

**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **MARCH 31, 2004**

or

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

Commission File No. 1-3548

**ALLETE, Inc.**

A Minnesota Corporation  
IRS Employer Identification No. 41-0418150  
30 West Superior Street  
Duluth, Minnesota 55802-2093  
Telephone - (218) 279-5000

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 and (2) has been subject to such filing requirements for the past 90 days.

Yes  X  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  X  No

Common Stock, no par value,  
88,243,607 shares outstanding  
as of March 31, 2004

## INDEX

	Page
Definitions	2
Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995	3
Part I. Financial Information	
Item 1. Financial Statements	
Consolidated Balance Sheet - March 31, 2004 and December 31, 2003	4
Consolidated Statement of Income - Quarter Ended March 31, 2004 and 2003	5
Consolidated Statement of Cash Flows - Quarter Ended March 31, 2004 and 2003	6
Notes to Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3. Quantitative and Qualitative Disclosures about Market Risk	24
Item 4. Controls and Procedures	25
Part II. Other Information	
Item 1. Legal Proceedings	25
Item 5. Other Information	26
Item 6. Exhibits and Reports on Form 8-K	27
Signatures	28

## 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.

<b>Abbreviation or Acronym</b>	<b>Term</b>
2003 Form 10-K	ALLETE’s Annual Report on Form 10-K for the Year Ended December 31, 2003
ADESA Impact	Collectively, Automotive Recovery Services, Inc. and Impact Auto Auctions Ltd.
AFC	Automotive Finance Corporation
ALLETE	ALLETE, Inc.
ALLETE Properties	ALLETE Properties, Inc.
APB	Accounting Principles Board
Company	ALLETE, Inc. and its subsidiaries
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization Expense
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Florida Water	Florida Water Services Corporation
FPSC	Florida Public Service Commission
GAAP	Generally Accepted Accounting Principles in the United States
GeoInsight	GeoInsight, Inc.
IPO	Initial Public Offering
LIBOR	London Interbank Offered Rate
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MDEP	Massachusetts Department of Environmental Protection
MGP	Manufactured Gas Plant
MPUC	Minnesota Public Utilities Commission
MTBE	Methyl Tertiary-Butyl Ether
MW	Megawatt(s)
NCUC	North Carolina Utilities Commission
NRG Energy	NRG Energy, Inc.
PSCW	Public Service Commission of Wisconsin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards No.
Split Rock Energy	Split Rock Energy LLC
Square Butte	Square Butte Electric Cooperative
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
WDNR	Wisconsin Department of Natural Resources

**SAFE HARBOR STATEMENT  
UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

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

Forward-looking statements involve estimates, assumptions, risks and uncertainties and are qualified in their entirety by reference to, and are accompanied by, the following important factors, which are difficult to predict, contain uncertainties, are beyond our control and may cause actual results or outcomes to differ materially from those contained in forward-looking statements:

- our ability to successfully implement our strategic objectives, including the completion and impact of the proposed IPO and spin-off of our Automotive Services business and the sale of our Water Services businesses;
- war and acts of terrorism;
- prevailing governmental policies and regulatory actions, including those of the United States Congress, Canadian federal government, state and provincial legislatures, the FERC, the MPUC, the FPSC, the NCUC, the PSCW, and various county regulators and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power and capital investments, and present or prospective wholesale and retail competition (including but not limited to transmission costs) as well as vehicle-related laws, including vehicle brokerage and auction laws;
- unanticipated effects of restructuring initiatives in the electric and automotive industries;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with environmental and safety laws and policies;
- weather conditions;
- natural disasters;
- market factors affecting supply and demand for used vehicles;
- wholesale power market conditions;
- population growth rates and demographic patterns;
- the effects of competition, including competition for retail and wholesale customers, as well as sellers and buyers of vehicles;
- pricing and transportation of commodities;
- changes in tax rates or policies or in rates of inflation;
- unanticipated project delays or changes in project costs;
- unanticipated changes in operating expenses and capital expenditures;
- capital market conditions;
- competition for economic expansion or development opportunities;
- our ability to manage expansion and integrate acquisitions; and
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this report are discussed in Item 7. under the heading “Factors that May Affect Future Results” beginning on page 46 of our 2003 Form 10-K. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which that statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all of these factors, nor can it assess the impact of each of these factors on the businesses of ALLETE or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement. Readers are urged to carefully review and consider the various disclosures made by us in our 2003 Form 10-K and in our other reports filed with the SEC that attempt to advise interested parties of the factors that may affect our business.

**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

**ALLETE**  
**CONSOLIDATED BALANCE SHEET**  
Millions - Unaudited

	<b>MARCH 31, 2004</b>	<b>DECEMBER 31, 2003</b>
<b>ASSETS</b>		
Current Assets		
Cash and Cash Equivalents	\$ 297.5	\$ 223.0
Accounts Receivable (Less Allowance of \$26.7 and \$26.4)	599.3	403.8
Inventories	35.7	37.9
Prepayments and Other	15.1	15.8
Discontinued Operations	13.5	14.9
Total Current Assets	961.1	695.4
Property, Plant and Equipment – Net	1,493.4	1,499.0
Investments	189.4	204.6
Goodwill	510.5	511.0
Other Intangible Assets	31.1	33.3
Other Assets	78.2	70.1
Discontinued Operations	89.7	87.9
<b>TOTAL ASSETS</b>	<b>\$3,353.4</b>	<b>\$3,101.3</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Current Liabilities		
Accounts Payable	\$ 475.0	\$ 243.9
Accrued Taxes and Interest	53.3	35.2
Notes Payable	53.0	53.0
Long-Term Debt Due Within One Year	36.0	37.5
Other	87.4	107.1
Discontinued Operations	17.3	49.5
Total Current Liabilities	722.0	526.2
Long-Term Debt	747.9	747.7
Accumulated Deferred Income Taxes	165.9	160.7
Other Liabilities	163.9	161.5
Discontinued Operations	41.9	45.0
Commitments and Contingencies		
Total Liabilities	1,841.6	1,641.1
<b>SHAREHOLDERS' EQUITY</b>		
Common Stock Without Par Value, 130.0 Shares Authorized		
88.2 and 87.3 Shares Outstanding	882.4	859.2
Unearned ESOP Shares	(44.6)	(45.4)
Accumulated Other Comprehensive Gain	12.4	14.5
Retained Earnings	661.6	631.9
Total Shareholders' Equity	1,511.8	1,460.2
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$3,353.4</b>	<b>\$3,101.3</b>

The accompanying notes are an integral part of these statements.

**ALLETE**  
**CONSOLIDATED STATEMENT OF INCOME**  
Millions Except Per Share Amounts - Unaudited

	<b>QUARTER ENDED</b>	
	<b>MARCH 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>OPERATING REVENUE</b>		
Energy Services		
Regulated Utility	\$141.4	\$138.0
Nonregulated	40.9	41.1
Automotive Services	247.7	232.9
Investments	28.5	10.9
<b>Total Operating Revenue</b>	<b>458.5</b>	<b>422.9</b>
<b>OPERATING EXPENSES</b>		
Fuel and Purchased Power		
Regulated Utility	57.1	56.0
Nonregulated	11.8	11.4
Operations		
Regulated Utility	57.4	57.8
Nonregulated	28.5	28.3
Automotive and Investments	203.4	190.1
Interest	13.1	16.9
<b>Total Operating Expenses</b>	<b>371.3</b>	<b>360.5</b>
<b>OPERATING INCOME FROM CONTINUING OPERATIONS</b>	<b>87.2</b>	<b>62.4</b>
<b>INCOME TAX EXPENSE</b>	<b>34.1</b>	<b>24.4</b>
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>53.1</b>	<b>38.0</b>
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS – NET OF TAX</b>	<b>(0.6)</b>	<b>6.3</b>
<b>NET INCOME</b>	<b>\$ 52.5</b>	<b>\$ 44.3</b>
<b>AVERAGE SHARES OF COMMON STOCK</b>		
Basic	84.3	82.2
Diluted	84.8	82.3
<b>BASIC AND DILUTED</b>		
<b>EARNINGS (LOSS) PER SHARE OF COMMON STOCK</b>		
Continuing Operations	\$0.63	\$0.46
Discontinued Operations	(0.01)	0.08
	<b>\$0.62</b>	<b>\$0.54</b>
<b>DIVIDENDS PER SHARE OF COMMON STOCK</b>	<b>\$0.2825</b>	<b>\$0.2825</b>

The accompanying notes are an integral part of these statements.

