ALLETE INC
Form 10-Q
May 02, 2019

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

# FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2019
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** | **41-0418150** |
| (State or other jurisdiction of incorporation or organization) | (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)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class | Trading symbol | Name of each exchange on which registered |
| --- | --- | --- |
| Common Stock, without par value | ALE | New York Stock Exchange |

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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer x Accelerated Filer ¨
Non-Accelerated Filer ¨ Smaller Reporting Company ¨
Emerging Growth Company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Common Stock, without par value,
51,624,422 shares outstanding
as of March 31, 2019

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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 – the cost of both debt and equity funds used to finance regulated utility plant additions during construction periods |
| ALLETE | ALLETE, Inc. |
| ALLETE Clean Energy | ALLETE Clean Energy, Inc. and its subsidiaries |
| ALLETE Properties | ALLETE Properties, LLC and its subsidiaries |
| ALLETE Transmission Holdings | ALLETE Transmission Holdings, Inc. |
| ATC | American Transmission Company LLC |
| Bison | Bison Wind Energy Center |
| Blanchard | Blanchard Solar Energy Facility |
| BNI Energy | BNI Energy, Inc. and its subsidiary |
| Boswell | Boswell Energy Center |
| Camp Ripley | Camp Ripley Solar Array |
| $CO_2$ | Carbon Dioxide |
| Company | ALLETE, Inc. and its subsidiaries |
| Cliffs | Cleveland-Cliffs Inc. |
| CSAPR | Cross-State Air Pollution Rule |
| DC | Direct Current |
| EIS | Environmental Impact Statement |
| EITE | Energy-Intensive Trade-Exposed |
| EPA | United States Environmental Protection Agency |
| ERP Iron Ore | ERP Iron Ore, LLC |
| 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 |
| GAAP | Generally Accepted Accounting Principles in the United States of America |
| GHG | Greenhouse Gases |
| GNTL | Great Northern Transmission Line |
| Hibbard | Hibbard Renewable Energy Center |
| Husky Energy | Husky Energy Inc. |
| Invest Direct | ALLETE’s Direct Stock Purchase and Dividend Reinvestment Plan |
| IRP | Integrated Resource Plan |
| Item ___ | Item ___ of this Form 10-Q |
| kV | Kilovolt(s) |
| kW / kWh | Kilowatt(s) / Kilowatt-hour(s) |
| Laskin | Laskin Energy Center |
| Manitoba Hydro | Manitoba Hydro-Electric Board |
| Minnesota Power | An operating division of ALLETE, Inc. |
| Minnkota Power | Minnkota Power Cooperative, Inc. |
| MISO | Midcontinent Independent System Operator, Inc. |
| MMTP | Manitoba-Minnesota Transmission Project |

| **Abbreviation or Acronym** | **Term** |
|---|---|
| Montana-Dakota Utilities | Montana-Dakota Utilities Co., a division of MDU Resources Group, Inc. |
| Moody’s | Moody’s Investors Service, Inc. |
| MPCA | Minnesota Pollution Control Agency |
| MPUC | Minnesota Public Utilities Commission |
| MW / MWh | Megawatt(s) / Megawatt-hour(s) |
| NAAQS | National Ambient Air Quality Standards |
| NDPSC | North Dakota Public Service Commission |
| Nobles 2 | Nobles 2 Power Partners, LLC |
| NOL | Net Operating Loss |
| NOX | Nitrogen Oxides |
| Northern States Power | Northern States Power Company, a subsidiary of Xcel Energy Inc. |
| Northshore Mining | Northshore Mining Company, a wholly-owned subsidiary of Cleveland-Cliffs Inc. |
| Note ___ | Note ___ to the Consolidated Financial Statements in this Form 10-Q |
| NPDES | National Pollutant Discharge Elimination System |
| NTEC | Nemadji Trail Energy Center |
| Oliver Wind I | Oliver Wind I Energy Center |
| Oliver Wind II | Oliver Wind II Energy Center |
| Palm Coast Park District | Palm Coast Park Community Development District in Florida |
| PolyMet | PolyMet Mining Corp. |
| PPA / PSA | Power Purchase Agreement / Power Sales Agreement |
| PPACA | Patient Protection and Affordable Care Act of 2010 |
| PSCW | Public Service Commission of Wisconsin |
| SEC | Securities and Exchange Commission |
| Silver Bay Power | Silver Bay Power Company, a wholly-owned subsidiary of Cleveland-Cliffs Inc. |
| $SO_2$ | Sulfur Dioxide |
| Square Butte | Square Butte Electric Cooperative, a North Dakota cooperative corporation |
| SWL&P | Superior Water, Light and Power Company |
| Taconite Harbor | Taconite Harbor Energy Center |
| TCJA | Tax Cuts and Job Act of 2017 (Public Law 115-97) |
| Town Center District | Town Center at Palm Coast Community Development District in Florida |
| U.S. | United States of America |
| U.S. Water Services | U.S. Water Services Holding Company and its subsidiaries |
| WTG | Wind Turbine Generator |

**Forward-Looking Statements**

Statements in this report that are not statements of historical facts are considered "forward-looking" and, accordingly, involve risks and uncertainties that could cause actual results to differ materially from those discussed. Although such forward-looking statements have been made in good faith and are based on reasonable assumptions, there can be no assurance that the expected results will be achieved. Any statements that express, or involve discussions as to, future expectations, risks, beliefs, plans, objectives, assumptions, events, uncertainties, financial performance, or growth strategies (often, but not always, through the use of words or phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "likely," "will continue," "could," "may," "potential," "target," "outlook" or words of similar m not statements of historical facts and may be forward-looking.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are providing this cautionary statement to identify important factors that could cause our actual results to differ materially from those indicated in forward-looking statements made by or on behalf of ALLETE in this Form 10-Q, in presentations, on our website, in response to questions or otherwise. 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 in connection with such forward-looking statements that could cause our actual results to differ materially from those indicated in the forward-looking statements:

- our ability to successfully implement our strategic objectives;
- global and domestic economic conditions affecting us or our customers;
- changes in and compliance with laws and regulations;
- changes in tax rates or policies or in rates of inflation;
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements;
- weather conditions, natural disasters and pandemic diseases;
- our ability to access capital markets and bank financing;
- changes in interest rates and the performance of the financial markets;
- project delays or changes in project costs;
- changes in operating expenses and capital expenditures and our ability to raise revenues from our customers in regulated rates or contract price increases at our Energy Infrastructure and Related Services and other businesses;
- the impacts of commodity prices on ALLETE and our customers;
- our ability to attract and retain qualified, skilled and experienced personnel;
- effects of emerging technology;
- war, acts of terrorism and cybersecurity attacks;
- our ability to manage expansion and integrate acquisitions;
- population growth rates and demographic patterns;
- wholesale power market conditions;
- federal and state regulatory and legislative actions that impact regulated utility economics, including our allowed rates of return, capital structure, ability to secure financing, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities and utility infrastructure, recovery of purchased power, capital investments and other expenses, including present or prospective environmental matters;
- effects of competition, including competition for retail and wholesale customers;
- effects of restructuring initiatives in the electric industry;
- the impacts on our Regulated Operations segment of climate change and future regulation to restrict the emissions of GHG;
- effects of increased deployment of distributed low-carbon electricity generation resources;

- the impacts of laws and regulations related to renewable and distributed generation;
- pricing, availability and transportation of fuel and other commodities and the ability to recover the costs of such commodities;
- our current and potential industrial and municipal customers’ ability to execute announced expansion plans;
- real estate market conditions where our legacy Florida real estate investment is located may not improve;
- the success of efforts to realize value from, invest in, and develop new opportunities in, our Energy Infrastructure and Related Services businesses; and
- factors affecting our Energy Infrastructure and Related Services businesses, including unanticipated cost increases, changes in legislation and regulations impacting the industries in which the customers served operate, the effects of weather, creditworthiness of customers, ability to obtain materials required to perform services, and changing market conditions.

**Forward-Looking Statements (Continued)**

Additional disclosures regarding factors that could cause our results or performance to differ from those anticipated by this report are discussed in Part I, Item 1A. Risk Factors of ALLETE’s 2018 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 ALLETE in this Form 10-Q and in other reports filed with the SEC that attempt to identify the risks and uncertainties that may affect ALLETE’s business.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

**ALLETE**
**CONSOLIDATED BALANCE SHEET**
**Unaudited**

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| **Millions** | | |
| **Assets** | | |
| Current Assets | | |
| Cash and Cash Equivalents | $353.3 | $69.1 |
| Accounts Receivable (Less Allowance of $1.0 and $1.7) | 98.9 | 144.4 |
| Inventories – Net | 73.8 | 86.7 |
| Prepayments and Other | 30.4 | 34.1 |
| Total Current Assets | 556.4 | 334.3 |
| Property, Plant and Equipment – Net | 3,940.5 | 3,904.4 |
| Regulatory Assets | 385.1 | 389.5 |
| Equity Investments | 154.8 | 161.1 |
| Goodwill and Intangible Assets – Net | 1.1 | 223.3 |
| Other Non-Current Assets | 180.9 | 152.4 |
| **Total Assets** | $5,218.8 | $5,165.0 |
| **Liabilities and Shareholders' Equity** | | |
| **Liabilities** | | |
| Current Liabilities | | |
| Accounts Payable | $134.4 | $149.8 |
| Accrued Taxes | 60.3 | 51.4 |
| Accrued Interest | 14.9 | 17.9 |
| Long-Term Debt Due Within One Year | 14.3 | 57.5 |
| Other | 98.5 | 128.5 |
| Total Current Liabilities | 322.4 | 405.1 |
| Long-Term Debt | 1,525.0 | 1,428.5 |
| Deferred Income Taxes | 215.5 | 223.6 |
| Regulatory Liabilities | 504.1 | 512.1 |
| Defined Benefit Pension and Other Postretirement Benefit Plans | 165.2 | 177.3 |
| Other Non-Current Liabilities | 287.9 | 262.6 |
| Total Liabilities | 3,020.1 | 3,009.2 |
| **Commitments, Guarantees and Contingencies (Note 7)** | | |
| **Shareholders' Equity** | | |
| Common Stock Without Par Value, 80.0 Shares Authorized, 51.6 and 51.5 Shares Issued and Outstanding | 1,431.1 | 1,428.5 |
| Accumulated Other Comprehensive Loss | (27.2) | (27.3) |
| Retained Earnings | 794.8 | 754.6 |
| Total Shareholders' Equity | 2,198.7 | 2,155.8 |
| **Total Liabilities and Shareholders' Equity** | $5,218.8 | $5,165.0 |

The accompanying notes are an integral part of these statements.

