larry. We tightened our guidance from the last time we spoke because of the clarity we have on our rate case. And the fact that two of our major unit outages are winding down, so we have clarity there. As we get into the fourth quarter, we certainly have the potential for weather, additional maintenance issues, potential for reconsideration issues in the rate case, results at our Florida real estate operations, so there’s some items that could swing it.

Larry Solow: OK. And then just in terms of the operating and maintenance expenses, I know you guys have been sort of warning that they will be ramping up, and that they have been pretty flat the last three quarters, around $70 million. In terms of ramping up, is this going to be something that – you know like a $10 million ramp up? Is that like a good ballpark number or just sequentially? Would it go up that much?

Mark Schober: I don't have a number right now, Larry. You'll continue to see a ramp-up. Again, as we finish some of our maintenance projects, you'll see reagent expenditures increasing over above what you've seen year to date at our power plants, you'll see increases very similar at Square Butte, as they've put in new environmental upgrades. Their expenses will be increasing, too. So those are the numbers that we're working through as we speak, and as we give 2011 guidance here in mid-December, we'll be able to provide you more clarity on the numbers.

Larry Solow: Got it. And just to clarify, Al said that some of the variables for 2011 – he mentioned your investments in transmission – the transmission expansion and the wind initiatives. Does he mean that you'll have more expenses towards that, or will actually start seeing revenue from it?

Mark Schober: Both. All of these are rider recoverable, to get approval from the Minnesota Public Utility Commission to construct. You'll see revenues starting to come through, and as they go into service, like Bison, going into service late this year, you'll see expenses starting to running through. So you'll see both sides ramping up.

Larry Solow: OK. And then on the ATC side, I know obviously utility expansion has been a little bit slower across the country, and these guys I think are no different. Any outlook? I mean, do you expect to continue to invest next year, or I guess that's sort of not in your hands? An do you have any better grasp of that?

Mark Schober: No, the only numbers that we have from ATC is that they look longer term. They have updated some of their long-term capital expense plans. I think they're up above $3 billion now over the next 10 years, but I don't have a feel yet for what our investment in 2011 will be. And again, we will have and more clarity as we give guidance here in December.

Larry Solow: Got you. OK. All right. Great, I appreciate it, Mark. Thanks.

Mark Schober: Thank you.

Operator: Thank you. Our next question from the line of James Bellessa from D.A. Davidson & Co.

Alan Hodnik: Good morning, Jim.

James Bellessa: Congratulations on a nice quarter.

Mark Schober: Good morning, Jim.

James Bellessa: Good morning. Can you hear me?

Alan Hodnik: Yes.

Alan Hodnik: We can. Thank you for your kind words.

James Bellessa: You bet. Now I'm looking at the guidance. Was there anything special in the fourth quarter last year when you reported 56 cents?

Mark Schober: The only unusual item that we recorded in the fourth quarter of 2009, Jim, was the – on our wholesale customers, if you recall, our wholesale customers have – we bill them actual expenses with a true-up. We did record a true-up of about $6 million, $6 million to $7 million in Q4 2009. This year we've been spreading that amount and trying to capture it during 2010. So that would be the only unusual item. The other item that you will see though is, as I've mentioned, O&M expenses will be up significantly, quarter over quarter.

James Bellessa: OK. So if I look at the guidance of $2.20 to $2.35, and you said you have $1.93 under your belt already, you're suggesting a fourth quarter number of 27 cents to 42 cents. This [fit] true-up you talked about, is that enough to – let me quick – I guess I have to tax affect that, would I not?

Mark Schober: Yes you would.

James Bellessa: To get it to a per share basis?

Mark Schober: Yes, you would.

James Bellessa: So, let’s say it’s $4 million divided by – that's about 12 cents a share. So last year was maybe 12 cents. We'll have to recalculate that, but that would make the quarter 44 cents. So you're really talking about a down quarter comparison. Is that fair?

Mark Schober: That's fair.

James Bellessa: Then another couple checks. You indicated that there was total CapEx of $177 million so far. I think on Bison 1 and the transmission system, or just Bison 1?

Alan Hodnik: Those projects are combined. And the total value or cost of the project is $177 million. We've spent around $100 million to date.