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

	QUARTER ENDED	
	2004	2003
<b>OPERATING ACTIVITIES</b>		
Net Income	\$ 52.5	\$ 44.3
Depreciation and Amortization	21.7	20.9
Deferred Income Taxes	3.6	10.6
Gain on Sale of Plant	-	(12.5)
Changes in Operating Assets and Liabilities		
Accounts Receivable	(194.5)	(79.0)
Inventories	2.2	4.4
Prepayments and Other	1.3	(1.0)
Accounts Payable	228.9	123.5
Other Current Liabilities	(32.5)	(17.8)
Other Assets	(8.6)	(4.9)
Other Liabilities	2.4	(2.4)
Cash from Operating Activities	77.0	86.1
<b>INVESTING ACTIVITIES</b>		
Proceeds from Sale of Available-For-Sale Securities	1.4	-
Changes to Investments	11.1	(3.0)
Additions to Property, Plant and Equipment	(16.6)	(27.1)
Other	4.4	(9.6)
Cash from (for) Investing Activities	0.3	(39.7)
<b>FINANCING ACTIVITIES</b>		
Issuance of Common Stock	23.2	11.3
Issuance of Long-Term Debt	2.8	11.1
Changes in Notes Payable – Net	0.9	(58.1)
Reductions of Long-Term Debt	(4.3)	(2.9)
Dividends on Common Stock	(22.8)	(22.2)
Cash for Financing Activities	(0.2)	(60.8)
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	(2.5)	13.0
<b>CHANGE IN CASH AND CASH EQUIVALENTS</b>	74.6	(1.4)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	229.5	203.0
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD (a)</b>	\$304.1	\$201.6
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash Paid During the Period for		
Interest – Net of Capitalized	\$18.4	\$21.7
Income Taxes	\$29.6	\$1.3

(a) Included \$6.6 million of cash from Discontinued Operations at March 31, 2004 (\$7.9 million at March 31, 2003).

The accompanying notes are an integral part of these statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements and notes should be read in conjunction with our 2003 Form 10-K. In our opinion, all adjustments necessary for a fair presentation of the results for the interim periods have been included. The results of operations for an interim period may not give a true indication of the results for the year.

### NOTE 1. BUSINESS SEGMENTS

Millions

	Consolidated	Energy Services		Automotive Services	Investments and Corporate Charges
		Regulated Utility	Non-regulated		
<b>For the Quarter Ended March 31, 2004</b>					
Operating Revenue	\$458.5	\$141.4	\$40.9	\$247.7 (c)	\$28.5
Operation and Other Expense	336.5	104.6	37.8	179.5	14.6
Depreciation and Amortization Expense	21.7	9.9	2.5	9.3	–
Interest Expense	13.1	4.7	0.3	4.0	4.1
Operating Income from Continuing Operations	87.2	22.2	0.3	54.9	9.8
Income Tax Expense (Benefit)	34.1	8.3	(0.1)	21.6	4.3
Income from Continuing Operations	53.1	13.9	0.4	33.3	5.5
Loss from Discontinued Operations – Net of Tax	(0.6) (a)	–	–	–	–
Net Income	\$ 52.5 (a)	\$ 13.9	\$ 0.4	\$ 33.3	\$ 5.5
Total Assets	\$3,353.4 (b)	\$970.7	\$234.1	\$1,900.8 (d)	\$144.6
Property, Plant and Equipment – Net	\$1,493.4	\$728.3	\$189.0	\$572.1	\$4.0
Accumulated Depreciation	\$854.9	\$700.7	\$45.2	\$109.0	–
Capital Expenditures	\$16.6 (b)	\$10.9	\$2.8	\$1.3	\$0.1
<b>For the Quarter Ended March 31, 2003</b>					
Operating Revenue	\$422.9	\$138.0	\$41.1	\$232.9 (c)	\$10.9
Operation and Other Expense	322.7	103.5	37.2	176.2	5.8
Depreciation and Amortization Expense	20.9	10.3	2.5	8.1	–
Interest Expense	16.9	5.2	0.4	4.4	6.9
Operating Income (Loss) from Continuing Operations	62.4	19.0	1.0	44.2	(1.8)
Income Tax Expense (Benefit)	24.4	7.6	0.2	17.5	(0.9)
Income (Loss) from Continuing Operations	38.0	11.4	0.8	26.7	(0.9)
Income from Discontinued Operations – Net of Tax	6.3 (a)	–	–	0.5	–
Net Income (Loss)	\$ 44.3 (a)	\$ 11.4	\$ 0.8	\$ 27.2	\$ (0.9)
Total Assets	\$3,273.7 (b)	\$915.2	\$208.0	\$1,603.5 (d)	\$161.8
Property, Plant and Equipment – Net	\$1,388.4	\$728.4	\$165.9	\$490.1	\$4.0
Accumulated Depreciation	\$801.7	\$677.5	\$38.6	\$85.6	–
Capital Expenditures	\$27.1 (b)	\$10.2	\$3.5	\$7.2	–

(a) Included a \$0.6 million loss from the Water Services businesses in 2004 (\$5.8 million of income in 2003).

(b) Discontinued Operations represented \$103.2 million of total assets in 2004 (\$385.2 million in 2003) and \$1.5 million of capital expenditures in 2004 (\$6.2 million in 2003).

(c) Included \$45.8 million of Canadian operating revenue in 2004 (\$40.1 million in 2003).

(d) Included \$273.5 million of Canadian assets in 2004 (\$198.0 million in 2003).



## NOTE 2. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

**Accounts Receivable.** AFC sells the majority of U.S. dollar denominated finance receivables on a revolving basis to a wholly owned, bankruptcy remote, special purpose subsidiary that is consolidated for accounting purposes. The special purpose subsidiary has entered into a securitization agreement, which expires in 2005, that allows for the revolving sale to a bank conduit facility of up to a maximum of \$500 million in undivided interests in eligible finance receivables. Receivables sold are not reported on our consolidated financial statements.

At March 31, 2004 AFC managed total finance receivables of \$618 million (\$539 million at December 31, 2003), of which \$527 million had been sold to the special purpose subsidiary (\$464 million at December 31, 2003). The special purpose subsidiary then in turn sold, with recourse to the special purpose subsidiary, \$350 million to the bank conduit facility at March 31, 2004 (\$334 million at December 31, 2003) leaving \$268 million of finance receivables recorded on our consolidated balance sheet at March 31, 2004 (\$205 million at December 31, 2003).

AFC's proceeds from the revolving sale of receivables to the bank conduit facility were used to repay borrowings from ALLETE and fund new loans to customers. AFC and the special purpose subsidiary must maintain certain financial covenants such as minimum tangible net worth to comply with the terms of the securitization agreement. AFC has historically performed better than the covenant thresholds set forth in the securitization agreement, and we are not aware of any changing circumstances that would put AFC in noncompliance with the covenants.

**Accounting for Stock-Based Compensation.** We have elected to account for stock-based compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, we recognize expense for performance share awards granted and do not recognize expense for employee stock options granted. The after-tax expense recognized for performance share awards was approximately \$0.4 million for the first three months of 2004 (\$0.7 million for the first three months of 2003). The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123, "Accounting for Stock-Based Compensation."

<b>Effect of SFAS 123</b> <b>Accounting for Stock-Based Compensation</b>	<b>Quarter Ended</b> <b>March 31,</b>	
	<b>2004</b>	<b>2003</b>
Millions Except Per Share Amounts		
Net Income		
As Reported	\$52.5	\$44.3
Less: Employee Stock Compensation Expense Determined Under SFAS 123 – Net of Tax	(0.1)	(0.1)
Pro Forma Net Income	\$52.4	\$44.2
Basic Earnings Per Share		
As Reported	\$0.62	\$0.54
Pro Forma	\$0.62	\$0.54
Diluted Earnings Per Share		
As Reported	\$0.62	\$0.54
Pro Forma	\$0.62	\$0.54

In the previous table, the expense for employee stock options granted determined under SFAS 123 was calculated using the Black-Scholes option pricing model and the following assumptions:

	<b>2004</b>	<b>2003</b>
Risk-Free Interest Rate	3.3%	3.1%
Expected Life – Years	5	5
Expected Volatility	28.1%	25.2%
Dividend Growth Rate	2%	2%

## **NOTE 2. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**New Accounting Standards.** In January 2004 the FASB issued FASB Staff Position SFAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (Act). This Staff Position allows employers who sponsor a postretirement health plan that provides prescription drug benefits to defer recognizing the effects of the Act in accounting for its plan under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" until authoritative accounting guidance is issued. We provide postretirement health benefits that include prescription drug benefits, and in accordance with this Staff Position, have elected not to reflect the impact of the Act in our 2003 financial statements. We expect the Act will eventually reduce our costs for postretirement health benefits and are reviewing the impact on our accumulated plan benefit obligation and expense going forward.