**ALLETE**
**CONSOLIDATED STATEMENT OF INCOME**
**Unaudited**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2019** | **2018** |
| **Millions Except Per Share Amounts** | | |
| **Operating Revenue** | | |
| Contracts with Customers – Utility | $282.2 | $270.2 |
| Contracts with Customers – Non-utility | 72.1 | 82.0 |
| Other – Non-utility | 2.9 | 6.0 |
| Total Operating Revenue | 357.2 | 358.2 |
| **Operating Expenses** | | |
| Fuel, Purchased Power and Gas – Utility | 109.8 | 100.9 |
| Transmission Services – Utility | 18.3 | 18.4 |
| Cost of Sales – Non-utility | 30.6 | 32.9 |
| Operating and Maintenance | 76.2 | 86.5 |
| Depreciation and Amortization | 51.9 | 45.8 |
| Taxes Other than Income Taxes | 13.6 | 16.3 |
| Total Operating Expenses | 300.4 | 300.8 |
| **Operating Income** | 56.8 | 57.4 |
| **Other Income (Expense)** | | |
| Interest Expense | (16.5) | (16.9) |
| Equity Earnings | 5.6 | 4.7 |
| Gain on Sale of U.S. Water Services | 20.1 | — |
| Other | 7.4 | 2.1 |
| Total Other Income (Expense) | 16.6 | (10.1) |
| **Income Before Income Taxes** | 73.4 | 47.3 |
| **Income Tax Expense (Benefit)** | 2.9 | (3.7) |
| **Net Income** | $70.5 | $51.0 |
| **Average Shares of Common Stock** | | |
| Basic | 51.6 | 51.2 |
| Diluted | 51.7 | 51.4 |
| **Basic Earnings Per Share of Common Stock** | $1.37 | $1.00 |
| **Diluted Earnings Per Share of Common Stock** | $1.37 | $0.99 |

The accompanying notes are an integral part of these statements.

**ALLETE**
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**
**Unaudited**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2019** | **2018** |
| **Millions** | | |
| **Net Income** | $70.5 | $51.0 |
| **Other Comprehensive Income (Loss)** | | |
| Unrealized Gain (Loss) on Securities | | |
| Net of Income Tax Expense of $– and $– | 0.1 | (0.1) |
| Defined Benefit Pension and Other Postretirement Benefit Plans | | |
| Net of Income Tax Expense of $0.1 and $0.1 | — | 0.4 |
| Total Other Comprehensive Income | 0.1 | 0.3 |
| **Total Comprehensive Income** | $70.6 | $51.3 |

The accompanying notes are an integral part of these statements.

**ALLETE**
**CONSOLIDATED STATEMENT OF CASH FLOWS**
**Unaudited**

| Millions | Three Months Ended March 31, 2019 | 2018 |
|---|---|---|
| **Operating Activities** | | |
| Net Income | $70.5 | $51.0 |
| AFUDC – Equity | (0.6) | (0.3) |
| Income from Equity Investments – Net of Dividends | (1.2) | (0.5) |
| Gain on Sales of Investments and Property, Plant and Equipment | (1.7) | (0.1) |
| Depreciation Expense | 50.7 | 44.5 |
| Amortization of PSAs | (2.9) | (6.0) |
| Amortization of Other Intangible Assets and Other Assets | 1.9 | 2.8 |
| Deferred Income Tax Expense (Benefit) | 2.6 | (4.4) |
| Share-Based and ESOP Compensation Expense | 1.8 | 1.7 |
| Defined Benefit Pension and Postretirement Benefit Expense | 1.1 | 2.2 |
| Provision for Interim Rate Refund | 0.6 | 4.4 |
| Payments / Provision for Tax Reform Refund | (10.2) | 7.5 |
| Bad Debt Expense | 0.4 | 0.3 |
| Gain on Sale of U.S. Water Services | (20.1) | — |
| Changes in Operating Assets and Liabilities | | |
| Accounts Receivable | 20.9 | 6.3 |
| Inventories | (5.1) | (0.3) |
| Prepayments and Other | 2.9 | (1.2) |
| Accounts Payable | (5.5) | (0.1) |
| Other Current Liabilities | (9.9) | 17.3 |
| Cash Contributions to Defined Benefit Pension Plans | (10.4) | (15.0) |
| Changes in Regulatory and Other Non-Current Assets | 0.3 | 3.8 |
| Changes in Regulatory and Other Non-Current Liabilities | (7.0) | 7.4 |
| Cash from Operating Activities | 79.1 | 121.3 |
| **Investing Activities** | | |
| Proceeds from Sale of Available-for-sale Securities | 2.7 | 3.3 |
| Payments for Purchase of Available-for-sale Securities | (2.6) | (5.3) |
| Payments for Equity Investments | (0.5) | (1.6) |
| Return of Capital from Equity Investments | 8.3 | — |
| Proceeds from Sale of U.S. Water Services – Net of Transaction Costs and Cash Retained | 264.7 | — |
| Additions to Property, Plant and Equipment | (89.3) | (88.1) |
| Other Investing Activities | 1.8 | 2.7 |
| Cash from (for) Investing Activities | 185.1 | (89.0) |
| **Financing Activities** | | |
| Proceeds from Issuance of Common Stock | 0.8 | 4.3 |
| Proceeds from Issuance of Long-Term Debt | 100.0 | — |
| Repayments of Long-Term Debt | (43.8) | (1.9) |
| Acquisition-Related Contingent Consideration Payments | (3.8) | — |

| | | |
|---|---|---|
| Dividends on Common Stock | (30.3 ) | (28.7 ) |
| Other Financing Activities | (0.9 ) | (0.2 ) |
| Cash from (for) Financing Activities | 22.0 | (26.5 ) |
| **Change in Cash, Cash Equivalents and Restricted Cash** | 286.2 | 5.8 |
| **Cash, Cash Equivalents and Restricted Cash at Beginning of Period** | 79.0 | 110.1 |
| **Cash, Cash Equivalents and Restricted Cash at End of Period** | $365.2 | $115.9 |

The accompanying notes are an integral part of these statements.

**ALLETE**
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**
**Unaudited**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2019** | **2018** |
| **Millions Except Per Share Amounts** | | |
| **Common Stock** | | |
| Balance, Beginning of Period | $1,428.5 | $1,401.4 |
| Common Stock Issued | 2.6 | 6.0 |
| Balance, End of Period | 1,431.1 | 1,407.4 |
| | | |
| **Accumulated Other Comprehensive Loss** | | |
| Balance, Beginning of Period | (27.3) | (28.2) |
| Other Comprehensive Income - Net of Income Taxes | | |
| Unrealized Gain (Loss) on Debt Securities | 0.1 | (0.1) |
| Defined Benefit Pension and Other Postretirement Plans | — | 0.4 |
| Balance, End of Period | (27.2) | (27.9) |
| | | |
| **Retained Earnings** | | |
| Balance, Beginning of Period | 754.6 | 695.5 |
| Net Income | 70.5 | 51.0 |
| Common Stock Dividends | (30.3) | (28.7) |
| Balance, End of Period | 794.8 | 717.8 |
| | | |
| Total Shareholders' Equity | $2,198.7 | $2,097.3 |
| | | |
| Dividends Per Share of Common Stock | $0.5875 | $0.56 |

The accompanying notes are an integral part of these statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – UNAUDITED**

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 31, 2018, Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. In management's opinion, these unaudited financial statements include all adjustments necessary for a fair statement of financial results. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Operating results for the three months ended March 31, 2019, are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2019. For further information, refer to the Consolidated Financial Statements and notes included in our 2018 Form 10-K.

**NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES**

**Cash, Cash Equivalents and Restricted Cash.** We consider all investments purchased with original maturities of three months or less to be cash equivalents. As of March 31, 2019, restricted cash amounts included in Prepayments and Other on the Consolidated Balance Sheet include collateral deposits required under an ALLETE Clean Energy loan agreement. In prior periods presented, the amounts also include U.S. Water Service's standby letters of credit. The restricted cash amounts included in Other Non-Current Assets represent collateral deposits required under an ALLETE Clean Energy loan agreement and PSAs, and deposits from a SWL&P customer in aid of future capital expenditures. The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the Consolidated Balance Sheet that aggregate to the amounts presented in the Consolidated Statement of Cash Flows.

| **Cash, Cash Equivalents and Restricted Cash** | **March 31, 2019** | **December 31, 2018** | **March 31, 2018** | **December 31, 2017** |
|---|---|---|---|---|
| **Millions** | | | | |
| Cash and Cash Equivalents | $353.3 | $69.1 | $98.5 | $98.9 |
| Restricted Cash included in Prepayments and Other | 7.2 | 1.3 | 8.8 | 2.6 |
| Restricted Cash included in Other Non-Current Assets | 4.7 | 8.6 | 8.6 | 8.6 |
| Cash, Cash Equivalents and Restricted Cash on the Consolidated Statement of Cash Flows | $365.2 | $79.0 | $115.9 | $110.1 |

**Inventories – Net.** Inventories are stated at the lower of cost or net realizable value. Inventories in our Regulated Operations segment are carried at an average cost or first-in, first-out basis. Inventories in our ALLETE Clean Energy segment and Corporate and Other businesses are carried at an average cost, first-in, first-out or specific identification basis.

| **Inventories – Net** | **March 31, 2019** | **December 31, 2018** |
|---|---|---|
| **Millions** | | |
| Fuel *(a)* | $29.4 | $26.0 |
| Materials and Supplies | 44.4 | 44.2 |
| Raw Materials *(b)* | — | 2.8 |
| Work in Progress *(b)* | — | 6.1 |
| Finished Goods *(b)* | — | 8.4 |
| Reserve for Obsolescence *(b)* | — | (0.8) |
| Total Inventories – Net | $73.8 | $86.7 |

*(a) Fuel consists primarily of coal inventory at Minnesota Power.*
*(b) On March 26, 2019, ALLETE completed the sale of U.S. Water Services which resulted in the removal of the related inventory items from the Consolidated Balance Sheet.*

**NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

| **Other Non-Current Assets** | **March 31, 2019** | **December 31, 2018** |
|---|---|---|
| **Millions** | | |
| Contract Assets *(a)* | $29.8 | $30.7 |
| Finance Receivable | 10.4 | 10.4 |
| Operating Lease Right-of-use Assets *(b)* | 34.0 | — |
| ALLETE Properties | 24.0 | 24.4 |
| Other | 82.7 | 86.9 |
| Total Other Non-Current Assets | $180.9 | $152.4 |

*(a)* *Contract Assets include payments made to customers as an incentive to execute or extend service agreements. The contract payments are being amortized over the term of the respective agreements as a reduction to revenue.*
*(b)* *See Leases.*

| **Other Current Liabilities** | **March 31, 2019** | **December 31, 2018** |
|---|---|---|
| **Millions** | | |
| Provision for Interim Rate Refund *(a)* | $40.6 | $40.0 |
| PSAs | 12.4 | 12.6 |
| Contract Liabilities *(b)* | 0.4 | 7.6 |
| Provision for Tax Reform Refund *(c)* | 0.5 | 10.7 |
| Contingent Consideration *(d)* | — | 3.8 |
| Operating Lease Liabilities *(e)* | 8.4 | — |
| Other | 36.2 | 53.8 |
| Total Other Current Liabilities | $98.5 | $128.5 |

