

ALLETE INC
Form 10-Q
August 01, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2008

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 1-3548

ALLETE, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of incorporation or
organization)

41-0418150

(IRS Employer Identification No.)

30 West Superior Street

Duluth, Minnesota 55802-2093

(Address of principal executive offices)

(Zip Code)

(218) 279-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large Accelerated Filer
Non-Accelerated Filer

Accelerated Filer
Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

Common Stock, no par value,
30,976,329 shares outstanding
as of June 30, 2008

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Definitions

The following abbreviations or acronyms are used in the text. References in this report to “we,” “us” and “our” are to ALLETE, Inc. and its subsidiaries, collectively.

Abbreviation or Acronym	Term
AFUDC	Allowance for Funds Used During Construction – consisting of the cost of both the debt and equity funds used to finance utility plant additions during construction periods
ALLETE	ALLETE, Inc.
ALLETE Properties	ALLETE Properties, LLC and its subsidiaries
AREA	Arrowhead Regional Emission Abatement
ATC	American Transmission Company LLC
BNI Coal	BNI Coal, Ltd.
BNSF	BNSF Railway Company
Boswell	Boswell Energy Center
Company	ALLETE, Inc. and its subsidiaries
DC	Direct Current
DOC	Minnesota Department of Commerce
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Form 10-K	ALLETE Annual Report on Form 10-K
Form 10-Q	ALLETE Quarterly Report on Form 10-Q
FPL Energy	FPL Energy, LLC
GAAP	United States Generally Accepted Accounting Principles
GHG	Greenhouse Gases
Invest Direct	ALLETE’s Direct Stock Purchase and Dividend Reinvestment Plan
kV	Kilovolt(s)
Laskin	Laskin Energy Center
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midwest Independent Transmission System Operator, Inc.
MPCA	Minnesota Pollution Control Agency
MPUC	Minnesota Public Utilities Commission
MW / MWh	Megawatt(s) / Megawatt-hour(s)
Non-residential	Retail commercial, non-retail commercial, office, industrial, warehouse, storage and institutional
NOX	Nitrogen Oxide
Note ____	Note ____ to the consolidated financial statements in this Form 10-Q
OAG	Office of the Attorney General
OES	Minnesota Office of Energy Security
Oliver Wind I	Oliver Wind I Energy Center
Oliver Wind II	Oliver Wind II Energy Center
Palm Coast Park	Palm Coast Park development project in Florida

Definitions (Continued)	
Abbreviation or Acronym	Term
Palm Coast Park District	Palm Coast Park Community Development District
PSCW	Public Service Commission of Wisconsin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards No.
SO ₂	Sulfur Dioxide
Square Butte	Square Butte Electric Cooperative
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
Town Center	Town Center at Palm Coast development project in Florida
Town Center District	Town Center at Palm Coast Community Development District
WDNR	Wisconsin Department of Natural Resources

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Safe Harbor Statement
Under the Private Securities Litigation Reform Act of 1995

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are hereby filing cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) made by or on behalf of ALLETE in this Quarterly Report on Form 10-Q, in presentations, in response to questions or otherwise. Any statements that express, or involve discussions as to expectations, beliefs, plans, objectives, assumptions, or future events or performance (often, but not always, through the use of words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “will likely result,” “will continue,” “potential,” “target,” “outlook” or similar expressions) are not statements of historical facts and may be forward-looking.

Forward-looking statements involve estimates, assumptions, risks and uncertainties, which are beyond our control and may cause actual results or outcomes to differ materially from those that may be projected. These statements are qualified in their entirety by reference to, and are accompanied by, the following important factors, in addition to any assumptions and other factors referred to specifically:

- our ability to successfully implement our strategic objectives;
- our ability to manage expansion and integrate acquisitions;
- prevailing governmental policies, regulatory actions, and legislation including those of the United States Congress, state legislatures, the FERC, the MPUC, the PSCW, and various local and county regulators, and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, real estate development, operation and construction of plant facilities, recovery of purchased power, capital investments and other expenses, present or prospective wholesale and retail competition (including but not limited to transmission costs), zoning and permitting of land held for resale and environmental matters;
- the potential impacts of climate change and future regulation to restrict the emissions of GHG on our Regulated Utility operations;
- effects of restructuring initiatives in the electric industry;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with laws and policies;
- weather conditions;
- natural disasters and pandemic diseases;
- war and acts of terrorism;
- wholesale power market conditions;
- population growth rates and demographic patterns;
- effects of competition, including competition for retail and wholesale customers;
- changes in the real estate market;
- pricing and transportation of commodities;
- changes in tax rates or policies or in rates of inflation;
- unanticipated project delays or changes in project costs;
- availability and management of construction materials and skilled construction labor for capital projects;
- unanticipated changes in operating expenses, capital and land development expenditures;
- global and domestic economic conditions;
- our ability to access capital markets and bank financing;
- changes in interest rates and the performance of the financial markets;

