

ALLETE INC
Form 10-Q
August 02, 2018

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2018

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)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). 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. (Check one):

Large Accelerated Filer 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 No

Common Stock, without par value,

51,360,616 shares outstanding

as of June 30, 2018

Index

<u>Definitions</u>	<u>3</u>
<u>Forward-Looking Statements</u>	<u>5</u>
<u>Part I. Financial Information</u>	
<u>Item 1. Consolidated Financial Statements - Unaudited</u>	<u>7</u>
<u>Consolidated Balance Sheet</u>	<u>7</u>
<u>Consolidated Statement of Income</u>	<u>8</u>
<u>Consolidated Statement of Comprehensive Income</u>	<u>9</u>
<u>Consolidated Statement of Cash Flows</u>	<u>10</u>
<u>Consolidated Statement of Shareholders' Equity</u>	<u>11</u>
<u>Notes to Consolidated Financial Statements</u>	<u>12</u>
<u>Note 1. Operations and Significant Accounting Policies</u>	<u>12</u>
<u>Note 2. Investments</u>	<u>19</u>
<u>Note 3. Acquisitions</u>	<u>19</u>
<u>Note 4. Goodwill and Intangible Assets</u>	<u>20</u>
<u>Note 5. Fair Value</u>	<u>21</u>
<u>Note 6. Regulatory Matters</u>	<u>23</u>
<u>Note 7. Investment in ATC</u>	<u>28</u>
<u>Note 8. Short-Term and Long-Term Debt</u>	<u>29</u>
<u>Note 9. Income Tax Expense</u>	<u>30</u>
<u>Note 10. Reclassifications out of Accumulated Other Comprehensive Loss</u>	<u>31</u>
<u>Note 11. Earnings Per Share and Common Stock</u>	<u>31</u>
<u>Note 12. Pension and Other Postretirement Benefit Plans</u>	<u>31</u>
<u>Note 13. Commitments, Guarantees and Contingencies</u>	<u>32</u>
<u>Note 14. Business Segments</u>	<u>38</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>40</u>
<u>Comparison of Quarters Ended</u>	<u>42</u>
<u>Comparison of the Six Months Ended</u>	<u>45</u>
<u>Critical Accounting Policies</u>	<u>49</u>
<u>Outlook</u>	<u>49</u>
<u>Liquidity and Capital Resources</u>	<u>58</u>
<u>Other</u>	<u>61</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>61</u>
<u>Item 4. Controls and Procedures</u>	<u>62</u>
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	<u>62</u>
<u>Item 1A. Risk Factors</u>	<u>62</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>63</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>63</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>63</u>
<u>Item 5. Other Information</u>	<u>63</u>
<u>Item 6. Exhibits</u>	<u>64</u>
<u>Signatures</u>	<u>65</u>

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
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
CIP	Conservation Improvement Program
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
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
Magnetation	Magnetation, LLC
Manitoba Hydro	Manitoba Hydro-Electric Board
MATS	Mercury and Air Toxics Standards
Mesabi Metallics	Mesabi Metallics Company, LLC (formerly Essar Steel Minnesota, LLC)
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.

MISO

Midcontinent Independent System Operator, Inc.

ALLETE, Inc. Second Quarter 2018 Form 10-Q

3

Abbreviation or Acronym Term

Montana-Dakota Utilities	Montana-Dakota Utilities Co., a division of MDU Resources Group, 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
NOL	Net Operating Loss
NO ₂	Nitrogen Dioxide
NO _x	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)
Tenaska	Tenaska Energy, Inc. and Tenaska Energy Holdings, LLC
Tonka Water	Tonka Equipment Company
Town Center District	Town Center at Palm Coast Community Development District in Florida
UPM Blandin	UPM, Blandin Paper Mill owned by UPM-Kymmene Corporation
U.S.	United States of America
U.S. Water Services	U.S. Water Services Holding Company and its subsidiaries
USS Corporation	United States Steel Corporation
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 meaning) are 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 sales price increases at our Energy Infrastructure and Related Services 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 fluctuations in the volume of customer orders, 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.

ALLETE, Inc. Second Quarter 2018 Form 10-Q

5

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 2017 Form 10-K, and in Part II, Item 1A. Risk Factors in this Form 10 Q. 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.