James Bellessa: OK. And then when O&M was described there were three items that changed, and I didn't catch them. I wasn't able to write them fast enough. Would you go over that, Mark, again?

Mark Schober: As we look forward, Jim? Yes, we’re expecting …

James Bellessa: No, no. In the most recent quarter, you described like reagent expenses and so forth.

Mark Schober: OK. There are a couple of things that were going on. Reagent contractor expenses at our power plants, due primarily driven by some of the large maintenance outages we had. They're up about $8 million.

James Bellessa: OK.

Mark Schober: We have increased labor and benefit costs are up about $5 million.

James Bellessa: OK.

Mark Schober: And then our MISO expenses related to the DC line; that's up about $3 million.

James Bellessa: OK.

Mark Schober: And then the last ones I mentioned were depreciation and interests together are up about $5 million, and that's again directly attributable to the growth in our property plant and equipment.

James Bellessa: OK. Very good. Thank you very much.

Mark Schober: OK. You bet.

Alan Hodnik: Thank you, Jim.

Operator: Thank you. Once again, if you have a question, please press star then one at this time. And we have a follow-up from Larry Solow from CJS Securities.

Larry Solow: Not to beat this issue. It's sort of trivial, but the wholesale true-up. So it's $6 million last – in Q4 last year. This year it is basically – I don't know if the true-up is in the same ballpark, but assuming it is it would have been like 1-1/2 million a quarter? Is that basically what's happening …

Mark Schober: Well, Larry, we spread it throughout the year. And the true-up this year – and I don't have a number handy, but it's going the other way.

Larry Solow: OK, so that could vary a lot.

Mark Schober: Yes, because the taconite customers have come back so much. There's credits going back.

Larry Solow: Got you. I got it.

Mark Schober: And we've built that into our quarterly results, so you won't see anything large in the quarter.

Larry Solow: Got you. OK, so you basically assume it's flat. So that – normally it wouldn't – it's sort of a nonrecurring thing that was – so that really was a 12 cents impact last year. OK and then just – and to clarify, it's – your guidance now is $2.20 or $2.25, I thought, right? $2.25 is the low end?

Mark Schober: … $2.25 to $2.35.

Larry Solow: Got it. So it is 32 cents to 42 cents essentially is what it implies in Q4.

Mark Schober: Yes.

Larry Solow: OK, great. Thanks.

Operator: Thank you. Our next question comes from Eric Jacobsohn of Columbia Wanger. Your line is open.

Eric Jacobsohn: Hey, guys, how you doing?

Mark Schober: Good morning, Eric.

Alan Hodnik: Good morning, Eric.

Eric Jacobsohn: Quick question. Just what percentage of your rate base right now is coming from transmission? And then can you kind of talk about what it would be in, let's say, 2015?

Alan Hodnik: Well, it's difficult to predict what it would be right now. Our transmission rate base is around 15 percent or so. And depending on the growth in transmission out over time and where policy makers take transmission, which is unclear at this point in time. We like transmission. We'll continue to invest in transmission. It'd be difficult to predict with any certainty where we would be in 2025.

Eric Jacobsohn: I mean, with what you guys have announced, would you – do you have a sense of what it ramps to, just with what you have approvals for?

Alan Hodnik: Don't have that with me today, no.

Eric Jacobsohn: OK.

Mark Schober: But the numbers, Eric, as Al went through it, it's $100 million, $125 million at – for the CapEx project. There will be some other minor items within

Minnesota Power, but then you also need to look at our investment in American Transmission Company, too. That's an investment in transmission, too.

Eric Jacobsohn: Great. Thank you. So – wait, I'm sorry. The 15 is including ATC stuff, right?

Mark Schober: It is not.

Eric Jacobsohn: It is not. OK. OK. Great. Thank you.

Operator: Thank you. I show no questions in the queue. I would like to turn the conference back to Mr. Al Hodnik for closing remarks.

Alan Hodnik: Well, thank you. And that wraps up our call for today, and we look forward seeing you all at the EEI Financial Conference next week. Thanks for joining us and have a good day.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may all disconnect at this time.

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