*(a)* *Provision for Interim Rate Refund is expected to be refunded to Minnesota Power's regulated retail customers in the second quarter of 2019.*
*(b)* *Contract Liabilities include deposits received as a result of entering into contracts with our customers prior to completing our performance obligations.*
*(c)* *Provision for Tax Reform Refund related to the income tax benefits of the TCJA in 2018 was refunded to Minnesota Power customers in the first quarter of 2019 and will be refunded to SWL&P customers in 2019 and 2020.*
*(d)* *Contingent Consideration related to the earnings-based payment resulting from the U.S. Water Services acquisition was paid in the first quarter of 2019.*
*(e)* *See Leases.*

| **Other Non-Current Liabilities** | **March 31, 2019** | **December 31, 2018** |
|---|---|---|
| **Millions** | | |
| Asset Retirement Obligation | $142.0 | $138.6 |
| PSAs | 73.9 | 76.9 |
| Operating Lease Liabilities *(a)* | 25.6 | — |
| Other | 46.4 | 47.1 |
| Total Other Non-Current Liabilities | $287.9 | $262.6 |

*(a)* *See Leases.*

**NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Supplemental Statement of Cash Flows Information.**

| **Three Months Ended March 31,** | **2019** | **2018** |
|---|---|---|
| **Millions** | | |
| Cash Paid for Interest – Net of Amounts Capitalized | $19.7 | $19.3 |
| Noncash Investing and Financing Activities | | |
| Decrease in Accounts Payable for Capital Additions to Property, Plant and Equipment | $(1.1) | $(48.1) |
| Reclassification of Property, Plant and Equipment to Inventory *(a)* | — | $46.9 |
| Recognition of Right-of-use Assets and Lease Liabilities *(b)* | $34.0 | — |
| Capitalized Asset Retirement Costs | $1.6 | $0.8 |
| AFUDC–Equity | $0.6 | $0.3 |

*(a)* *In February 2018, Montana-Dakota Utilities exercised its option to purchase the Thunder Spirit II wind energy facility upon completion, resulting in a reclassification from Property, Plant and Equipment – Net to Inventories – Net for project costs incurred in the prior year.*
*(b)* *See Leases.*

**New Accounting Pronouncements.**

***Recently Adopted Pronouncements***

*Disclosure Update and Simplification*. In November 2018, the SEC adopted amendments to certain disclosure requirements. The amendments adopted include requirements that interim financial statements should include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the year-end balance sheet. It further includes a requirement analyzing the changes in each caption of shareholders' equity either separately in a note or on the face of the financial statement. These amendments were effective for ALLETE in the first quarter of 2019. We have included the presentation of our Statement of Shareholders' Equity to meet these requirements.

*Leases.* In 2016, the FASB issued an accounting standard update which revised the existing guidance for leases. Under the revised guidance, lessees will be required to recognize right-of-use assets and lease liabilities on the Consolidated Balance Sheet for leases with terms greater than 12 months. The new standard also requires additional qualitative and quantitative disclosures by lessees and lessors to enable users of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The accounting for leases by lessors and the recognition, measurement and presentation of expenses and cash flows from leases is not expected to significantly change as a result of the new guidance. The Company adopted this guidance in the first quarter of 2019 using the optional transition method and the package of practical expedients, which allowed for the adoption of the standard as of January 1, 2019 without restating previously disclosed information. Management elected the optional transition method of adoption due to the overall immateriality of the balance sheet gross up in the period of adoption. The package of practical expedients allowed management to not reassess the lease classification for leases, including those that had expired during the periods presented or that still existed at the time of adoption. We have included additional disclosures in the notes to the consolidated financial statements including additional information about the Company's leases. (See *Leases*.)

**Leases.** We determine if a contract is or contains a lease at inception and recognize a right-of-use asset and lease liability for all leases with a term greater than 12 months. Our right-of-use assets and lease liabilities for operating leases are included in Other Non-Current Assets, Other Current Liabilities and Other Non-Current Liabilities, respectively, in our Consolidated Balance Sheet. We currently do not have any finance leases.

Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease right-of-use assets and lease liabilities are recognized at the commencement date based on the estimated present value of lease payments over the lease term. As our leases do not provide an explicit rate, we determine the present value of future lease payments based on our estimated incremental borrowing rate using information available at the lease commencement date. The operating lease right-of-use asset includes lease payments to be made during the lease term and any lease incentives, as applicable.

**NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**
**Leases (Continued)**

Our leases may include options to extend or buy out the lease at certain points throughout the term, and if it is reasonably certain that we will exercise that option at lease commencement, we include those rental payments in our calculation of the right-of-use asset and lease liability. Lease and rent expense is recognized on a straight-line basis over the lease term. Leases with a term of 12 months or less are not recorded on the Consolidated Balance Sheet.

The majority of our operating leases are for heavy equipment, vehicles and land with fixed monthly payments which we group into two categories: Vehicles and Equipment; and Land and Other. Our largest operating lease is for the dragline at BNI Energy which includes a termination payment at the end of the lease term if we do not exercise our purchase option. The amount of this payment is $3 million and is included in our calculation of the right-of-use asset and lease liability recorded. None of our other leases contain residual value guarantees.

The components of lease cost were as follows:

| **Three Months Ended March 31,** | **2019** | |
|---|---|---|
| **Millions** | | |
| Operating Lease Cost | $2.9 | |
| | | |
| Other Information: | | |
| Operating Cash Flows From Operating Leases | $2.9 | |
| | | |
| Balance Sheet Information Related to Leases: | | |
| Other Non-Current Assets | $34.0 | |
| Total Operating Lease Right-of-use Assets | $34.0 | |
| | | |
| Other Current Liabilities | $8.4 | |
| Other Non-Current Liabilities | 25.6 | |
| Total Operating Lease Liabilities | $34.0 | |
| | | |
| **Weighted Average Remaining Lease Term (Years):** | | |
| Operating Leases - Vehicles and Equipment | 4 | |
| Operating Leases - Land and Other | 29 | |
| | | |
| **Weighted Average Discount Rate:** | | |
| Operating Leases - Vehicles and Equipment | 3.6 | % |
| Operating Leases - Land and Other | 4.5 | % |

**NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**
**Leases (Continued)**

Maturities of lease liabilities were as follows:

| | **March 31, 2019** |
|---|---|
| **Millions** | |
| 2019 | $9.9 |
| 2020 | 7.9 |
| 2021 | 6.1 |
| 2022 | 4.9 |
| 2023 | 3.1 |
| Thereafter | 9.4 |
| Total Lease Payments Due | 41.3 |
| Less: Imputed Interest | 7.3 |
| Total Lease Obligations | 34.0 |
| Less: Current Lease Obligations | 8.4 |
| Long-term Lease Obligations | $25.6 |

**Subsequent Events.** The Company performed an evaluation of subsequent events for potential recognition and disclosure through the date of the financial statements issuance.

**Sale of U.S. Water Services.** On February 8, 2019, the Company entered into a stock purchase agreement providing for the sale of U.S. Water Services to a subsidiary of Kurita Water Industries Ltd. for a cash purchase price of $270 million. On March 26, 2019, ALLETE completed the sale and received approximately $265 million in cash at closing, net of transaction costs and cash retained. This amount is subject to adjustment for finalization of such items as estimated working capital. The Company recognized a gain on the sale of U.S. Water Services of approximately $10 million after-tax during the three months ended March 31, 2019.

**NOTE 2. REGULATORY MATTERS**

Regulatory matters are summarized in Note 4. Regulatory Matters to the Consolidated Financial Statements in our 2018 Form 10 K, with additional disclosure provided in the following paragraphs.

**Electric Rates.** Entities within our Regulated Operations segment file for periodic rate revisions with the MPUC, PSCW or FERC. As authorized by the MPUC, Minnesota Power also recognizes revenue under cost recovery riders for transmission, renewable, and environmental investments and expenditures. Revenue from cost recovery riders was $7.4 million for the three months ended March 31, 2019 ($24.1 million for three months ended March 31, 2018). With the implementation of final rates in Minnesota Power's general rate case, certain revenue previously recognized under cost recovery riders was incorporated into base rates. (See *2016 Minnesota General Rate Case.*)

*2016 Minnesota General Rate Case.* The MPUC issued an order dated March 12, 2018, in Minnesota Power's general rate case approving a return on common equity of 9.25 percent and a 53.81 percent equity ratio. Final rates went into effect on December 1, 2018, which is expected to result in additional revenue of approximately $13 million on an annualized basis. Interim rates were collected from January 1, 2017, through November 30, 2018, which were fully offset by the recognition of a corresponding reserve. Minnesota Power has recorded a reserve for an interim rate refund, net of discounts provided to EITE customers, of $40.6 million as of March 31, 2019 ($40.0 million as of December 31, 2018), which is expected to be refunded in the second quarter of 2019.

*2018 Wisconsin General Rate Case.* In an order dated December 20, 2018, the PSCW approved a rate increase for SWL&P including a return on equity of 10.4 percent and a 55.0 percent equity ratio. Final rates went into effect January 1, 2019, which is expected to result in additional revenue of approximately $1.3 million on an annualized basis.

**NOTE 2. REGULATORY MATTERS (Continued)**

**Integrated Resource Plan.** In a 2016 order, the MPUC approved Minnesota Power’s 2015 IRP with modifications. The order accepted Minnesota Power’s plans for the economic idling of Taconite Harbor Units 1 and 2 and the ceasing of coal-fired operations at Taconite Harbor in 2020, directed Minnesota Power to retire Boswell Units 1 and 2 no later than 2022, required an analysis of generation and demand response alternatives to be filed with a natural gas resource proposal, and required Minnesota Power to conduct request for proposals for additional wind, solar and demand response resource additions subject to further MPUC approvals. Minnesota Power retired Boswell Units 1 and 2 in the fourth quarter of 2018. Minnesota Power’s next IRP filing is due October 1, 2020.

In 2017, Minnesota Power submitted a resource package to the MPUC requesting approval of PPAs for the output of a 250 MW wind energy facility and a 10 MW solar energy facility as well as approval of a 250 MW natural gas capacity dedication agreement. These agreements were subject to MPUC approval of the construction of NTEC, a 525 MW to 550 MW combined-cycle natural gas fired generating facility which will be jointly owned by Dairyland Power Cooperative and a subsidiary of ALLETE. Minnesota Power would purchase approximately 50 percent of the facility's output starting in 2025. In an order dated January 24, 2019, the MPUC approved Minnesota Power’s request for approval of the NTEC natural gas capacity dedication agreement. Separately, the MPUC required a baseload retirement evaluation in Minnesota Power’s next IRP filing analyzing its existing fleet, including potential early retirement scenarios of Boswell Units 3 and 4, as well as a securitization plan. On January 8, 2019, an application for a certificate of public convenience and necessity for NTEC was submitted to the PSCW. A decision on the application is expected in 2020.