## **NOTE 3. SPIN-OFF AND IPO OF AUTOMOTIVE SERVICES**

In October 2003 our Board of Directors approved a plan to spin off to ALLETE shareholders our Automotive Services business which will become a publicly traded company doing business as ADESA, Inc. The spin-off is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive a pro rata number of shares of ADESA common stock for each share of ALLETE common stock they own. The spin-off is subject to the approval of the final plan by ALLETE's Board of Directors, favorable market conditions, receipt of tax opinions, satisfaction of SEC requirements and other customary conditions, and is expected to occur in the third quarter of 2004. In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we will report the Automotive Services business in discontinued operations after the spin-off.

In March 2004 our Board of Directors approved an IPO of approximately \$150 million in common shares of ADESA, representing less than 20 percent of all ADESA common stock outstanding. A registration statement was filed with the SEC in March 2004, with the sale of ADESA stock expected to take place as soon as practical after the registration statement becomes effective. Subsequent to the IPO, ALLETE will continue to own and consolidate the remaining portion of ADESA until the completion of the spin-off.

## **NOTE 4. DISCONTINUED OPERATIONS**

During 2003, we sold, under condemnation or imminent threat of condemnation, substantially all of our water assets in Florida for a total sales price of approximately \$445 million. In addition, we reached an agreement to sell our North Carolina water assets for \$48 million and the assumption of approximately \$28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. In April 2004 we reached an agreement to sell our remaining 72 water and wastewater systems in Florida to Aqua America, Inc. for \$18 million. The transaction is scheduled to close by the end of June 2004 and is subject to regulatory approval by the FPSC. This approval process may result in an adjustment of the final purchase price based on the FPSC's determination of plant investment for the system. The ultimate ownership of nine of the 72 water and wastewater systems is subject to the outcome of an asserted right of first refusal with a local municipality. We expect to sell our water assets in Georgia in 2004. We exited our vehicle import business in the first quarter of 2003.

Earnings from Discontinued Operations for 2003 included a \$71.6 million, or \$0.86 per share, after-tax gain on the sale of substantially all our Water Services businesses (\$0.2 million first quarter and second quarter; \$3.0 million, or \$0.04 per share, third quarter; \$68.2 million, or \$0.82 per share, fourth quarter). The gain was net of all selling, transaction and employee termination benefit expenses, as well as impairment losses on certain remaining assets. The net cash proceeds from the sale of all water assets, after transaction costs, retirement of most Florida Water debt and payment of income taxes, are expected to be approximately \$300 million. These net proceeds have been, and will be, used to retire debt at ALLETE.

In October 2003 the FPSC voted to initiate a proceeding to examine whether the sale of Florida Water's assets involves a gain that should be shared with Florida Water's customers. The question raised is whether the entire gain from the asset sales should go to Florida Water and its shareholders, or should it be shared with customers. In November 2003 the FPSC issued a final order regarding a similar gain on sale for Utilities, Inc. In that order the FPSC made several findings that could be helpful to Florida Water's case including among others; that courts have found that rates paid by customers do not vest

#### NOTE 4. DISCONTINUED OPERATIONS (Continued)

ratepayers with ownership rights to the property used to render service, and shareholders bear the risk of gain or loss associated with investments made to provide service. Florida Water intends to vigorously contest any decision to seek sharing of the gain with customers. Florida Water is unable to predict the outcome of this proceeding.

##### Summary of Discontinued Operations

Millions	Quarter Ended March 31,	
Income Statement	2004	2003
Operating Revenue	\$7.6	\$30.9
Pre-Tax Income (Loss) from Operations	\$(0.4)	\$7.9
Income Tax Expense (Benefit)	(0.2)	3.1
	(0.2)	4.8
Gain (Loss) on Disposal	(0.6)	2.7 <sup>(a)</sup>
Income Tax Expense (Benefit)	(0.2)	1.2
	(0.4)	1.5
Income (Loss) from Discontinued Operations	\$(0.6)	\$6.3
Balance Sheet Information	March 31, 2004	December 31, 2003
Assets of Discontinued Operations		
Cash and Cash Equivalents	\$ 6.6	\$ 6.5
Other Current Assets	6.9	8.4
Property, Plant and Equipment	83.0	81.2
Other Assets	6.7	6.7
	\$103.2	\$102.8
Liabilities of Discontinued Operations		
Current Liabilities	\$17.3	\$49.5
Long-Term Debt	19.7	19.9
Other Liabilities	22.2	25.1
	\$59.2	\$94.5

(a) Included a \$2.0 million recovery from a settlement related to the 2002 sale of our vehicle transport business in 2003.

#### NOTE 5. INVESTMENTS

Investments includes the real estate assets of ALLETE Properties, debt and equity securities consisting primarily of \$43.9 million of securities held for employee benefits (\$41.4 million at December 31, 2003) and \$34.5 million of economic development revenue bonds held by ADESA in conjunction with a capital lease of a vehicle auction facility in Georgia (\$34.5 million at December 31, 2003), and our emerging technology investments.

Investments	March 31, 2004	December 31, 2003
Millions		
Real Estate Assets	\$ 75.5	\$ 78.5
Debt and Equity Securities	78.8	88.6
Emerging Technology Investments	35.1	37.5
	\$189.4	\$204.6

## NOTE 6. GOODWILL AND OTHER INTANGIBLES

We conduct our annual goodwill impairment testing in the second quarter of each year and the 2003 test resulted in no impairment. No event or change has occurred that would indicate the carrying amount has been impaired since our annual test.

### Goodwill

Millions	
Carrying Value, December 31, 2003	\$511.0
Acquired during Year	—
Change due to Foreign Currency Translation Adjustment	(0.5)
Carrying Value, March 31, 2004	\$510.5

Other Intangible Assets	March 31, 2004	December 31, 2003
Millions		
Customer Relationships	\$ 29.6	\$ 29.6
Computer Software	27.7	28.1
Other	5.7	5.7
Accumulated Amortization	(31.9)	(30.1)
	\$ 31.1	\$ 33.3

Other Intangible Assets are amortized using the straight-line method. Amortization periods are three to fifty years for Customer Relationships, one to seven years for Computer Software and three to ten years for Other.

## NOTE 7. SHORT-TERM BORROWINGS AND COMPENSATING BALANCES

In July 2003 ALLETE entered into a credit agreement to borrow \$250 million from a consortium of financial institutions, the proceeds of which were used to redeem \$250 million of the Company's Floating Rate First Mortgage Bonds due October 20, 2003. The credit agreement expires in July 2004, has an interest rate of LIBOR plus 0.875% and is secured by the lien of the Company's Mortgage and Deed of Trust. The credit agreement also has certain mandatory prepayment provisions, including a requirement to repay an amount equal to 75 percent of the net proceeds from the sale of water assets. In accordance with these provisions, \$197.0 million was repaid in 2003. The remaining \$53.0 million outstanding at March 31, 2004 was repaid in April 2004.

Our lines of credit contain financial covenants. The most restrictive of these covenants requires ALLETE (1) not to exceed a maximum ratio of funded debt to total capital of .60 to 1.0 and (2) to maintain an interest coverage ratio of not less than 3.00 to 1.00. Failure to meet these covenants could give rise to an event of default, if not corrected after notice from the lender; in which event ALLETE may need to pursue alternative sources of funding. As of March 31, 2004 ALLETE's ratio of funded debt to total capital was .36 to 1.0, the interest coverage ratio was 6.53 to 1.00 and ALLETE was in compliance with these financial covenants.

ALLETE's lines of credit contain a cross-default provision, under which an event of default would arise if other ALLETE obligations in excess of \$5.0 million were in default.

## NOTE 8. LONG-TERM DEBT

In January 2004 we used internally generated funds to retire approximately \$3.5 million in principal amount of Industrial Development Revenue Bonds Series 1994-A, due January 1, 2004.

ALLETE's long-term debt arrangements contain financial covenants. The most restrictive covenant requires ALLETE not to exceed a maximum ratio of funded debt to total capital of .65 to 1.0. Failure to meet this covenant could give rise to an event of default, if not corrected after notice from the trustee or security holder; in which event ALLETE may need to pursue alternative sources of funding. As of March 31, 2004 ALLETE's ratio of funded debt to total capital was .36 to 1.0 and ALLETE was in compliance with its financial covenants.

Some of ALLETE's long-term 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.