ALLETE, Inc. Second Quarter 2018 Form 10-Q

6

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

ALLETE
CONSOLIDATED BALANCE SHEET
Unaudited

	June 30, 2018	December 31, 2017
Millions		
Assets		
Current Assets		
Cash and Cash Equivalents	\$121.9	\$98.9
Accounts Receivable (Less Allowance of \$2.3 and \$2.1)	132.4	135.1
Inventories – Net	145.4	95.9
Prepayments and Other	24.3	37.6
Total Current Assets	424.0	367.5
Property, Plant and Equipment – Net	3,809.3	3,822.4
Regulatory Assets	374.5	384.7
Investment in ATC	123.6	118.7
Other Investments	52.5	53.1
Goodwill and Intangible Assets – Net	225.8	225.9
Other Non-Current Assets	105.0	107.7
Total Assets	\$5,114.7	\$5,080.0
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	\$105.0	\$136.3
Accrued Taxes	42.0	50.0
Accrued Interest	18.0	17.6
Long-Term Debt Due Within One Year	56.7	64.1
Other	128.5	83.2
Total Current Liabilities	350.2	351.2
Long-Term Debt	1,462.2	1,439.2
Deferred Income Taxes	228.5	230.5
Regulatory Liabilities	516.0	532.0
Defined Benefit Pension and Other Postretirement Benefit Plans	175.2	191.8
Other Non-Current Liabilities	274.4	267.1
Total Liabilities	3,006.5	3,011.8
Commitments, Guarantees and Contingencies (Note 13)		
Shareholders' Equity		
Common Stock Without Par Value, 80.0 Shares Authorized, 51.4 and 51.1 Shares Issued and Outstanding	1,415.4	1,401.4
Accumulated Other Comprehensive Loss	(27.6)	(22.6)
Retained Earnings	720.4	689.4
Total Shareholders' Equity	2,108.2	2,068.2
Total Liabilities and Shareholders' Equity	\$5,114.7	\$5,080.0
The accompanying notes are an integral part of these statements.		

ALLETE, Inc. Second Quarter 2018 Form 10-Q

7

ALLETE
CONSOLIDATED STATEMENT OF INCOME
Unaudited

	Quarter Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Millions Except Per Share Amounts				
Operating Revenue				
Contracts with Customers – Utility	\$257.8	\$264.9	\$528.0	\$546.5
Contracts with Customers – Non-utility	80.4	82.5	162.4	160.6
Other – Non-utility	5.9	5.9	11.9	11.8
Total Operating Revenue	344.1	353.3	702.3	718.9
Operating Expenses				
Fuel, Purchased Power and Gas – Utility	96.5	93.1	197.4	189.7
Transmission Services – Utility	16.8	17.6	35.2	34.2
Cost of Sales – Non-utility	37.0	38.4	69.9	69.9
Operating and Maintenance	86.8	85.9	173.3	170.3
Depreciation and Amortization	56.1	50.1	101.9	100.6
Taxes Other than Income Taxes	14.4	14.2	30.7	28.6
Total Operating Expenses	307.6	299.3	608.4	593.3
Operating Income	36.5	54.0	93.9	125.6
Other Income (Expense)				
Interest Expense	(17.1)	(16.7)	(34.0)	(33.9)
Equity Earnings in ATC	4.3	5.3	9.0	11.4
Other	2.2	1.6	4.3	3.2
Total Other Expense	(10.6)	(9.8)	(20.7)	(19.3)
Income Before Income Taxes	25.9	44.2	73.2	106.3
Income Tax Expense (Benefit)	(5.4)	7.3	(9.1)	20.4
Net Income	\$31.3	\$36.9	\$82.3	\$85.9
Average Shares of Common Stock				
Basic	51.3	50.9	51.2	50.5
Diluted	51.5	51.1	51.4	50.7
Basic Earnings Per Share of Common Stock	\$0.61	\$0.73	\$1.61	\$1.70
Diluted Earnings Per Share of Common Stock	\$0.61	\$0.72	\$1.60	\$1.69
Dividends Per Share of Common Stock	\$0.56	\$0.535	\$1.12	\$1.07

The accompanying notes are an integral part of these statements.

ALLETE, Inc. Second Quarter 2018 Form 10-Q

ALLETE
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Unaudited

Quarter Ended	Six Months Ended
June 30, 2018	June 30, 2017