**Regulatory Assets and Liabilities.** Our regulated utility operations are subject to accounting guidance for the effect of certain types of regulation. Regulatory assets represent incurred costs that have been deferred as they are probable for recovery in customer rates. Regulatory liabilities represent obligations to make refunds to customers and amounts collected in rates for which the related costs have not yet been incurred. The Company assesses quarterly whether regulatory assets and liabilities meet the criteria for probability of future recovery or deferral. With the exception of the regulatory asset for Boswell Units 1 and 2 net plant and equipment, no other regulatory assets are currently earning a return. The recovery, refund or credit to rates for these regulatory assets and liabilities will occur over the periods either specified by the applicable regulatory authority or over the corresponding period related to the asset or liability.

**NOTE 2. REGULATORY MATTERS (Continued)**

| **Regulatory Assets and Liabilities** | **March 31, 2019** | **December 31, 2018** |
|---|---|---|
| **Millions** | | |
| **Non-Current Regulatory Assets** | | |
| Defined Benefit Pension and Other Postretirement Benefit Plans | $218.0 | $218.5 |
| Income Taxes | 103.2 | 105.5 |
| Asset Retirement Obligations | 32.4 | 32.6 |
| Boswell 1 and 2 Net Plant and Equipment | 14.8 | 16.3 |
| Manufactured Gas Plant | 8.1 | 8.0 |
| PPACA Income Tax Deferral | 4.9 | 5.0 |
| Other | 3.7 | 3.6 |
| Total Non-Current Regulatory Assets | $385.1 | $389.5 |
| | | |
| **Current Regulatory Liabilities** *(a)* | | |
| Provision for Interim Rate Refund *(b)* | $40.6 | $40.0 |
| Transmission Formula Rates Refund | 3.3 | 4.4 |
| Provision for Tax Reform Refund *(c)* | 0.5 | 10.7 |
| Total Current Regulatory Liabilities | 44.4 | 55.1 |
| **Non-Current Regulatory Liabilities** | | |
| Income Taxes | 389.4 | 396.4 |
| Wholesale and Retail Contra AFUDC | 67.3 | 64.4 |
| Plant Removal Obligations | 26.8 | 25.1 |
| North Dakota Investment Tax Credits | 12.3 | 14.7 |
| Conservation Improvement Program | 5.2 | 1.5 |
| Transmission Formula Rates Refund | 1.6 | 1.6 |
| Cost Recovery Riders | — | 6.9 |
| Other | 1.5 | 1.5 |
| Total Non-Current Regulatory Liabilities | 504.1 | 512.1 |
| Total Regulatory Liabilities | $548.5 | $567.2 |

*(a) Current regulatory liabilities are presented within Other Current Liabilities on the Consolidated Balance Sheet.*
*(b) This amount is expected to be refunded to Minnesota Power's regulated retail customers in the second quarter of 2019.*
*(c) Provision for Tax Reform Refund related to the income tax benefits of the TCJA in 2018 was refunded to Minnesota Power customers in the first quarter of 2019 and will be refunded to SWL&P customers in 2019 and 2020.*

**NOTE 3. EQUITY INVESTMENTS**

**Investment in ATC**. Our wholly-owned subsidiary, ALLETE Transmission Holdings, owns approximately 8 percent of ATC, a Wisconsin-based utility that owns and maintains electric transmission assets in portions of Wisconsin, Michigan, Minnesota and Illinois. We account for our investment in ATC under the equity method of accounting. In the three months ended March 31, 2019, we invested $0.4 million in ATC, and on April 30, 2019, we invested an additional $2.3 million. We expect to make $5.8 million in additional investments in 2019.

| **ALLETE's Investment in ATC** | |
|---|---|
| **Millions** | |
| Equity Investment Balance as of December 31, 2018 | $128.1 |

| | |
|---|---|
| Cash Investments | 0.4 |
| Equity in ATC Earnings | 5.6 |
| Distributed ATC Earnings | (4.4 ) |
| Amortization of the Remeasurement of Deferred Income Taxes | 0.3 |
| Equity Investment Balance as of March 31, 2019 | $130.0 |

ATC’s authorized return on equity is 10.32 percent, or 10.82 percent including an incentive adder for participation in a regional transmission organization.

**NOTE 3. EQUITY INVESTMENTS (Continued)**
**Investment in ATC (Continued)**

In 2016, a federal administrative law judge ruled on a complaint proposing a reduction in the base return on equity to 9.70 percent, or 10.20 percent including an incentive adder for participation in a regional transmission organization, subject to approval or adjustment by the FERC. A final decision from the FERC on the administrative law judge's recommendation is pending.

**Investment in Nobles 2.** Our wholly-owned subsidiary, ALLETE South Wind, owns 49 percent of Nobles 2, the entity that will own and operate a 250 MW wind energy facility in southwestern Minnesota pursuant to a 20-year PPA with Minnesota Power. We account for our investment in Nobles 2 under the equity method of accounting. As of March 31, 2019, our equity investment in Nobles 2 was $24.8 million ($33.0 million at December 31, 2018). In the first quarter of 2019, Nobles 2 returned capital of $8.3 million based on its cash needs.

**NOTE 4. GOODWILL AND INTANGIBLE ASSETS**

As a result of completing the sale of U.S. Water Services on March 26, 2019, there was no goodwill recorded as of March 31, 2019 ($148.5 million at December 31, 2018).

The balance of intangible assets, net, as of March 31, 2019, is as follows:

| | **December 31, 2018** | **Amortization** | **Other** *(b)* | **March 31, 2019** |
|---|---|---|---|---|
| **Millions** | | | | |
| Intangible Assets | | | | |
| Definite-Lived Intangible Assets | | | | |
| Customer Relationships | $50.7 | $(1.1) | $(49.6) | — |
| Developed Technology and Other *(a)* | 7.5 | (0.3) | (6.1) | $1.1 |
| Total Definite-Lived Intangible Assets | 58.2 | (1.4) | (55.7) | 1.1 |
| Indefinite-Lived Intangible Assets | | | | |
| Trademarks and Trade Names | 16.6 | n/a | (16.6) | — |
| Total Intangible Assets | $74.8 | $(1.4) | $(72.3) | $1.1 |

*(a) Developed Technology and Other includes patents, non-compete agreements, land easements and trade names with finite lives.*
*(b) On March 26, 2019, ALLETE completed the sale of U.S. Water Services which resulted in the removal of the related intangible assets from the Consolidated Balance Sheet.*

Amortization expense for intangible assets was $1.4 million for the three months ended March 31, 2019, and 2018. The remaining definite-lived intangible assets will continue to be amortized ratably through 2028.

**NOTE 5. FAIR VALUE**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. We primarily apply the market approach for recurring fair value measurements and endeavor to utilize the best available information. Accordingly, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs, which are used to measure fair value, are prioritized through the fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Descriptions of the three levels of the fair value hierarchy are discussed in Note 9. Fair Value to the Consolidated Financial Statements in our 2018 Form 10-K.

**NOTE 5. FAIR VALUE (Continued)**

The following tables set forth, by level within the fair value hierarchy, our assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2019, and December 31, 2018. Each asset and liability is classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of these assets and liabilities and their placement within the fair value hierarchy levels. The estimated fair value of Cash and Cash Equivalents listed on the Consolidated Balance Sheet approximates the carrying amount and therefore is excluded from the recurring fair value measures in the following tables.

| | **Fair Value as of March 31, 2019** | | | |
|---|---|---|---|---|
| **Recurring Fair Value Measures** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Millions** | | | | |
| **Assets** | | | | |
| Investments *(a)* | | | | |
| Available-for-sale – Equity Securities | $12.3 | — | — | $12.3 |
| Available-for-sale – Corporate and Governmental Debt Securities *(b)* | — | $8.3 | — | 8.3 |
| Cash Equivalents | 1.0 | — | — | 1.0 |
| Total Fair Value of Assets | $13.3 | $8.3 | — | $21.6 |
| | | | | |
| **Liabilities** | | | | |
| Deferred Compensation *(c)* | — | $21.6 | — | $21.6 |
| Total Fair Value of Liabilities | — | $21.6 | — | $21.6 |
| Total Net Fair Value of Assets (Liabilities) | $13.3 | $(13.3) | — | — |

| | **Fair Value as of December 31, 2018** | | | |
|---|---|---|---|---|
| **Recurring Fair Value Measures** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Millions** | | | | |
| **Assets** | | | | |
| Investments *(a)* | | | | |
| Available-for-sale – Equity Securities | $12.2 | — | — | $12.2 |
| Available-for-sale – Corporate and Governmental Debt Securities | — | $8.0 | — | 8.0 |
| Cash Equivalents | 1.0 | — | — | 1.0 |
| Total Fair Value of Assets | $13.2 | $8.0 | — | $21.2 |
| | | | | |
| **Liabilities** | | | | |
| Deferred Compensation *(c)* | — | $19.8 | — | $19.8 |
| U.S. Water Services Contingent Consideration *(d)* | — | — | $3.8 | 3.8 |
| Total Fair Value of Liabilities | — | $19.8 | $3.8 | $23.6 |
| Total Net Fair Value of Assets (Liabilities) | $13.2 | $(11.8) | $(3.8) | $(2.4) |

*(a) Included in Other Investments on the Consolidated Balance Sheet.*

*(b) As of March 31, 2019, the aggregate amount of available-for-sale corporate and governmental debt securities maturing in one year or less was $1.7 million, in one year to less than three years was $4.0 million, in three years to less than five years was $1.8 million and in five or*

*more years was $0.8 million.*
(c) *Included in Other Non-Current Liabilities on the Consolidated Balance Sheet.*
(d) *Included in Other Current Liabilities on the Consolidated Balance Sheet.*

The Level 3 liability in the preceding table is related to the contingent consideration liability that resulted from the 2015 acquisition of U.S. Water Services. Based on the terms and conditions of the acquisition agreement, a final payout of $3.8 million was made in the first quarter of 2019 for the remaining outstanding shares.

**NOTE 5. FAIR VALUE (Continued)**

**Fair Value of Financial Instruments.** With the exception of the item listed in the following table, the estimated fair value of all financial instruments approximates the carrying amount. The fair value for the item listed in the following table was based on quoted market prices for the same or similar instruments (Level 2).

| Financial Instruments | Carrying Amount | Fair Value |
|---|---|---|
| Millions | | |
| Long-Term Debt, Including Long-Term Debt Due Within One Year | | |
| March 31, 2019 | $1,549.0 | $1,639.5 |
| December 31, 2018 | $1,495.2 | $1,534.6 |

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis.** Non-financial assets such as equity method investments, land inventory, and property, plant and equipment are measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment is recognized. For the three months ended March 31, 2019, and the year ended December 31, 2018, there were no triggering events or indicators of impairment for these non-financial assets.