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- our ability to replace a mature workforce and retain qualified, skilled and experienced personnel; and
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this report are discussed in Item 1A under the heading “Risk Factors” in Part I of our 2007 Form 10-K. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which that statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all of these factors, nor can it assess the impact of each of these factors on the businesses of ALLETE or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement. Readers are urged to carefully review and consider the various disclosures made by us in this Form 10-Q and in our other reports filed with the SEC that attempt to advise interested parties of the factors that may affect our business.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ALLETE
CONSOLIDATED BALANCE SHEET
Millions – Unaudited

	June 30, 2008	December 31, 2007
Assets		
Current Assets		
Cash and Cash Equivalents	\$ 99.1	\$ 23.3
Short-Term Investments	–	23.1
Accounts Receivable (Less Allowance of \$1.0 at June 30, 2008 and \$1.0 at December 31, 2007)	59.2	79.5
Inventories	53.7	49.5
Prepayments and Other	27.2	39.1
Total Current Assets	239.2	214.5
Property, Plant and Equipment - Net	1,224.3	1,104.5
Investments	208.3	213.8
Other Assets	117.0	111.4
Total Assets	\$ 1,788.8	\$ 1,644.2
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	\$ 69.2	\$ 72.7
Accrued Taxes	15.7	14.8
Accrued Interest	9.6	7.8
Notes Payable	6.0	–
Long-Term Debt Due Within One Year	14.8	11.8
Deferred Profit on Sales of Real Estate	2.7	2.7
Other	24.0	27.3
Total Current Liabilities	142.0	137.1
Long-Term Debt	538.5	410.9
Deferred Income Taxes	152.6	144.2
Other Liabilities	187.2	200.1
Minority Interest	9.3	9.3
Total Liabilities	1,029.6	901.6
Commitments and Contingencies		
Shareholders' Equity		
Common Stock Without Par Value, 43.3 Shares Authorized, 31.0 and 30.8		
Shares Outstanding	469.8	461.2
Unearned ESOP Shares	(60.4)	(64.5)
Accumulated Other Comprehensive Loss	(7.7)	(4.5)
Retained Earnings	357.5	350.4
Total Shareholders' Equity	759.2	742.6

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Total Liabilities and Shareholders' Equity	\$ 1,788.8	\$ 1,644.2
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The accompanying notes are an integral part of these statements.

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ALLETE
CONSOLIDATED STATEMENT OF INCOME
Millions Except Per Share Amounts – Unaudited

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Operating Revenue	\$ 189.8	\$ 223.3	\$ 403.2	\$ 428.6
Operating Expenses				
Fuel and Purchased Power	75.0	92.9	161.3	170.6
Operating and Maintenance	83.8	84.6	166.2	159.2
Depreciation	12.9	11.9	25.6	23.6
Total Operating Expenses	171.7	189.4	353.1	353.4
Operating Income	18.1	33.9	50.1	75.2
Other Income (Expense)				
Interest Expense	(7.2)	(6.1)	(13.9)	(12.4)
Equity Earnings in ATC	3.6	3.2	7.0	6.1
Other	2.5	4.1	11.1	8.7
Total Other Income (Expense)	(1.1)	1.2	4.2	2.4
Income Before Minority Interest and Income Taxes	17.0	35.1	54.3	77.6
Income Tax Expense	6.2	11.2	19.9	27.3
Minority Interest	0.1	1.3	0.1	1.4
Net Income	\$ 10.7	\$ 22.6	\$ 34.3	\$ 48.9
Average Shares of Common Stock				
Basic	28.8	28.2	28.7	28.1
Diluted	28.9	28.3	28.8	28.2
Earnings Per Share of Common Stock				
Basic	\$ 0.37	\$ 0.80	\$ 1.19	\$ 1.74
Diluted	\$ 0.37	\$ 0.80	\$ 1.19	\$ 1.73
Dividends Per Share of Common Stock	\$ 0.43	\$ 0.41	\$ 0.86	\$ 0.82

The accompanying notes are an integral part of these statements.