## NOTE 9. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Components of Periodic Benefit Expense Three Months Ended March 31, Millions	Pension		Postretirement Health and Life	
	2004	2003	2004	2003
Service Cost	\$ 2.1	\$ 1.7	\$ 1.1	\$ 0.9
Interest Cost	5.2	4.9	1.8	1.7
Expected Return on Plan Assets	(6.9)	(7.2)	(1.1)	(1.0)
Amortization of Prior Service Costs	0.2	0.2	—	—
Amortization of Net Loss	0.4	—	0.2	—
Amortization of Transition Obligation	0.1	0.1	0.6	0.6
Periodic Benefit Expense (Benefit)	\$ 1.1	\$ (0.3)	\$ 2.6	\$ 2.2

## NOTE 10. INCOME TAX EXPENSE

Millions	Quarter Ended March 31,	
	2004	2003
Current Tax Expense		
Federal	\$22.1	\$16.6
Foreign	3.7	1.9
State	5.0	3.7
	30.8	22.2
Deferred Tax Expense		
Federal	3.6	2.2
State	0.3	0.4
	3.9	2.6
Deferred Tax Credits	(0.6)	(0.4)
Income Tax Expense on Continuing Operations	34.1	24.4
Income Tax Expense (Benefit) on Discontinued Operations	(0.4)	4.3
Total Income Tax Expense	\$33.7	\$28.7

## NOTE 11. EARNINGS PER SHARE

The difference between basic and diluted earnings per share arises from outstanding stock options and performance share awards granted under our Executive and Director Long-Term Incentive Compensation Plans. For the quarters ended March 31, 2004 and 2003, there were no differences between basic and diluted earnings per share.

Reconciliation of Basic and Diluted Shares	Quarter Ended March 31, 2004			Quarter Ended March 31, 2003		
	Basic	Dilutive Securities	Diluted	Basic	Dilutive Securities	Diluted
Millions						
Common Shares	84.3	0.5	84.8	82.2	0.1	82.3

## NOTE 12. COMPREHENSIVE INCOME

For the quarter ended March 31, 2004 total comprehensive income was \$50.4 million (\$56.6 million for the quarter ended March 31, 2003). Total comprehensive income includes net income, unrealized gains and losses on securities classified as available-for-sale, additional pension liability and foreign currency translation adjustments.

Accumulated Other Comprehensive Gain	March 31, 2004	December 31, 2003
Millions		
Unrealized Gain on Securities	\$ 1.2	\$ 0.8
Foreign Currency Translation Gain	21.0	23.5
Additional Pension Liability	(9.8)	(9.8)
	\$12.4	\$14.5

## NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES

**Square Butte Power Purchase Agreement.** Minnesota Power has a power purchase agreement with Square Butte that extends through 2026 (Agreement). It provides a long-term supply of low-cost energy to customers in our electric service territory and enables Minnesota Power to meet power pool reserve requirements. Square Butte, a North Dakota cooperative corporation, owns a 455-MW coal-fired generating unit (Unit) near Center, North Dakota. The Unit is adjacent to a generating unit owned by Minnkota Power, a North Dakota cooperative corporation whose Class A members are also members of Square Butte. Minnkota Power serves as the operator of the Unit and also purchases power from Square Butte.

Minnesota Power is entitled to approximately 71 percent of the Unit's output under the Agreement. After 2005 and upon compliance with a two-year advance notice requirement, Minnkota Power has the option to reduce Minnesota Power's entitlement by 5 percent annually, to a minimum of 50 percent. In December 2003 we received notice from Minnkota Power that they will reduce our output entitlement, effective January 1, 2006, by 5 percent to approximately 66 percent. Minnesota Power is obligated to pay its pro rata share of Square Butte's costs based on Minnesota Power's entitlement to Unit output. Minnesota Power's payment obligation is suspended if Square Butte fails to deliver any power, whether produced or purchased, for a period of one year. Square Butte's fixed costs consist primarily of debt service. At March 31, 2004 Square Butte had total debt outstanding of \$284.5 million. Total annual debt service for Square Butte is expected to be approximately \$23 million in each of the years 2004 through 2008. Variable operating costs include the price of coal purchased from BNI Coal, our subsidiary, under a long-term contract. Minnesota Power's payments to Square Butte are approved as purchased power expense for ratemaking purposes by both the MPUC and the FERC.

## NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)

**Leasing Agreements.** We lease properties and equipment under operating lease agreements with terms expiring through 2019. The aggregate amount of minimum lease payments for all operating leases during 2004 is \$19.9 million (\$16.1 million in 2005; \$13.6 million in 2006; \$6.5 million in 2007; \$5.9 million in 2008; and \$49.5 million thereafter). Automotive Services' portion of these minimum lease payments is \$18.8 million in 2004 (\$15.2 million in 2005; \$12.7 million in 2006; \$5.9 million in 2007; \$5.6 million in 2008; and \$48.8 million thereafter).

**Kendall County Power Purchase Agreement.** We have 275 MW of nonregulated generation (non rate-base generation sold at market-based rates to the wholesale market) through an agreement with NRG Energy that extends through September 2017. Under the agreement we pay a fixed capacity charge for the right, but not the obligation, to capacity and energy from a 275 MW generating unit at NRG Energy's Kendall County facility near Chicago, Illinois. The annual fixed capacity charge is approximately \$21 million. We are also responsible for arranging the natural gas fuel supply. Our strategy is to enter into long-term contracts to sell a significant portion of the 275 MW from the Kendall County facility; the balance will be sold in the spot market through short-term agreements. We currently have 130 MW (100 MW in 2003) of long-term capacity sales contracts for the Kendall County generation, with 50 MW expiring in April 2012 and 80 MW in September 2017. Neither the Kendall County agreement nor the related sales contracts are derivatives under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." To date, the Kendall County facility has operated at a loss due to negative spark spreads (the differential between electric and natural gas prices) in the wholesale power market and our resulting inability to cover the fixed capacity charge on unsold capacity (currently 145 MW). We expect the facility to continue to generate losses until such time as spark spreads improve or we are able to enter into additional long-term capacity sales contracts. We are utilizing Tenaska Power Services Company to provide operational and scheduling services for the Kendall County generating unit.

**Coal and Shipping Contracts.** We have three coal supply agreements with various expiration dates ranging from December 2006 to December 2009. We also have rail and shipping agreements for transportation of all of our coal with various expiration dates ranging from December 2005 to December 2011. Our minimum annual obligation under these coal and shipping agreements range from approximately \$28 million in 2004 to \$10 million in 2008.

**Emerging Technology Investments.** We have investments in emerging technologies through minority investments in venture capital funds and privately-held start-up companies. We have committed to make additional investments in certain emerging technology holdings. The total future commitment was \$4.7 million at March 31, 2004 (\$4.8 million at December 31, 2003) and is expected to be invested at various times through 2007.

**Environmental Matters.** Our businesses are subject to regulation by various U.S. and Canadian federal, state, provincial and local authorities concerning environmental matters. We do not currently anticipate that potential expenditures for environmental matters will be material; however, we are unable to predict the outcome of the issues discussed below.

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. These accruals are adjusted periodically as assessment and remediation efforts progress or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the 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 charged to expense unless recoverable in rates from customers.

**SWL&P Manufactured Gas Plant.** In May 2001 SWL&P received notice from the WDNR that the City of Superior had found soil contamination on property adjoining a former Manufactured Gas Plant (MGP) site owned and operated by SWL&P's predecessors from 1889 to 1904. The WDNR requested SWL&P to initiate an environmental investigation. The WDNR also issued SWL&P a Responsible Party letter in February 2002. The environmental investigation is underway. In February 2003 SWL&P submitted a Phase II environmental site investigation report to the WDNR. This report identified some MGP-like chemicals that were found in the soil. During March and April 2003 sediment samples were taken from nearby Superior Bay. The report on the results of this sampling was completed and sent to the WDNR

### **NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**

during the first quarter of 2004. The next phase of the investigation will be to determine any impact to soil or ground water between the former MGP site and Superior Bay. A work plan for this additional investigation by SWL&P was filed on December 17, 2003 with the WDNR. Although it is not possible to quantify the potential clean-up cost until the investigation is completed and a work plan is developed, a \$0.5 million liability was recorded as of December 31, 2003 to address the known areas of contamination. We have recorded a corresponding dollar amount as a regulatory asset to offset this liability. The PSCW has approved SWL&P's deferral of these MGP environmental investigation and potential clean-up costs for future recovery in rates, subject to regulatory prudence review.

*Minnesota Power Coal-Fired Generating Facilities.* During 2002 Minnesota Power received and responded to a third request from the EPA, under Section 114 of the federal Clean Air Act Amendments of 1990 (Clean Air Act), seeking additional information regarding capital expenditures at all of its coal-fired generating stations. This action is part of an industry-wide investigation assessing compliance with the New Source Review and the New Source Performance Standards (emissions standards that apply to new and changed units) of the Clean Air Act at electric generating stations. We have received no feedback from the EPA based on the information we submitted. There is, however, ongoing litigation involving the EPA and other electric utilities for alleged violations of these rules. It is expected that the outcome of some of the cases could provide the utility industry direction on this topic. We are unable to predict what actions, if any, may be required as a result of the EPA's request for information. As a result, we have not accrued any liability for this environmental matter.