**NOTE 6. SHORT-TERM AND LONG-TERM DEBT**

The following tables present the Company's short-term and long-term debt as of March 31, 2019, and December 31, 2018:

| March 31, 2019 | Principal | Unamortized Debt Issuance Costs | Total |
|---|---|---|---|
| Millions | | | |
| Short-Term Debt | $14.7 | $(0.4) | $14.3 |
| Long-Term Debt | 1,534.3 | (9.3) | 1,525.0 |
| Total Debt | $1,549.0 | $(9.7) | $1,539.3 |

| December 31, 2018 | Principal | Unamortized Debt Issuance Costs | Total |
|---|---|---|---|
| Millions | | | |
| Short-Term Debt | $57.9 | $(0.4) | $57.5 |
| Long-Term Debt | 1,437.3 | (8.8) | 1,428.5 |
| Total Debt | $1,495.2 | $(9.2) | $1,486.0 |

On January 10, 2019, ALLETE entered into an amended and restated $400 million credit agreement (Credit Agreement). The Credit Agreement is unsecured, has a variable interest rate and will expire in January 2024. At ALLETE's request and subject to certain conditions, the Credit Agreement may be increased by up to $150 million and ALLETE may make two requests to extend the maturity date, each for a one-year extension. Advances may be used by ALLETE for general corporate purposes, to provide liquidity in support of ALLETE's commercial paper program and to issue up to $60 million in letters of credit.

On March 1, 2019, ALLETE issued and sold the following First Mortgage Bonds (the Bonds):

| Maturity Date | Principal Amount | Interest Rate |
|---|---|---|
| March 1, 2029 | $70 Million | 4.08% |
| March 1, 2049 | $30 Million | 4.47% |

ALLETE has the option to prepay all or a portion of the Bonds at its discretion, subject to a make-whole provision. The Bonds are subject to additional terms and conditions which are customary for these types of transactions. ALLETE intends to use the proceeds from the sale of the Bonds to fund utility capital investment and for general corporate purposes. The Bonds were sold in reliance on an exemption from registration under Section 4(a)(2) of the Securities Act of 1933, as amended, to institutional accredited investors.

**NOTE 6. SHORT-TERM AND LONG-TERM DEBT (Continued)**

**Financial Covenants.** Our long-term debt arrangements contain customary covenants. In addition, our lines of credit and letters of credit supporting certain long-term debt arrangements contain financial covenants. Our compliance with financial covenants is not dependent on debt ratings. The most restrictive financial covenant requires ALLETE to maintain a ratio of indebtedness to total capitalization (as the amounts are calculated in accordance with the respective long-term debt arrangements) of less than or equal to 0.65 to 1.00, measured quarterly. As of March 31, 2019, our ratio was approximately 0.41 to 1.00. Failure to meet this covenant would give rise to an event of default if not cured after notice from the lender, in which event ALLETE may need to pursue alternative sources of funding. Some of ALLETE's debt arrangements contain "cross-default" provisions that would result in an event of default if there is a failure under other financing arrangements to meet payment terms or to observe other covenants that would result in an acceleration of payments due. ALLETE has no significant restrictions on its ability to pay dividends from retained earnings or net income. As of March 31, 2019, ALLETE was in compliance with its financial covenants.

**NOTE 7. COMMITMENTS, GUARANTEES AND CONTINGENCIES**

**Power Purchase Agreements.** Our long-term PPAs have been evaluated under the accounting guidance for variable interest entities. We have determined that either we have no variable interest in the PPAs or, where we do have variable interests, we are not the primary beneficiary; therefore, consolidation is not required. These conclusions are based on the fact that we do not have both control over activities that are most significant to the entity and an obligation to absorb losses or receive benefits from the entity's performance. Our financial exposure relating to these PPAs is limited to our capacity and energy payments.

Our PPAs are summarized in Note 11. Commitments, Guarantees and Contingencies to the Consolidated Financial Statements in our 2018 Form 10-K, with additional disclosure provided in the following paragraphs.

*Square Butte PPA.* As of March 31, 2019, Square Butte had total debt outstanding of $302.6 million. Fuel expenses are recoverable through Minnesota Power's fuel adjustment clause and include the cost of coal purchased from BNI Energy under a long-term contract. Minnesota Power's cost of power purchased from Square Butte during the three months ended March 31, 2019, was $20.5 million ($17.3 million for the three months ended March 31, 2018). This reflects Minnesota Power's pro rata share of total Square Butte costs based on the 50 percent output entitlement. Included in this amount was Minnesota Power's pro rata share of interest expense of $2.1 million ($2.3 million for the same period in 2018). Minnesota Power's payments to Square Butte are approved as a purchased power expense for ratemaking purposes by both the MPUC and the FERC.

*Minnkota Power PSA.* Minnesota Power has a PSA with Minnkota Power, which commenced in 2014. Under the PSA, Minnesota Power is selling a portion of its entitlement from Square Butte to Minnkota Power, resulting in Minnkota Power's net entitlement increasing and Minnesota Power's net entitlement decreasing until Minnesota Power's share is eliminated at the end of 2025. Of Minnesota Power's 50 percent output entitlement, it sold to Minnkota Power approximately 28 percent in 2019 and in 2018.

**Coal, Rail and Shipping Contracts.** Minnesota Power has coal supply agreements providing for the purchase of a significant portion of its coal requirements through December 2019 and a portion of its coal requirements through December 2021. Minnesota Power also has coal transportation agreements in place for the delivery of a significant portion of its coal requirements through December 2021. The estimated minimum payments under these supply and transportation agreements is $5.7 million for the remainder of 2019, $9.0 million in 2020, $7.5 million in 2021 and none thereafter. The costs of fuel and related transportation costs for Minnesota Power's generation are recoverable from Minnesota Power's utility customers through the fuel adjustment clause.

**Transmission.** We continue to make investments in transmission opportunities that strengthen or enhance the transmission grid or take advantage of our geographical location between sources of renewable energy and end users. These include the GNTL, investments to enhance our own transmission facilities, investments in other transmission assets (individually or in combination with others) and our investment in ATC.

*Great Northern Transmission Line.* As a condition of the 250-MW long-term PPA entered into with Manitoba Hydro, construction of additional transmission capacity is required. As a result, Minnesota Power is constructing the GNTL, an approximately 220 mile 500-kV transmission line between Manitoba and Minnesota's Iron Range that was proposed by Minnesota Power and Manitoba Hydro in order to strengthen the electric grid, enhance regional reliability and promote a greater exchange of sustainable energy.

**NOTE 7. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**
**Transmission (Continued)**

In a 2016 order, the MPUC approved the route permit for the GNTL, and in 2016, the U.S. Department of Energy issued a presidential permit to cross the U.S.  Canadian border, which was the final major regulatory approval needed before construction in the U.S. could begin. Site clearing and pre  construction activities commenced in the first quarter of 2017 with construction expected to be completed in 2020. To date, most of the right-of-way has been cleared while foundation installation and transmission tower construction have commenced. The total project cost in the U.S., including substation work, is estimated to be between $560 million and $710 million, of which Minnesota Power's portion is expected to be between $300 million and $350 million; the difference will be recovered from a subsidiary of Manitoba Hydro as non-shareholder contributions to capital. Total project costs of $458.2 million have been incurred through March 31, 2019, of which $245.0 million has been recovered from a subsidiary of Manitoba Hydro.

Manitoba Hydro must obtain regulatory and governmental approvals related to the MMTP, a new transmission line in Canada that will connect with the GNTL. In 2015, Manitoba Hydro submitted the final preferred route and EIS for the MMTP to the Manitoba Conservation and Water Stewardship for siting and environmental approval, which was received on April 4, 2019. In 2016, Manitoba Hydro filed an application with the Canadian National Energy Board (NEB) requesting authorization to construct and operate the MMTP, which was recommended for approval on November 15, 2018. Approval of the Canadian federal cabinet is also required.

The MMTP is subject to legal and regulatory challenges which Minnesota Power is actively monitoring. Manitoba Hydro has informed Minnesota Power that it continues to work towards completing the MMTP on schedule. In order to meet the transmission in  service requirements in PPAs with Minnesota Power, Manitoba Hydro has indicated that it would need to start construction of the MMTP by September 2019. We are unable to predict the outcome of the Canadian regulatory review process, including the timing thereof or whether any onerous conditions may be imposed, or the timing of the completion of the MMTP, including the impact of any delays that may result in construction schedule adjustments. Any significant delays in the MMTP construction schedule may result in Minnesota Power adjusting the GNTL construction schedule and impact the timing of capital expenditures and associated cost recovery under our transmission cost recovery rider.

Construction of Manitoba Hydro's Keeyask hydroelectric generation facility, which will provide the power to be sold under PPAs with Minnesota Power and transmitted on the MMTP and the GNTL, commenced in 2014 and is anticipated to be in service by early 2021.

**Environmental Matters.**

Our businesses are subject to regulation of environmental matters by various federal, state and local authorities. A number of regulatory changes to the Clean Air Act, the Clean Water Act and various waste management requirements have been promulgated by both the EPA and state authorities over the past several years. Minnesota Power's facilities are subject to additional requirements under many of these regulations. Minnesota Power is reshaping its generation portfolio, over time, to reduce its reliance on coal, has installed cost-effective emission control technology, and advocates for sound science and policy during rulemaking implementation.

We consider our businesses to be in substantial compliance with currently applicable environmental regulations and believe all necessary permits have been obtained. We anticipate that with many state and federal environmental regulations and requirements finalized, or to be finalized in the near future, potential expenditures for future environmental matters may be material and require significant capital investments. Minnesota Power has evaluated various environmental compliance scenarios using possible outcomes of environmental regulations to project power supply trends and impacts on customers.

We review environmental matters on a quarterly basis. Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated based on current law and existing technologies. Accruals are adjusted as assessment and remediation efforts progress, or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the Consolidated Balance Sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are expensed unless recoverable in rates from customers.

**NOTE 7. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**
**Environmental Matters (Continued)**

***Air.*** The electric utility industry is regulated both at the federal and state level to address air emissions. Minnesota Power's generating facilities mainly burn low-sulfur western sub-bituminous coal. All of Minnesota Power's coal-fired generating facilities are equipped with pollution control equipment such as scrubbers, baghouses and low $NO_X$ technologies. Under currently applicable environmental regulations, these facilities are substantially compliant with emission requirements.

*Cross-State Air Pollution Rule (CSAPR).* The CSAPR requires certain states in the eastern half of the U.S., including Minnesota, to reduce power plant emissions that contribute to ozone or fine particulate pollution in other states. The CSAPR does not require installation of controls but does require facilities have sufficient allowances to cover their emissions on an annual basis. These allowances are allocated to facilities from each state's annual budget, and can be bought and sold. Based on our review of the $NO_x$ and $SO_2$ allowances issued and pending issuance, we currently expect generation levels and emission rates will result in continued compliance with the CSAPR.

*National Ambient Air Quality Standards (NAAQS).* The EPA is required to review the NAAQS every five years. If the EPA determines that a state's air quality is not in compliance with the NAAQS, the state is required to adopt plans describing how it will reduce emissions to attain the NAAQS. None of the compliance costs for proposed or current NAAQS revisions are expected to be material.