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ALLETE
CONSOLIDATED STATEMENT OF CASH FLOWS
Millions - Unaudited

	Six Months Ended June 30,	
	2008	2007
Operating Activities		
Net Income	\$ 34.3	\$ 48.9
Allowance for Funds Used During Construction	(2.0)	(1.2)
Income from Equity Investments, net of dividends	(1.0)	(1.6)
Gain on Sale of Assets	(4.6)	(2.1)
Gain on Sale of Available for Sale Securities	(6.5)	-
Depreciation	25.6	23.6
Deferred Income Taxes	9.1	(1.1)
Minority Interest	-	1.4
Stock Compensation Expense	0.8	1.0
Bad Debt Expense	0.5	0.5
Changes in Operating Assets and Liabilities		
Accounts Receivable	19.7	5.6
Inventories	(4.2)	(3.5)
Prepayments and Other	11.1	(9.7)
Accounts Payable	(15.5)	(6.9)
Other Current Liabilities	(0.6)	(9.7)
Other Assets	(5.6)	1.0
Other Liabilities	(7.5)	4.9
Cash from Operating Activities	53.6	51.1
Investing Activities		
Proceeds from Sale of Available-For-Sale Securities	52.3	187.2
Payments for Purchase of Available-For-Sale Securities	(39.3)	(204.5)
Changes to Investments	3.7	(17.8)
Additions to Property, Plant and Equipment	(130.5)	(68.9)
Proceeds from Sale of Assets	20.2	1.4
Other	(3.0)	1.5
Cash for Investing Activities	(96.6)	(101.1)
Financing Activities		
Issuance of Common Stock	7.9	15.4
Issuance of Debt	138.7	110.2
Payments of Long-Term Debt	(8.2)	(61.0)
Dividends on Common Stock and Distributions to Minority Shareholders	(25.6)	(22.3)
Changes in Notes Payable	6.0	-
Cash from Financing Activities	118.8	42.3
Change in Cash and Cash Equivalents	75.8	(7.7)
Cash and Cash Equivalents at Beginning of Period	23.3	44.8

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Cash and Cash Equivalents at End of Period	\$ 99.1	\$ 37.1
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The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and do not include all of the information and notes required by GAAP for complete financial statements. Similarly, the December 2007 consolidated balance sheet was derived from audited financial statements but does not include all disclosures required by GAAP. In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal and recurring adjustments necessary to make a fair statement of the consolidated financial position, results of operations and cash flows of ALLETE for the interim periods presented. Operating results for the periods ended June 30, 2008, are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and notes included in our 2007 Form 10-K.

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Inventories. Inventories are stated at the lower of cost or market. Cost is determined by the average cost method.

	June 30, December 31,	
	2008	2007
Inventories		
Millions		
Fuel	\$23.6	\$22.1
Materials and Supplies	30.1	27.4
Total Inventories	\$53.7	\$49.5

Supplemental Statement of Cash Flows Information.

Consolidated Statement of Cash Flows		
Supplemental Disclosure		
	2008	2007
For the Six Months Ended June 30,		
Millions		
Cash Paid During the Period for		
Interest – Net of Amounts Capitalized	\$11.8	\$13.2
Income Taxes	\$4.2	\$20.3
Noncash Investing Activities		
Accounts Payable for Capital Additions to Property Plant and Equipment	\$12.0	\$1.2

New Accounting Standards. SFAS 157. In September 2006, the FASB issued SFAS 157, "Fair Value Measurements," to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value in GAAP, and expanding disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. It clarifies the extent to which fair

value is used to measure recognized assets and liabilities, the inputs used to develop the measurements, and the effect of certain measurements on earnings for the period. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and is applied on a prospective basis. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-1, "Application of FAS 157 to FAS 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under FAS 13", which excludes FAS 13, "Accounting for Leases," and its related interpretive accounting pronouncements that address leasing transactions, from the scope of FAS 157.

Also in February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement 157," which delays the effective date of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008. The Company elected to defer the adoption of the nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities. The adoption of FSP FAS 157-2 is not expected to have a material impact on the Company's results of operations, cash flows or financial position.

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NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES – New Accounting Standards (Continued)

The implementation of SFAS 157 for financial assets and financial liabilities and FSP FAS 157-1, effective January 1, 2008, did not have a material impact on our consolidated financial position and results of operations. See Note 12 – Recurring Fair Value Measures for additional information. We are currently assessing the impact of SFAS 157 for nonfinancial assets and nonfinancial liabilities on our consolidated financial position, results of operations and cash flows, but we do not believe it will have a material impact on the Company.