*Square Butte Generating Facility.* In June 2002 Minnkota Power, the operator of Square Butte, received a Notice of Violation from the EPA regarding alleged New Source Review violations at the M.R. Young Station which includes the Square Butte generating unit. The EPA claims certain capital projects completed by Minnkota Power should have been reviewed pursuant to the New Source Review regulations potentially resulting in new air permit operating conditions. Minnkota Power has held several meetings with the EPA to discuss the alleged violations. Based on an EPA request, Minnkota Power performed a study related to the technological feasibility of installing various controls for the reduction of nitrogen oxides and sulfur dioxide emissions. Discussions with the EPA are ongoing and we are unable to predict the outcome or cost impacts. If Square Butte is required to make significant capital expenditures to comply with EPA requirements, we expect such capital expenditures to be debt financed. Our future cost of purchased power would include our pro rata share of this additional debt service.

*ADESA Impact Taunton Facility.* In December 2003 the MDEP identified ADESA Impact as a potentially responsible party regarding contamination of several private drinking water wells in a residential development that abuts the Taunton, Massachusetts salvage vehicle auction facility. The wells had elevated levels of MTBE. MTBE is an oxygenating additive in gasoline to reduce harmful emissions. The EPA has identified MTBE as a possible carcinogen. ADESA Impact engaged GeoInsight, an environmental services firm, to conduct tests of the soil and groundwater at the salvage vehicle auction site.

GeoInsight prepared an immediate response action (IRA) plan, which was required by the MDEP, to determine the extent of the environmental impact and define activities to prevent further environmental contamination. The IRA plan, which was filed on January 24, 2004, describes the initial activities ADESA Impact performed, and proposes additional measures that it will use to further assess the existence of any imminent hazard to human health. In addition, as required by the MDEP, ADESA Impact is conducting an analysis to identify sensitive receptors that may have been affected, including area schools and municipal wells. GeoInsight does not believe that an imminent hazard condition exists at the Taunton site; however, the investigation and assessment of site conditions are ongoing.

In December 2003 GeoInsight collected soil samples, conducted groundwater tests and provided oversight for the installation of monitoring wells in various locations on and adjacent to the property adjoining the residential community. The results of the soil and water tests indicated levels of MTBE exceeding MDEP standards. In January 2004 we collected air samples from two residences that we identified as having elevated drinking water concentrations of MTBE. We have determined that inhalation of, or contact exposure to, this air poses minimal risk to human health. In response to our empirical findings, we proposed to the MDEP that we install water filtration units in the approximately 30 affected residences.



**NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES (Continued)**

ADESA Impact submitted an IRA plan status report to the MDEP on March 30, 2004. Additionally, ADESA Impact is submitting bi-weekly status updates to the MDEP. We have installed the water filtration units and have lowered MTBE detection limits at the instruction of the MDEP. As a result, another three homes have been identified as having detectable levels of MTBE in the drinking water.

A comprehensive ground water sampling event and residential sampling event were conducted in April 2004. ADESA Impact's representatives met with the Taunton City Council on April 20, 2004 to propose that ADESA Impact extend municipal water services to the Matthews Landing community at an approximate cost of \$1 million. By late June 2004, ADESA Impact expects to provide the Taunton City Council with a detailed proposal to provide water service including engineering work, flow modeling, surveys, site work, road-opening detail and a safety plan.

As of March 31, 2004 ADESA has accrued \$1 million to cover the estimated costs associated with the solution proposed to the Taunton City Council.

ADESA Impact has filed a claim with our insurance carrier with respect to this matter. On March 30, 2004 our insurance carrier responded with a request for additional information regarding the claims.

**Other.** 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, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to change materially our present liquidity position, nor have a material adverse effect on our financial condition.

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

ALLETE's core operations are focused on two business segments. **Energy Services** includes electric and gas services, coal mining and telecommunications. **Automotive Services**, with operations across the United States, Canada and Mexico, includes wholesale vehicle auctions and related vehicle redistribution services as well as dealer financing. Auctions and related services include wholesale used vehicle and salvage vehicle auctions. **Investments and Corporate Charges** includes our Florida real estate operations, investments in emerging technologies, and general corporate charges and interest not specifically related to any one business segment. General corporate charges include employee salaries and benefits as well as legal and other outside service fees. **Discontinued Operations** includes our Water Services businesses, and our vehicle transport and import businesses.

### CONSOLIDATED OVERVIEW

Strong performance across all business segments for the quarter ended March 31, 2004 increased net income and diluted earnings per share 19 percent and 15 percent, respectively, from the same period in 2003. Net income and diluted earnings per share from continuing operations for the quarter ended March 31, 2004 increased 40 percent and 37 percent, respectively, from the same period in 2003.

	Three Months Ended March 31,	
	2004	2003
Millions Except Per Share Amounts		
Operating Revenue		
Energy Services	\$182.3	\$179.1
Automotive Services	247.7	232.9
Investments	28.5	10.9
	\$458.5	\$422.9
Operating Expenses		
Energy Services	\$159.8	\$159.1
Automotive Services	192.8	188.7
Investments and Corporate Charges	18.7	12.7
	\$371.3	\$360.5
Net Income (Loss)		
Energy Services	\$14.3	\$12.2
Automotive Services	33.3	26.7
Investments and Corporate Charges	5.5	(0.9)
	53.1	38.0
Continuing Operations	53.1	38.0
Discontinued Operations	(0.6)	6.3
	\$52.5	\$44.3
Diluted Average Shares of Common Stock – Millions	84.8	82.3
Diluted Earnings (Loss) Per Share of Common Stock		
Continuing Operations	\$0.63	\$0.46
Discontinued Operations	(0.01)	0.08
	\$0.62	\$0.54

*Non-GAAP Measure of Liquidity.* We believe earnings before interest, taxes, depreciation and amortization expense (EBITDA) provides meaningful additional information that helps us monitor and evaluate our ongoing results and trends. EBITDA should not be considered in isolation nor as a substitute for measures of liquidity prepared in accordance with GAAP which include:

#### Consolidated Cash Flow

Three Months Ended March 31,	2004	2003
Millions		
Cash from Operating Activities	\$77.0	\$86.1
Cash from (for) Investing Activities	\$0.3	\$(39.7)
Cash for Financing Activities	\$(0.2)	\$(60.8)

We believe EBITDA is a widely accepted measure of liquidity considered by investors, financial analysts and rating agencies. EBITDA is not an alternative to cash flows as a measure of liquidity and may not be comparable with EBITDA as defined by other companies.

EBITDA	Consolidated	Energy Services		Automotive Services	Investments and Corporate Charges
		Regulated Utility	Non-regulated		
<b>For the Quarter Ended March 31, 2004</b>					
Net Income	\$ 52.5				
Less: Loss from Discontinued Operations	(0.6)				
Income from Continuing Operations	53.1	\$13.9	\$0.4	\$33.3	\$ 5.5
Add Back: Income Tax Expense (Benefit)	34.1	8.3	(0.1)	21.6	4.3
Interest Expense	13.1	4.7	0.3	4.0	4.1
Depreciation and Amortization Expense	21.7	9.9	2.5	9.3	–
EBITDA	\$122.0	\$36.8	\$3.1	\$68.2	\$13.9
<b>For the Quarter Ended March 31, 2003</b>					
Net Income	\$ 44.3				
Less: Income from Discontinued Operations	6.3				
Income (Loss) from Continuing Operations	38.0	\$11.4	\$0.8	\$26.7	\$(0.9)
Add Back: Income Tax Expense (Benefit)	24.4	7.6	0.2	17.5	(0.9)
Interest Expense	16.9	5.2	0.4	4.4	6.9
Depreciation and Amortization Expense	20.9	10.3	2.5	8.1	–
EBITDA	\$100.2	\$34.5	\$3.9	\$56.7	\$ 5.1

Statistical Information	Three Months Ended March 31,	
	2004	2003
<b>Energy Services</b>		
Millions of Kilowatthours Sold		
Regulated Utility		
Retail		
Residential	310.3	312.9
Commercial	331.9	326.4
Industrial	1,766.8	1,718.5
Other	20.2	20.5
Resale		
Municipals	213.8	200.6
Other Power Suppliers	217.2	207.3
	2,860.2	2,786.2
Nonregulated	434.0	419.1
	3,294.2	3,205.3
<b>Automotive Services</b>		
Vehicles Sold		
Used	481,000	462,000
Salvage	58,000	49,000
	539,000	511,000
Conversion Rate * – Used Vehicles	68.4%	62.4%
Loan Transactions	263,000	233,000

\* Conversion rate is the percentage of vehicles sold from those that were offered at auction.