***Climate Change.*** The scientific community generally accepts that emissions of GHG are linked to global climate change which creates physical and financial risks. Physical risks could include, but are not limited to: increased or decreased precipitation and water levels in lakes and rivers; increased temperatures; and changes in the intensity and frequency of extreme weather events. These all have the potential to affect the Company's business and operations. We are addressing climate change by taking the following steps that also ensure reliable and environmentally compliant generation resources to meet our customers' requirements:

- Expanding renewable power supply for both our operations and the operations of others;
- Providing energy conservation initiatives for our customers and engaging in other demand side management efforts;
- Improving efficiency of our generating facilities;
- Supporting research of technologies to reduce carbon emissions from generating facilities and carbon sequestration efforts;
- Evaluating and developing less carbon intensive future generating assets such as efficient and flexible natural gas-fired generating facilities;
- Managing vegetation on right-of-way corridors to reduce potential wildfire or storm damage risks; and
- Practicing sound forestry management in our service territories to create landscapes more resilient to disruption from climate-related changes, including planting and managing long-lived conifer species.

*EPA Regulation of GHG Emissions.* In 2014, the EPA announced a proposed rule under Section 111(d) of the Clean Air Act for existing power plants entitled "Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Generating Units", also referred to as the Clean Power Plan (CPP). The EPA issued the final CPP in 2015, together with a proposed federal implementation plan and a model rule for emissions trading. In 2016, the U.S. Supreme Court issued an order staying the effectiveness of the rule until after the appellate court process is complete. In 2016, the U.S. Court of Appeals for the District of Columbia Circuit heard oral arguments and is currently deliberating. If the CPP is upheld at the completion of the appellate process, all of the CPP regulatory deadlines are expected to be reset based on the length of time that the appeals process takes. The EPA is precluded from enforcing the CPP while the U.S. Supreme Court stay is in force.

If upheld, the CPP would establish uniform $CO_2$ emission performance rates for existing fossil fuel-fired and natural gas-fired combined cycle generating units, setting state-specific goals for $CO_2$ emissions from the power sector. State goals were determined based on CPP source-specific performance emission rates and each state's mix of power plants. The EPA filed a motion with the U.S. Court of Appeals for the District of Columbia Circuit to hold CPP-related litigation in suspension while the EPA is reviewing the rule. In 2017, an Advanced Notice of Proposed Rulemaking for a CPP replacement rule was published in the Federal Register.

In August 2018, the EPA published the proposed Affordable Clean Energy Rule in the Federal Register, which is intended to replace the CPP with revised emission guidelines that inform the development, submittal, and implementation of State Implementation Plans (SIP) to reduce GHG emissions for existing steam generating units. If a state does not submit a SIP or submits a plan that is unacceptable to the EPA, the EPA would develop a Federal Implementation Plan (FIP). Minnesota Power generating facilities affected by this proposal include Boswell, Laskin, Taconite Harbor and Hibbard.

**NOTE 7. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**
**Environmental Matters (Continued)**

The proposed Affordable Clean Energy Rule seeks to reduce carbon intensity at existing steam generation units by prescribing Best System of Emission Reduction (BSER), primarily through Heat Rate Improvement (HRI) technologies. Under the proposal, states will have up to three years to develop a SIP, which is subject to EPA approval. While many of the HRIs proposed by the EPA in the proposed rule have already been installed in Minnesota Power's largest coal-fired generating units, compliance specifics would be detailed in either Minnesota's SIP or a FIP.

Minnesota has already initiated several measures consistent with those called for under the CPP and proposed Affordable Clean Energy Rule. Minnesota Power is implementing its *EnergyForward* strategic plan that provides for significant emission reductions and diversifying its electricity generation mix to include more renewable and natural gas energy. (See Note 2. Regulatory Matters.) We are unable to predict the GHG emission compliance costs we might incur; however, the costs could be material. Minnesota Power would seek recovery of additional costs through a rate proceeding.

***Water.*** The Clean Water Act requires NPDES permits be obtained from the EPA (or, when delegated, from individual state pollution control agencies) for any wastewater discharged into navigable waters. We have obtained all necessary NPDES permits, including NPDES storm water permits for applicable facilities, to conduct our operations.

*Steam Electric Power Generating Effluent Limitations Guidelines.* In 2015, the EPA issued revised federal effluent limitation guidelines (ELG) for steam electric power generating stations under the Clean Water Act. It set effluent limits and prescribed BACT for several wastewater streams, including flue gas desulphurization (FGD) water, bottom ash transport water and coal combustion landfill leachate. In 2017, the EPA announced a two-year postponement of the ELG compliance date of November 1, 2018, to November 1, 2020, while the agency reconsiders the bottom ash transport water and FGD wastewater provisions.

The final ELG rule's potential impact on Minnesota Power operations is primarily at Boswell. Boswell currently discharges bottom ash contact water through its NPDES permit, and also has a closed-loop FGD system that does not discharge to surface waters, but may do so in the future. Under the existing ELG rule, bottom ash transport water discharge to surface waters must cease no later than December 31, 2023. Bottom ash contact water will either need to be re-used in a closed-loop process, routed to a FGD scrubber, or the bottom ash handling system will need to be converted to a dry process. If FGD wastewater is discharged in the future, it will require additional wastewater treatment. The ELG rule provision regarding these two waste-streams are being reconsidered and may change prior to November 1, 2020. Efforts have been underway at Boswell to reduce the amount of water discharged and evaluate potential re use options in its plant processes.

At this time, we cannot estimate what compliance costs we might incur related to these or other potential future water discharge regulations; however, the costs could be material, including costs associated with retrofits for bottom ash handling, pond dewatering, pond closure, and wastewater treatment and re-use. Minnesota Power would seek recovery of additional costs through a rate proceeding.

**Solid and Hazardous Waste.** The Resource Conservation and Recovery Act of 1976 regulates the management and disposal of solid and hazardous wastes. We are required to notify the EPA of hazardous waste activity and, consequently, routinely submit reports to the EPA.

*Coal Ash Management Facilities.* Minnesota Power stores or disposes coal ash at four of its electric generating facilities by the following methods: storing ash in lined onsite impoundments (ash ponds), disposing of dry ash in a lined dry ash landfill, applying ash to land as an approved beneficial use and trucking ash to state permitted landfills.

*Coal Combustion Residuals from Electric Utilities (CCR).* In 2015, the EPA published the final rule regulating CCR as nonhazardous waste under Subtitle D of the Resource Conservation and Recovery Act (RCRA) in the Federal Register. The rule includes additional requirements for new landfill and impoundment construction as well as closure activities related to certain existing impoundments. Costs of compliance for Boswell and Laskin are expected to occur primarily over the next 15 years and be between approximately $65 million and $120 million. The EPA has indicated to Minnesota Power that the landfill at Taconite Harbor, which has been idled and has a temporary landfill cover in place, is a CCR unit based on the EPA's interpretation of the CCR rule language. Minnesota Power has agreed to post the required CCR information for the Taconite Harbor landfill on Minnesota Power's website while the CCR issue is resolved. Compliance costs for CCR at Taconite Harbor are not expected to be material. Minnesota Power would seek recovery of additional costs through a rate proceeding.

**NOTE 7. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**
**Environmental Matters (Continued)**

Minnesota Power continues to work on minimizing costs through evaluation of beneficial re-use and recycling of CCR and CCR related waters. In 2017, the EPA announced its intention to formally reconsider the CCR rule under Subtitle D of the RCRA and in March 2018, published the first phase of the proposed rule revisions in the Federal Register. In July 2018, the EPA finalized revisions to elements of the CCR rule, including extending certain deadlines by two years, the establishment of alternative groundwater protection standards for certain constituents and the potential for risk based management options at facilities based on site characteristics. In August 2018, a U.S. District Court for the District of Columbia decision vacated specific provisions of the CCR rule. The court decision changes the status of three existing impoundments at Boswell that must now be considered unlined. Compliance costs at Boswell due to the court decision are unknown at this time. Minnesota Power would seek recovery of additional costs through a rate proceeding.

**Other Environmental Matters**

*Manufactured Gas Plant Site.* We are reviewing and addressing environmental conditions at a former manufactured gas plant site located in Superior, Wisconsin, and formerly operated by SWL&P. SWL&P has been working with the Wisconsin Department of Natural Resources (WDNR) in determining the extent and location of contamination at the site and surrounding properties. In December 2017, the WDNR authorized SWL&P to transition from site investigation into the remedial design process. As of March 31, 2019, we have recorded a liability of approximately $7 million for remediation costs at this site (approximately $7 million as of December 31, 2018), and an associated regulatory asset as we expect recovery of these remediation costs to be allowed by the PSCW. We expect to incur some or all of these costs over the next four years.

**Other Matters.**

**ALLETE Clean Energy.** ALLETE Clean Energy’s wind energy facilities have PSAs in place for their entire output and expire in various years between 2019 and 2032. As of March 31, 2019, ALLETE Clean Energy has $21.6 million outstanding in standby letters of credit.

**BNI Energy.** As of March 31, 2019, BNI Energy had surety bonds outstanding of $49.9 million and a letter of credit for an additional $0.6 million related to the reclamation liability for closing costs associated with its mine and mine facilities. Although its coal supply agreements obligate the customers to provide for the closing costs, additional assurance is required by federal and state regulations. BNI Energy’s total reclamation liability is currently estimated at $47.5 million. BNI Energy does not believe it is likely that any of these outstanding surety bonds or the letter of credit will be drawn upon.

**ALLETE Properties.** As of March 31, 2019, ALLETE Properties had surety bonds outstanding and letters of credit to governmental entities totaling $8.6 million primarily related to development and maintenance obligations for various projects. The estimated cost of the remaining development work is $6.1 million. ALLETE Properties does not believe it is likely that any of these outstanding surety bonds or letters of credit will be drawn upon.

**Community Development District Obligations.** As of March 31, 2019, we owned 68 percent of the assessable land in the Town Center District (68 percent as of December 31, 2018) and 12 percent of the assessable land in the Palm Coast Park District (19 percent as of December 31, 2018). As of March 31, 2019, ownership levels, our annual assessments related to capital improvement and special assessment bonds for the ALLETE Properties projects within these districts are approximately $1.4 million for Town Center at Palm Coast and $0.6 million for Palm Coast Park. As we sell property at these projects, the obligation to pay special assessments will pass to the new landowners. In accordance with accounting guidance, these bonds are not reflected as debt on our Consolidated Balance Sheet.

**Legal Proceedings.**

We are involved in litigation arising in the normal course of business. Also in the normal course of business, we are involved in tax, regulatory and other governmental audits, inspections, investigations and other proceedings that involve state and federal taxes, safety, and compliance with regulations, rate base and cost of service issues, among other things. We do not expect the outcome of these matters to have a material effect on our financial position, results of operations or cash flows.