SFAS 141R. In December 2007, the FASB issued SFAS 141 (revised 2007), “Business Combinations,” to increase the relevance, representational faithfulness, and comparability of the information a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R replaces SFAS 141, “Business Combinations”, but retains the fundamental requirements of SFAS 141 that the acquisition method of accounting be used and an acquirer be identified for all business combinations. SFAS 141R expands the definition of a business and of a business combination and establishes how the acquirer is to: (1) recognize and measure in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognize and measure the goodwill acquired in the business combination or a gain from a bargain purchase; and (3) determine what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is applicable to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and is to be applied prospectively. Early adoption is prohibited. SFAS 141R will impact ALLETE if we elect to enter into a business combination subsequent to December 31, 2008.

SFAS 160. In December 2007, the FASB issued SFAS 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin (ARB) 51,” to improve the relevance, comparability, and transparency of the financial information a reporting entity provides in its consolidated financial statements. SFAS 160 amends ARB 51 to establish accounting and reporting standards for noncontrolling interests in subsidiaries and to make certain consolidation procedures consistent with the requirements of SFAS 141R. It defines a noncontrolling interest in a subsidiary as an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 changes the way the consolidated income statement is presented by requiring consolidated net income to include amounts attributable to the parent and the noncontrolling interest. SFAS 160 establishes a single method of accounting for changes in a parent’s ownership interest in a subsidiary which do not result in deconsolidation. SFAS 160 also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for financial statements issued for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. SFAS 160 shall be applied prospectively, with the exception of the presentation and disclosure requirements which shall be applied retrospectively for all periods presented. ALLETE Properties does have certain noncontrolling interests in consolidated subsidiaries. If SFAS 160 had been applied as of June 30, 2008, the \$9.3 million reported as Minority Interest in the Liabilities section on our consolidated balance sheet would have been reported as \$9.3 million of Noncontrolling Interest in Subsidiaries in the Equity section of our consolidated balance sheet. After December 15, 2008, SFAS 160 will impact the presentation of our consolidated balance sheet; however, we do not believe it will have a material impact on the consolidated financial position, results of operations, and cash flows of the Company.

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES – New Accounting Standards (Continued)

SFAS 161. In March 2008, the FASB issued SFAS 161, “Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS 133,” to enhance disclosures about an entity’s derivative and hedging activities and improve the transparency of financial reporting. Entities will be required to provide enhanced disclosures about (1) how and why derivatives instruments are used, (2) how derivative instruments are accounted for, and (3) how derivative instruments affect the entities financial position, financial performance and cash flows. These disclosures better convey the purpose of derivative use in terms of the risks that the entity is intending to manage by requiring fair value disclosures in a tabular format, providing more information about an entity’s liquidity and requiring cross-referencing within the footnotes. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. We did not have any material derivative instruments at June 30, 2008. In the event we elect to enter into a material derivative or hedging activity in the future, SFAS 161 will have an impact on our disclosure requirements.

NOTE 2. BUSINESS SEGMENTS

	Energy					
	Regulated		Nonregulated			
	Consolidated	Utility	Energy Operations	Investment in ATC	Real Estate	Other
Millions						
For the Quarter Ended June 30, 2008						
Operating Revenue	\$189.8	\$163.5	\$18.3	–	\$7.9	\$0.1
Fuel and Purchased Power	75.0	75.0	–	–	–	–
Operating and Maintenance	83.8	63.4	16.3	\$0.1	3.8	0.2
Depreciation	12.9	11.7	1.1	–	–	0.1
Operating Income (Loss)	18.1	13.4	0.9	(0.1)	4.1	(0.2)
Interest Expense	(7.2)	(5.6)	–	–	(0.1)	(1.5)
Equity Earnings in ATC	3.6	–	–	3.6	–	–
Other Income	2.5	1.1	0.7	–	0.2	0.5
Income (Loss) Before Minority Interest and Income Taxes	17.0	8.9	1.6	3.5	4.2	(1.2)
Income Tax Expense (Benefit)	6.2	3.7	0.4	1.5	1.6	(1.0)
Minority Interest	0.1	–	–	–	0.1	–
Net Income (Loss)	\$10.7	\$5.2	\$1.2	\$2.0	\$2.5	\$(0.2)