## NET INCOME

The following net income discussion summarizes a comparison of the three months ended March 31, 2004 to the three months ended March 31, 2003.

**Energy Services'** net income in 2004 was up \$2.1 million. At Minnesota Power, higher demand for energy by industrial customers contributed to the increase. Total regulated utility kilowatthour sales increased 3 percent from last year.

**Automotive Services** reported a \$6.6 million increase in net income primarily due to higher conversion rates and increased vehicle sales at ADESA auctions. Vehicle sales were higher in 2004 due to increased demand for wholesale used vehicles as demand for retail used vehicles continued to improve. The increase in demand resulted in an increase in the number of vehicles sold the first time offered at auction which raised the conversion rate to 68.4 percent in 2004 (62.4 percent in 2003). AFC, which provides dealer financing, arranged 13 percent more loan transactions in 2004 and contributed 30 percent of the net income for Automotive Services in 2004 (32 percent in 2003).

**Investments and Corporate Charges'** net income in 2004 was up \$6.4 million reflecting strong demand for our real estate in Florida and reduced interest expense. These positive developments were partially offset by an increase in general corporate charges primarily resulting from costs associated with the planned spin-off of Automotive Services. Net income from ALLETE Properties, our real estate operations, was up \$6.8 million in 2004 (\$11.0 million in 2004; \$4.2 million in 2003) primarily due an increase in the number as well as the profitability of real estate sales closing during the first quarter of 2004. The timing of real estate sales is unpredictable.

**Discontinued Operations** included the financial results of our Water Services businesses, and the vehicle transport and import businesses. Net income from Discontinued Operations was down \$6.9 million in 2004 primarily due to the absence of water and wastewater systems sold in 2003. In 2003 the net gain on disposal included gains on system sales as well as selling, transaction and employee termination benefit expenses associated with selling the Water Services businesses. Net income in 2003 also included a \$1.3 million recovery from the settlement of a lawsuit associated with our vehicle transport business.

## COMPARISON OF THE QUARTERS ENDED MARCH 31, 2004 AND 2003

### Energy Services

Regulated utility operations include retail and wholesale rate regulated activities under the jurisdiction of state and federal regulatory authorities. Nonregulated operations consist of nonregulated generation (non-rate base generation sold at market-based rates to the wholesale market), coal mining and telecommunication activities. Nonregulated generation consists primarily of the Taconite Harbor Energy Center in northern Minnesota and generation secured through the Kendall County power purchase agreement, a 15-year agreement with NRG Energy at a facility near Chicago, Illinois.

**Operating revenue** in total was up \$3.2 million, or 2 percent, in 2004 primarily due to increases at our regulated utility operations. Regulated utility revenue was up \$3.4 million, or 2 percent, in 2004 primarily due to increased electric sales and higher fuel clause recoveries because of higher purchased power costs. Regulated utility kilowatthour sales were up 3 percent from last year reflecting increased usage by industrial customers due to higher production levels. Equity in net income from Split Rock Energy was \$4.3 million lower in 2004 as a result of Minnesota Power withdrawing from Split Rock Energy.

Revenue from electric sales to taconite customers accounted for 10 percent of consolidated operating revenue in both 2004 and 2003. Electric sales to paper and pulp mills accounted for 3 percent of consolidated operating revenue in both 2004 and 2003.

**Operating expenses** in total were up \$0.7 million, or less than 1 percent in 2004. Regulated utility operating expenses were up \$0.2 million, or less than 1 percent, reflecting increased purchased power expense, and higher pension and benefit expenses mostly offset by the absence of a demand payment associated with a purchased power agreement that expired in 2003.

## Automotive Services

**Operating revenue** was up \$14.8 million, or 6 percent, in 2004. Revenue from auctions and related services was up \$11.7 million, or 6 percent, primarily due to increased vehicle sales volume and a favorable Canadian exchange rate. The number of vehicles sold at the Company's vehicle auction facilities increased 6 percent from last year (4 percent at our wholesale used vehicle auctions; 18 percent at our salvage vehicle auctions). The demand for wholesale used vehicles has increased as retail used vehicle sales continue to show improvement. At our salvage auctions, vehicles sold increased due in part to market share gains at U.S. locations and improved overall market conditions. Dealer financing revenue was up \$3.1 million, or 12 percent, in 2004 reflecting a 13 percent increase in the number of loan transactions. The increase in retail used vehicle sales has increased the demand for wholesale used vehicles and the inventory turnover rate of AFC's customers which has driven up the number of loan transactions. Total receivables managed by AFC were \$618 million at March 31, 2004 (\$527 million at March 31, 2003).

**Operating expenses** were up \$4.1 million, or 2 percent, in 2004 reflecting additional corporate charges of \$1.2 million and separation expenses of \$1.6 million incurred as Automotive Services prepares to be a stand-alone publicly traded company, independent of ALLETE. In addition, 2004 expenses were negatively impacted by higher Canadian exchange rates in 2004.

## Investments and Corporate Charges

**Operating revenue** was up \$17.6 million in 2004 primarily due to a \$16.7 million increase in revenue from ALLETE Properties as a result of more land sales. In 2004 ten large real estate sales contributed \$20.1 million to revenue, while in 2003 four large real estate sales contributed \$6.6 million to revenue.

**Operating expenses** were up \$6.0 million, or 47 percent, in 2004 primarily due to more real estate sales and increased general corporate charges. These increases were partially offset by lower interest expense. Operating expenses at ALLETE Properties were up \$5.3 million in 2004 because of more land sales. Corporate charges increased \$3.5 million (\$5.2 million in 2004; \$1.7 million in 2003) reflecting higher personnel costs and \$1.7 million of costs associated with the planned spin-off of Automotive Services. Interest expense not specifically related to any one business segment decreased \$2.9 million (\$4.0 million in 2004; \$6.9 million in 2003) due to the redemption of quarterly income preferred securities and various long-term debt issues in 2003 with both the proceeds from the sale of our Water Services businesses and internally generated cash.

## CRITICAL ACCOUNTING POLICIES

Certain accounting measurements under applicable GAAP involve management's judgment about subjective factors and estimates, the effects of which are inherently uncertain. Accounting measurements that we believe are most critical to our reported results of operations and financial condition include: uncollectible receivables and allowance for doubtful accounts, impairment of goodwill and long-lived assets, pension and postretirement health and life actuarial assumptions, valuation of investments and provisions for environmental remediation. These policies are reviewed with the audit committee of our Board of Directors on a regular basis and summarized in our 2003 Form 10-K.

## OUTLOOK

We remain focused on continuously improving the performance of our two core businesses, Energy Services and Automotive Services, which remain strong and poised for growth in their respective markets.

**Spin-Off of Automotive Services.** We continue to anticipate that the spin-off to ALLETE shareholders of our Automotive Services business will occur in the third quarter of 2004. The spin-off of Automotive Services, which will become a publicly traded company doing business as ADESA, Inc., is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive a pro rata number of shares of ADESA common stock for each share of ALLETE common stock they own. The spin-off is subject to the approval of the final plan by ALLETE's Board of Directors, favorable market conditions, receipt of tax opinions, satisfaction of SEC requirements and other customary conditions.

In March 2004 our Board of Directors approved an IPO of approximately \$150 million in common shares of ADESA, representing less than 20 percent of all ADESA common stock outstanding. A registration statement was filed with the SEC in March 2004, with the sale of ADESA stock expected to take place as soon as practical after the registration statement becomes effective. Subsequent to the IPO, ALLETE will continue to own and consolidate the remaining portion of ADESA until the completion of the spin-off.

**2004 Earnings Guidance.** After the separation of Automotive Services is completed, ALLETE will be comprised of what is now classified as (1) Energy Services, and (2) Investments and Corporate Charges. In 2003 net income from these operations totaled \$28.3 million. ALLETE now estimates that 2004 net income from these remaining businesses will increase by 10 percent to 15 percent over 2003, due primarily to stronger than originally anticipated sales at both Minnesota Power and ALLETE Properties.

ALLETE expects to reduce its debt by an additional \$150 million to \$200 million after the ADESA IPO and recapitalization, which is expected to occur in the second quarter of 2004. The 2004 net income estimate does not include the financial implications of the spin-off of Automotive Services such as one-time expenses of the transaction for advisor fees, debt retirement premiums and the impact of cash received from ADESA after the IPO.