**NOTE 8. EARNINGS PER SHARE AND COMMON STOCK**

We compute basic earnings per share using the weighted average number of shares of common stock outstanding during each period. The difference between basic and diluted earnings per share, if any, arises from non-vested restricted stock units and performance share awards granted under our Executive Long-Term Incentive Compensation Plan.

| Reconciliation of Basic and Diluted Earnings Per Share | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Basic | Dilutive Securities | Diluted | Basic | Dilutive Securities | Diluted |
| **Millions Except Per Share Amounts** | | | | | | |
| **Three Months Ended March 31,** | | | | | | |
| Net Income | $70.5 | | $70.5 | $51.0 | | $51.0 |
| Average Common Shares | 51.6 | 0.1 | 51.7 | 51.2 | 0.2 | 51.4 |
| Earnings Per Share | $1.37 | | $1.37 | $1.00 | | $0.99 |

**NOTE 9. INCOME TAX EXPENSE**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| **Millions** | | |
| Current Income Tax Expense *(a)* | | |
| Federal | — | — |
| State | $0.3 | $0.7 |
| Total Current Income Tax Expense | $0.3 | $0.7 |
| Deferred Income Tax Expense (Benefit) | | |
| Federal *(b)* | $(9.7) | $(6.8) |
| State *(c)* | 12.5 | 2.6 |
| Investment Tax Credit Amortization | (0.2 ) | (0.2 ) |
| Total Deferred Income Tax Expense (Benefit) | $2.6 | $(4.4) |
| Total Income Tax Expense (Benefit) | $2.9 | $(3.7) |

*(a)* *For each of the three months ended March 31, 2019, and 2018, the federal and state current tax expense was minimal due to NOLs which resulted from the bonus depreciation provisions of the Protecting Americans from Tax Hikes Act of 2015, the Tax Increase Prevention Act of 2014 and the American Taxpayer Relief Act of 2012. Federal and state NOLs are being carried forward to offset current and future taxable income.*

*(b)* *For each of the three months ended March 31, 2019, and 2018, the federal income tax benefit is primarily due to production tax credits.*

*(c)* *For the three months ended March 31, 2019, the state income tax expense is primarily due to the sale of U.S. Water Services.*

The Company's tax provision for interim periods is determined using an estimate of its annual effective tax rate, adjusted for discrete items arising in that quarter. In each quarter, the Company updates its estimate of the annual effective tax rate and if the estimated annual effective tax rate changes, the Company would make a cumulative adjustment in that quarter.

**NOTE 9. INCOME TAX EXPENSE (Continued)**

| Reconciliation of Taxes from Federal Statutory Rate to Total Income Tax Expense | Three Months Ended March 31, 2019 | 2018 |
|---|---|---|
| **Millions** | | |
| Income Before Income Taxes | $73.4 | $47.3 |
| Statutory Federal Income Tax Rate | 21 % | 21 % |
| Income Taxes Computed at Statutory Federal Rate | $15.4 | $9.9 |
| Increase (Decrease) in Income Tax Due to: | | |
| State Income Taxes – Net of Federal Income Tax Benefit | 10.1 | 2.6 |
| Production Tax Credits | (16.3 ) | (14.4 ) |
| Regulatory Differences – Excess Deferred Tax | (3.2 ) | (2.2 ) |
| U.S. Water Services Sale of Stock Basis Difference | 2.4 | — |
| Share-Based Compensation | (0.9 ) | (0.5 ) |
| Other | (4.6 ) | 0.9 |
| Total Income Tax Expense (Benefit) | $2.9 | $(3.7) |

For the three months ended March 31, 2019, the effective tax rate was an expense of 4.0 percent (benefit of 7.8 percent for the three months ended March 31, 2018). The effective tax rate included income tax expense of $10.2 million on the sale of U.S. Water Services.

**Uncertain Tax Positions.** As of March 31, 2019, we had gross unrecognized tax benefits of $1.3 million ($1.6 million as of December 31, 2018). Of the total gross unrecognized tax benefits, $0.6 million represents the amount of unrecognized tax benefits included on the Consolidated Balance Sheet that, if recognized, would favorably impact the effective income tax rate. The unrecognized tax benefit amounts have been presented as reductions to the tax benefits associated with NOL and tax credit carryforwards on the Consolidated Balance Sheet.

ALLETE and its subsidiaries file a consolidated federal income tax return as well as combined and separate state income tax returns in various jurisdictions. ALLETE has no open federal or state audits, and is no longer subject to federal examination for years before 2015, or state examination for years before 2014.

**NOTE 10. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS**

| | Pension | | Other Postretirement | |
|---|---|---|---|---|
| **Components of Net Periodic Benefit Cost** | **2019** | **2018** | **2019** | **2018** |
| **Millions** | | | | |
| **Three Months Ended March 31,** | | | | |
| Service Cost | $2.3 | $2.7 | $1.0 | $1.2 |
| Non-Service Cost Components *(a)* | | | | |
| Interest Cost | 8.0 | 7.4 | 1.9 | 1.8 |
| Expected Return on Plan Assets | (11.0) | (11.0) | (2.6 ) | (2.7 ) |
| Amortization of Prior Service Credits | — | — | (0.4 ) | (0.4 ) |
| Amortization of Net Loss | 1.8 | 3.0 | 0.1 | 0.2 |
| Net Periodic Benefit Cost | $1.1 | $2.1 | — | $0.1 |

(a) *These components of net periodic benefit cost are included in the line item "Other" under Other Income (Expense) on the Consolidated Statement of Income.*

**Employer Contributions.** For the three months ended March 31, 2019, we contributed $10.4 million in cash to the defined benefit pension plans ($15.0 million for the three months ended March 31, 2018); we do not expect to make additional contributions to our defined benefit pension plans in 2019. For the three months ended March 31, 2019, and 2018, we made no contributions to our other postretirement benefit plans; we do not expect to make any contributions to our other postretirement benefit plans in 2019.

**NOTE 11. BUSINESS SEGMENTS**

We present three reportable segments: Regulated Operations, ALLETE Clean Energy and U.S. Water Services. We measure performance of our operations through budgeting and monitoring of contributions to consolidated net income by each business segment.

Regulated Operations includes three operating segments which consist of our regulated utilities, Minnesota Power and SWL&P, as well as our investment in ATC. ALLETE Clean Energy is our business focused on developing, acquiring and operating clean and renewable energy projects. U.S. Water Services was our integrated water management company, which reflects operating results until the closing date of its sale on March 26, 2019. The ALLETE Clean Energy and U.S. Water Services reportable segments comprise our Energy Infrastructure and Related Services businesses. We also present Corporate and Other which includes two operating segments, BNI Energy, our coal mining operations in North Dakota, and ALLETE Properties, our legacy Florida real estate investment, along with our investment in Nobles 2, other business development and corporate expenditures, unallocated interest expense, a small amount of non-rate base generation, approximately 4,000 acres of land in Minnesota, and earnings on cash and investments.

| | **Three Months Ended March 31,** | |
|---|---|---|
| | **2019** | **2018** |
| **Millions** | | |
| **Operating Revenue** | | |
| Regulated Operations | | |
| Residential | $45.2 | $40.7 |
| Commercial | 38.9 | 36.6 |
| Municipal | 15.4 | 14.0 |
| Industrial | 121.6 | 114.9 |
| Other Power Suppliers | 39.4 | 43.7 |
| Other | 21.7 | 20.3 |
| Total Regulated Operations | 282.2 | 270.2 |
| | | |
| Energy Infrastructure and Related Services | | |
| | | |
| ALLETE Clean Energy | | |
| Long-term PSA | 14.6 | 18.6 |
| Other | 2.9 | 6.0 |
| Total ALLETE Clean Energy | 17.5 | 24.6 |
| | | |
| U.S. Water Services *(a)* | | |
| Point-in-Time | 19.0 | 22.3 |
| Contract | 9.2 | 9.5 |
| Capital Project | 5.2 | 6.4 |
| Total U.S. Water Services | 33.4 | 38.2 |
| | | |
| Corporate and Other | | |
| Long-term Contract | 20.2 | 20.0 |
| Other | 3.9 | 5.2 |

| | | |
|---|---|---|
| Total Corporate and Other | 24.1 | 25.2 |
| **Total Operating Revenue** | $357.2 | $358.2 |
| **Net Income (Loss)** | | |
| Regulated Operations | $51.5 | $43.9 |
| Energy Infrastructure and Related Services | | |
| ALLETE Clean Energy | 5.8 | 8.1 |
| U.S. Water Services *(a)* | (1.1 ) | (1.4 ) |
| Corporate and Other *(a)* | 14.3 | 0.4 |
| **Total Net Income** | $70.5 | $51.0 |

*(a)* *On March 26, 2019, ALLETE completed the sale of U.S. Water Services. The Company recognized a gain on the sale of approximately $10 million after-tax reflected in Corporate and Other in 2019. (See Note 1. Operations and Significant Accounting Policies.)*

**NOTE 11. BUSINESS SEGMENTS (Continued)**

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| **Millions** | | |
| **Assets** | | |
| Regulated Operations | $3,962.7 | $3,952.5 |
| Energy Infrastructure and Related Services | | |
| ALLETE Clean Energy | 643.8 | 606.6 |
| U.S. Water Services *(a)* | — | 295.8 |
| Corporate and Other | 612.3 | 310.1 |
| **Total Assets** | $5,218.8 | $5,165.0 |

*(a) On March 26, 2019, ALLETE completed the sale of U.S. Water Services. (See Note 1. Operations and Significant Accounting Policies.)*

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OVERVIEW

The following discussion should be read in conjunction with our Consolidated Financial Statements and notes to those statements, Management's Discussion and Analysis of Financial Condition and Results of Operations from our 2018 Form 10-K, and the other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this Form 10-Q contain forward-looking information that involves risks and uncertainties. Readers are cautioned that forward-looking statements should be read in conjunction with our disclosures in this Form 10-Q and our 2018 Form 10-K under the headings: "Forward-Looking Statements" located on page 6 and "Risk Factors" located in Part I, Item 1A, beginning on page 23 of our 2018 Form 10-K. The risks and uncertainties described in this Form 10-Q and our 2018 Form 10-K are not the only risks facing our Company. Additional risks and uncertainties that we are not presently aware of, or that we currently consider immaterial, may also affect our business operations. Our business, financial condition or results of operations could suffer if the risks are realized.

**Regulated Operations** includes our regulated utilities, Minnesota Power and SWL&P, as well as our investment in ATC, a Wisconsin-based regulated utility that owns and maintains electric transmission assets in portions of Wisconsin, Michigan, Minnesota and Illinois. Minnesota Power provides regulated utility electric service in northeastern Minnesota to approximately 145,000 retail customers. Minnesota Power also has 16 non-affiliated municipal customers in Minnesota. SWL&P is a Wisconsin utility and a wholesale customer of Minnesota Power. SWL&P provides regulated utility electric, natural gas and water service in northwestern Wisconsin to approximately 15,000 electric customers, 13,000 natural gas customers and 10,000 water customers. Our regulated utility operations include retail and wholesale activities under the jurisdiction of state and federal regulatory authorities. (See Note 2. Regulatory Matters.)

**ALLETE Clean Energy** focuses on developing, acquiring, and operating clean and renewable energy projects. ALLETE Clean Energy currently owns and operates, in four states, approximately 555 MW of nameplate capacity wind energy generation that is contracted under PSAs of various durations. ALLETE Clean Energy also engages in the development of wind energy facilities to operate under long-term PSAs or for sale to others upon completion.

**U.S. Water Services** provided integrated water management for industry by combining chemical, equipment, engineering and service for customized solutions to reduce water and energy usage, and improve efficiency. On February 8, 2019, the Company entered into a stock purchase agreement providing for the sale of U.S. Water Services to a subsidiary of Kurita Water Industries Ltd. for a cash purchase price of $270 million. On March 26, 2019, ALLETE completed the sale and received approximately $265 million in cash at closing, net of transaction costs and cash retained. This amount is subject to adjustment for finalization of such items as estimated working capital.

**Corporate and Other** is comprised of BNI Energy, our coal mining operations in North Dakota, ALLETE Properties, our legacy Florida real estate investment, our investment in Nobles 2, other business development and corporate expenditures, unallocated interest expense, a small amount of non-rate base generation, approximately 4,000 acres of land in Minnesota, and earnings on cash and investments.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

ALLETE is incorporated under the laws of Minnesota. Our corporate headquarters are in Duluth, Minnesota. Statistical information is presented as of March 31, 2019, unless otherwise indicated. All subsidiaries are wholly-owned unless otherwise specifically indicated. References in this report to "we," "us" and "our" are to ALLETE and its subsidiaries, collectively.

**Financial Overview**

The following net income discussion summarizes a comparison of the three months ended March 31, 2019, to the three months ended March 31, 2018.

Net income for the three months ended March 31, 2019, was $70.5 million, or $1.37 per diluted share, compared to $51.0 million, or $0.99 per diluted share, for the same period in 2018. Net income in 2019 included the gain on sale of U.S. Water Services of approximately $10 million after-tax, or $0.19 per share.

**Regulated Operations** net income was $51.5 million for the three months ended March 31, 2019, compared to $43.9 million for the same period in 2018. Net income at Minnesota Power was higher than in 2018 primarily due to lower operating and maintenance expenses, increased cost recovery rider revenue, lower property tax expense, and higher sales to residential customers resulting from cooler weather conditions in 2019. These increases were partially offset by lower industrial sales and the timing of fuel adjustment clause recoveries. Net income at SWL&P was higher than 2018 primarily due to higher rates effective January 1, 2019, and lower operating and maintenance expenses. Our after-tax equity earnings in ATC were higher than in 2018 primarily due to additional investments in ATC.

**ALLETE Clean Energy** net income was $5.8 million for the three months ended March 31, 2019, compared to $8.1 million for the same period in 2018. Net income in 2019 included lower revenue resulting from lower wind resources and availability due to weather as well as the renewal of PSAs at lower prices. These decreases were partially offset by $1.8 million of additional production tax credits generated as ALLETE Clean Energy continues to execute its refurbishment strategy.

**U.S. Water Services** net loss was $1.1 million for the three months ended March 31, 2019, compared to a net loss of $1.4 million for the same period in 2018.

**Corporate and Other** net income was $14.3 million for the three months ended March 31, 2019, compared to net income of $0.4 million for the same period in 2018. Net income in 2019 included the gain on sale of U.S. Water Services of approximately $10 million after-tax. Net income in 2019 included additional income tax benefit as GAAP requires the recognition of income tax expense at the estimated annual effective tax rate.

**COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2019 AND 2018**

(See Note 11. Business Segments for financial results by segment.)

**Regulated Operations**

| **Three Months Ended March 31,** | **2019** | **2018** |
|---|---|---|
| **Millions** | | |
| Operating Revenue – Utility | $282.2 | $270.2 |
| Fuel, Purchased Power and Gas – Utility | 109.8 | 100.9 |
| Transmission Services – Utility | 18.3 | 18.4 |
| Operating and Maintenance | 47.7 | 55.5 |
| Depreciation and Amortization | 39.8 | 34.3 |
| Taxes Other than Income Taxes | 12.3 | 15.1 |
| Operating Income | 54.3 | 46.0 |
| Interest Expense | (15.5) | (14.9) |
| Equity Earnings in ATC | 5.6 | 4.7 |
| Other Income | 4.3 | 1.6 |
| Income Before Income Taxes | 48.7 | 37.4 |
| Income Tax Benefit | (2.8) | (6.5) |
| Net Income | $51.5 | $43.9 |

***Operating Revenue – Utility*** increased $12.0 million, or 4 percent, from 2018 reflecting increased cost recovery rider revenue, higher fuel adjustment clause recoveries, and the timing of the provision for tax reform refund in 2018 related to income tax changes resulting from the TCJA, partially offset by lower revenue from kWh sales.

Cost recovery rider revenue contributed an incremental $7.3 million over current base rates compared to 2018 primarily due to higher expenditures related to the construction of the GNTL and fewer production tax credits recognized by Minnesota Power. (See Note 2. Regulatory Matters.) If production tax credits are recognized at a level below those assumed in Minnesota Power’s base rates, an increase in cost recovery rider revenue is recognized to offset the impact of lower production tax credits on income tax expense.

Fuel adjustment clause recoveries increased $6.8 million due to higher fuel and purchased power costs attributable to retail and municipal customers.

Revenue was $4.7 million higher than 2018 reflecting the timing of Minnesota Power’s provision for tax reform refund in 2018. In the first quarter of 2018, Minnesota Power reserved for income tax benefits resulting from the reduction of the federal income tax rate enacted as part of the TCJA. In the second quarter of 2018, the MPUC allowed Minnesota Power to retain these income tax benefits to mostly offset an increase in depreciation expense resulting from the reconsideration of its decision in Minnesota Power’s general rate case to reduce the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2035. (See *Operating Expenses - Depreciation and Amortization*.)

Revenue from kWh sales decreased $7.3 million from 2018 reflecting lower sales to Other Power Suppliers, Industrial customers and Municipal customers. These decreases were partially offset by higher sales to Residential customers. Sales to Residential customers increased in 2019 primarily due to cooler weather conditions in 2019 compared to 2018. Sales to Industrial customers decreased from 2018 reflecting in part lower sales to Husky Energy due to an April 2018 fire at its refinery in Superior, Wisconsin. Sales to Municipal customers decreased in 2019 as a result of additional customer self-generation in 2019. Sales to Other Power Suppliers decreased from 2018 primarily due to fewer market sales, partially offset by the commencement of Minnesota Power's PSA with Oconto Electric Cooperative in January 2019. Sales to Other Power Suppliers are sold at market-based prices into the MISO market on a daily basis or through PSAs of various durations.

**COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2019 AND 2018 (Continued)**
**Regulated Operations (Continued)**

| **Kilowatt-hours Sold** | | | **Quantity** | **%** |
|---|---|---|---|---|
| **Three Months Ended March 31,** | **2019** | **2018** | **Variance** | **Variance** |
| **Millions** | | | | |
| Regulated Utility | | | | |
| Retail and Municipal | | | | |
| Residential | 349 | 342 | 7 | 2.0 % |
| Commercial | 366 | 367 | (1) | (0.3)% |
| Industrial | 1,814 | 1,843 | (29) | (1.6)% |
| Municipal | 203 | 219 | (16) | (7.3)% |
| Total Retail and Municipal | 2,732 | 2,771 | (39) | (1.4)% |
| Other Power Suppliers | 822 | 1,003 | (181) | (18.0)% |
| Total Regulated Utility Kilowatt-hours Sold | 3,554 | 3,774 | (220) | (5.8)% |

Revenue from electric sales to taconite and iron concentrate customers accounted for 22 percent of consolidated operating revenue in 2019 (21 percent in 2018). Revenue from electric sales to paper, pulp and secondary wood product customers accounted for 5 percent of consolidated operating revenue in 2019 (4 percent in 2018). Revenue from electric sales to pipelines and other industrial customers accounted for 7 percent of consolidated operating revenue in 2019 (7 percent in 2018).

***Operating Expenses*** increased $3.7 million, or 2 percent, from 2018.

*Fuel, Purchased Power and Gas – Utility* expense increased $8.9 million, or 9 percent, from 2018 primarily due to less generation and more purchased power, partially offset by lower kWh sales. Fuel and purchased power expense related to our retail and municipal customers is recovered through the fuel adjustment clause.

*Operating and Maintenance* expense decreased $7.8 million, or 14 percent, from 2018 primarily due to lower salary and benefit expenses, and lower materials purchased for generation facilities.

*Depreciation and Amortization* expense increased $5.5 million, or 16 percent, from 2018 primarily due to the timing of modifications of the depreciable lives for Boswell as part of Minnesota Power's general rate case. As part of its decision in Minnesota Power's general rate case in 2018, the MPUC extended the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2050, and shortened the depreciable lives of Boswell Unit 1 and Unit 2 to 2022, resulting in a net decrease to depreciation expense in the first quarter of 2018. In the second quarter of 2018, as part of the reconsideration of its decision in Minnesota Power's general rate case, the MPUC reduced the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2035, resulting in higher depreciation expense beginning in the second quarter of 2018. (See *Operating Revenue*.)

*Taxes Other than Income Taxes* decreased $2.8 million, or 19 percent, from 2018 primarily due to lower property tax expenses resulting from lower estimated taxable market values.

***Equity Earnings in ATC*** increased $0.9 million, or 19 percent, from 2018 primarily due to additional investments in ATC.

***Other Income*** increased $2.7 million from 2018 due to various individually immaterial items.

***Income Tax Benefit*** decreased $3.7 million from 2018 primarily due to higher pre-tax income. We expect our annual effective tax rate in 2019 to be a lower income tax benefit than in 2018 primarily due to higher pre-tax income.

**ALLETE Clean Energy**

| **Three Months Ended March 31,** | **2019** | **2018** |
|---|---|---|
| **Millions** | | |
| Operating Revenue | $17.5 | $24.6 |
| Net Income | $5.8 | $8.1 |

***Operating Revenue*** decreased $7.1 million, or 29 percent, from 2018 primarily due to lower kWh sales resulting from lower wind resources and availability due to weather, and the renewal of PSAs at lower prices.

**COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2019 AND 2018 (Continued)**
**ALLETE Clean Energy (Continued)**

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| **Production and Operating Revenue** | **kWh** | **Revenue** | **kWh** | **Revenue** |
| **Millions** | | | | |
| Wind Energy Facilities | | | | |
| Armenia Mountain | 80.4 | $7.4 | 91.5 | $8.3 |
| Chanarambie/Viking | 65.2 | 3.2 | 78.7 | 3.9 |
| Condon | 13.4 | 1.1 | 34.3 | 2.8 |
| Lake Benton | 52.6 | 2.9 | 70.4 | 3.4 |
| Storm Lake I | 53.4 | 1.1 | 62.5 | 3.3 |
| Storm Lake II | 34.8 | 1.6 | | |