*Energy Services.* In February 2004 we experienced a generator failure at our 534-MW Boswell Energy Center Unit 4 (Unit 4). As a result of the failure, we expect to replace significant components of the generator at an estimated capital cost of \$5 million. The majority of the replacement cost is covered by insurance, subject to a deductible of \$1 million. We have entered into power purchase agreements to replace the power lost during the Unit 4 outage, which is expected to continue through May 2004. The cost of this additional power will be recovered through the regulated utility fuel adjustment clause in Minnesota. With Unit 4 down, some work originally planned for 2005 and 2006 is being done now to minimize future outages. We do not expect this outage to have a material impact on our results of operations. Wisconsin Public Power, Inc. owns 20 percent of Unit 4.

*Investments and Corporate Charges.* ALLETE Properties, our Florida real estate operations, owns approximately 18,000 acres of land near Fort Myers, Palm Coast and Ormond Beach, Florida, as well as Winter Haven Citi Centre, a retail shopping center in Winter Haven, Florida. We add value to the land through entitlements and infrastructure improvements, and then sell it at current market prices. Historically, proceeds from land sales have been three to four times our book basis. Rental income at the retail shopping center in Winter Haven provides a recurring stream of revenue. At March 31, 2004 our basis in land held by ALLETE Properties was \$47.1 million. ALLETE Properties does occasionally provide seller financing, and outstanding finance receivables were \$10.3 million at March 31, 2004 with maturities ranging up to ten years. Outstanding finance receivables accrue interest at market-based rates. At March 31, 2004 ALLETE Properties also had \$18.1 million of other assets which consisted primarily of Winter Haven Citi Centre. We may selectively acquire additional land if it meets our strategy of adding value through entitlement and infrastructure improvements.

**Sale of Remaining Water Assets.** In 2003 we reached an agreement to sell our North Carolina water assets for \$48 million and the assumption of approximately \$28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. In April 2004 we reached an agreement to sell our remaining 72 water and wastewater systems in Florida to Aqua America, Inc. for \$18 million. The transaction is scheduled to close by the end of June 2004 and is subject to regulatory approval by the FPSC. This approval process may result in an adjustment of the final purchase price based on the FPSC's determination of plant investment for the system. The ultimate ownership of nine of the 72 water and wastewater systems is subject to the outcome of an asserted right of first refusal with a local municipality. We expect to sell our water assets in Georgia in 2004.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flow Activities

A primary goal of our strategic plan is to improve cash flow from operations. Our strategy includes growing the businesses both internally by expanding facilities, services and operations (see Capital Requirements), and externally through acquisitions.

During the first three months of 2004 and 2003, cash flow from operating activities was affected by a number of factors representative of normal operations.

Consolidated cash and cash equivalents was \$297.5 million at March 31, 2004 (\$223.0 million at December 31, 2003) of which \$203.4 million (\$116.2 million at December 31, 2003) was at Automotive Services. The remaining balance was held by ALLETE and its other subsidiaries.

**Working Capital.** Additional working capital, if and when needed, generally is provided by the sale of commercial paper. Approximately 3.6 million original issue shares of our common stock are available for issuance through *Invest Direct*, our direct stock purchase and dividend reinvestment plan.

A substantial amount of ADESA's working capital is generated internally from payments for services provided. ADESA, however, currently has arrangements to use proceeds from the sale of commercial paper issued by ALLETE to meet short-term working capital requirements arising from the timing of payment obligations to vehicle sellers and the availability of funds from vehicle buyers. During the sales process, ADESA does not generally take title to or ownership of the vehicles consigned for auction but instead facilitates the transfer of vehicle ownership directly from sellers to buyers.

AFC offers floorplan financing for dealers to purchase vehicles mostly at auctions and takes a security interest in each financed vehicle. The financing is provided through the earlier of the date the dealer sells the vehicle or a general borrowing term of 30 to 45 days. Currently, AFC has arrangements to use proceeds from the sale of commercial paper issued by ALLETE to meet its short-term working capital requirements not funded through securitization.

Significant changes in accounts receivable and accounts payable balances at March 31, 2004 compared to December 31, 2003 were due to increased sales and financing activity at Automotive Services. Typically auction volumes are down during December because of the holidays. As a result, ADESA and AFC had higher receivables and higher payables at March 31, 2004.

**AFC Receivables.** AFC sells the majority of U.S. dollar denominated finance receivables on a revolving basis to a wholly owned, bankruptcy remote, special purpose subsidiary that is consolidated for accounting purposes. The special purpose subsidiary has entered into a securitization agreement, which expires in 2005, that allows for the revolving sale to a bank conduit facility of up to a maximum of \$500 million in undivided interests in eligible finance receivables. Receivables sold are not reported on our consolidated financial statements.

At March 31, 2004 AFC managed total finance receivables of \$618 million (\$539 million at December 31, 2003), of which \$527 million had been sold to the special purpose subsidiary (\$464 million at December 31, 2003). The special purpose subsidiary then in turn sold, with recourse to the special purpose subsidiary, \$350 million to the bank conduit facility at March 31, 2004 (\$334 million at December 31, 2003) leaving \$268 million of finance receivables recorded on our consolidated balance sheet at March 31, 2004 (\$205 million at December 31, 2003).

AFC's proceeds from the revolving sale of receivables to the bank conduit facility were used to repay borrowings from ALLETE and fund new loans to customers. AFC and the special purpose subsidiary must maintain certain financial covenants such as minimum tangible net worth to comply with the terms of the securitization agreement. AFC has historically performed better than the covenant thresholds set forth in the securitization agreement, and we are not aware of any changing circumstances that would put AFC in noncompliance with the covenants.

**Securities.** In March 2001 ALLETE, ALLETE Capital II and ALLETE Capital III, jointly filed a registration statement with the SEC pursuant to Rule 415 under the Securities Act of 1933. The registration statement, which has been declared effective by the SEC, relates to the possible issuance of a remaining aggregate amount of \$387 million of securities which may include ALLETE common stock, first mortgage bonds and other debt securities, and ALLETE Capital II and ALLETE Capital III preferred trust securities. ALLETE also previously filed a registration statement, which has been declared effective by the SEC, relating to the possible issuance of \$25 million of first mortgage bonds and other debt securities. We may sell all or a portion of the remaining registered securities if warranted by market conditions and our capital requirements. Any offer and sale of the above mentioned securities will be made only by means of a prospectus meeting the requirements of the Securities Act of 1933 and the rules and regulations thereunder.

In January 2004 we used internally generated funds to retire approximately \$3.5 million in principal amount of Industrial Development Revenue Bonds Series 1994-A, due January 1, 2004.

In April 2004 we used internally generated funds to repay the remaining \$53.0 million outstanding on a \$250 million credit agreement which would have expired in July 2004.

Our lines of credit and long-term debt agreements contain various financial covenants. The most restrictive of these covenants are discussed in Notes 7 and 8 to our consolidated financial statements in Item 1 in this Form 10-Q.

### **Capital Requirements**

Consolidated capital expenditures for the quarter ended March 31, 2004 totaled \$16.6 million (\$27.1 million in 2003). Expenditures for the quarter ended March 31, 2004 included \$13.7 million for Energy Services, \$1.3 million for Automotive Services and \$0.1 million for Investments and Corporate Charges. Expenditures for the quarter ended March 31, 2004 also included \$1.5 million to maintain our remaining Water Services businesses while they are in the process of being sold. Internally generated funds were the primary source of funding for these expenditures.

### **ENVIRONMENTAL MATTERS**

Our businesses are subject to regulation by various U.S. and Canadian federal, state, provincial and local authorities concerning environmental matters. We do not currently anticipate that potential expenditures for environmental matters will be material; however, we are unable to predict the outcome of the issues discussed in Note 13 to our consolidated financial statements in Item 1 in this Form 10-Q.

### **OTHER**

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, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to change materially our present liquidity position, nor have a material adverse effect on our financial condition.

### **NEW ACCOUNTING STANDARDS**

New accounting standards are discussed in Note 2 to our consolidated financial statements in Item 1 in this Form 10-Q.

---

*Readers are cautioned that forward-looking statements including those contained above, should be read in conjunction with our disclosures under the heading: "SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" located on page 3 of this Form 10-Q.*



### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **SECURITIES INVESTMENTS**

Our securities investments include certain securities held for an indefinite period of time which are accounted for as available-for-sale securities. Available-for-sale securities are recorded at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of tax. Unrealized losses that are other than temporary are recognized in earnings. At March 31, 2004 our available-for-sale securities portfolio consisted of securities in a grantor trust established to fund certain employee benefits. Our available-for-sale securities portfolio had a fair value of \$20.9 million at March 31, 2004 (\$20.2 million at December 31, 2003) and a total unrealized after-tax gain of \$1.2 million at March 31, 2004 (\$0.8 million at December 31, 2003).

As part of our Emerging Technology portfolio, we also have several minority investments in venture capital funds and privately-held start-up companies. These investments are accounted for using the cost method and included in Investments on our consolidated balance sheet. The total carrying value of these investments was \$35.1 million at March 31, 2004 (\$37.5 million at December 31, 2003). Our policy is to periodically review these investments for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment.

#### **FOREIGN CURRENCY**

Our foreign currency exposure is limited to the conversion of the operating results of our Canadian subsidiaries and, to a lesser extent, Mexican subsidiaries. We have not entered into any foreign exchange contracts to hedge the conversion of our Canadian or Mexican operating results into United States dollars. Mexican operations are not material.

#### **COMMODITY PRICE RISK**

Our regulated utility operations in Minnesota and Wisconsin incur costs for fuel (primarily coal), power and natural gas purchased for resale in our regulated service territories, and related transportation. Our regulated utilities' exposure to price risk for these commodities is significantly mitigated by the current ratemaking process and regulatory environment which generally allows a fuel clause surcharge if costs are in excess of those in our last rate filing. Conversely, costs below those in our last rate filing result in a rate credit. We prudently manage our customers' exposure to price risk by entering into contracts of various durations and terms for the purchase of coal and power (in Minnesota), power and natural gas (in Wisconsin), and related transportation costs.

#### **POWER MARKETING**

Our power marketing activities consist of selling excess available regulated utility generation and purchased power, as well as selling nonregulated generation.

From time-to-time, our regulated utility operations may have excess generation that is temporarily not required by retail and municipal customers in our regulated service territory. We actively sell this generation to the wholesale market to optimize the value of our generating facilities. This generation is generally sold in the spot market or under short-term contracts at market prices.

We have approximately 500 MW of nonregulated generation available for sale to the wholesale markets. This primarily consists of about 200 MW at our Taconite Harbor facility in northern Minnesota and 275 MW obtained through a 15-year power purchase agreement with NRG Energy at the Kendall County facility near Chicago, Illinois.

The majority of Taconite Harbor's capability of approximately 200 MW has been sold through various short-term and long-term capacity and energy contracts. Short term, we have approximately 180 MW of capacity and energy sales contracts and a 15 MW of forward energy sales contract, all of which expire on April 30, 2005. Long term, we have entered into two capacity and energy sales contracts totaling 175 MW

(201 MW including a 15 percent reserve) which are effective May 1, 2005 and expire on April 30, 2010. Both contracts contain fixed monthly capacity charges and fixed minimum energy charges. One contract provides for an annual escalator to the energy charge based on increases in our cost of coal, subject to a small minimum annual escalation. The other contract provides that the energy charge will be the greater of a fixed minimum charge or an amount based on the variable production cost of a combined cycle natural gas unit. Our exposure in the event of a full or partial outage at our Taconite Harbor facility is significantly limited under both contracts. When the buyer is notified at least two months prior to an outage, there is no exposure. Outages with less than two months notice are subject to an annual duration limitation typical of this type of contract.

Under the Kendall County agreement, which expires in September 2017, we pay a fixed capacity charge for the right, but not the obligation, to capacity and energy from a 275 MW generating unit. We are responsible for arranging the natural gas fuel supply. Our strategy is to sell a significant portion of this generation through long-term contracts of various durations. The balance will be sold in the daily spot market or through short-term contracts. We currently have long-term capacity sales contracts for 130 MW, with 50 MW expiring in April 2012 and the balance in September 2017. To date, the Kendall County facility has operated at a loss due to negative spark spreads (the differential between electric and natural gas prices) in the wholesale power market and our resulting inability to cover the fixed capacity charge on the unsold capacity (currently 145 MW). We expect the facility to continue to generate losses until such time as spark spreads improve or we are able to enter into additional long-term capacity sales contracts.

#### **ITEM 4. CONTROLS AND PROCEDURES**

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of management, including our chief executive officer and chief financial officer, as of the end of the period covered by this Form 10-Q. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings. There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

Material legal and regulatory proceedings are included in the discussion of Other Information in Item 5. and are incorporated by reference herein.

In late 2003 the staff of the SEC initiated an informal inquiry relating to our internal audit function, internal financial reporting and the loan loss methodology at AFC. We have fully and voluntarily cooperated with the informal inquiry, and the SEC staff has not asserted that we have acted improperly or illegally. Although we cannot predict the length, scope or results of the informal inquiry, based upon extensive review by the Audit Committee of our Board of Directors with the assistance of independent counsel and our independent auditors, we believe that we have acted appropriately and that this inquiry will not result in action that has a material adverse impact on us or our reported results of operations.

## ITEM 5. OTHER INFORMATION

Reference is made to our 2003 Form 10-K for background information on the following updates. Unless otherwise indicated, cited references are to our 2003 Form 10-K.

Ref. Page 12 – First Partial Paragraph

In April 2004 we reached an agreement to sell our remaining 72 water and wastewater systems in Florida to Aqua America, Inc. for \$18 million. The transaction is scheduled to close by the end of June 2004 and is subject to regulatory approval by the FPSC. This approval process may result in an adjustment of the final purchase price based on the FPSC's determination of plant investment for the system. The ultimate ownership of nine of the 72 water and wastewater systems is subject to the outcome of an asserted right of first refusal with a local municipality.

Ref. Page 12 – Seventh Full Paragraph

Ref. Page 39 – Eighth Paragraph

Ref. Page 46 – First Full Paragraph

Effective March 15, 2004 the FERC approved the termination of our ownership interest in Split Rock Energy, the joint venture between Minnesota Power and Great River Energy.

Ref. Page 18 – First Paragraph

In April 2004 the National Park Service (NPS) issued a draft Environmental Impact Statement (DEIS) for a 60-day public comment period. The DEIS describes the NPS' preferred option to cross the Namekagon River. Construction activities have begun in Minnesota and eminent domain court actions are underway.

Ref. Page 18 – Eighth Paragraph

On March 30, 2004 the International Brotherhood of Electrical Workers Local 1593 and BNI Coal, Ltd., a wholly owned subsidiary of ALLETE, signed a one year extension of the existing labor agreement which expired on March 31, 2004. The contract terms remain the same.

Ref. Page 26 – Second through Fifth Paragraphs

ADESA Impact submitted an IRA plan status report to the MDEP on March 30, 2004. Additionally, ADESA Impact is submitting bi-weekly status updates to the MDEP. We have installed the water filtration units and have lowered MTBE detection limits at the instruction of the MDEP. As a result, another three homes have been identified as having detectable levels of MTBE in the drinking water.

A comprehensive ground water sampling event and residential sampling event were conducted in April 2004. ADESA Impact's representatives met with the Taunton City Council on April 20, 2004 to propose that ADESA Impact extend municipal water services to the Matthews Landing community at an approximate cost of \$1 million. By late June 2004, ADESA Impact expects to provide the Taunton City Council with a detailed proposal to provide water service including engineering work, flow modeling, surveys, site work, road-opening detail and a safety plan.

As of March 31, 2004 ADESA has accrued \$1 million to cover the estimated costs associated with the solution proposed to the Taunton City Council.

ADESA Impact has filed a claim with our insurance carrier with respect to this matter. On March 30, 2004 our insurance carrier responded with a request for additional information regarding the claims.

## **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

### **(a) Exhibits.**

- 3 Bylaws of ALLETE, Inc., as amended effective March 8, 2004.
- 31(a) Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31(b) Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Section 1350 Certification of Periodic Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

### **(b) Reports on Form 8-K.**

Report on Form 8-K filed January 26, 2004 with respect to Item 5. Other Events and Regulation FD Disclosure.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### ALLETE, Inc.

April 30, 2004

\_\_\_\_\_  
/s/ James K. Vizanko  
James K. Vizanko  
Senior Vice President,  
Chief Financial Officer and Treasurer

April 30, 2004

\_\_\_\_\_  
/s/ Mark A. Schober  
Mark A. Schober  
Senior Vice President and Controller

## EXHIBIT INDEX

**Exhibit  
Number**

---

- 3 Bylaws of ALLETE, Inc., as amended effective March 8, 2004.
- 31(a) Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31(b) Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Section 1350 Certification of Periodic Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

BYLAWS OF

ALLETE, INC.

As Amended Effective March 8, 2004

---

BYLAWS OF  
ALLETE, INC.

Section 1. The annual meeting of the shareholders of this Corporation for the election of Directors and the transaction of such other corporate business as may properly come before such meeting shall be held at a time and place anywhere within or without the State of Minnesota as may be designated by the Board of Directors on the second Tuesday of May in each year after the year 1923, unless such day is a legal holiday, in which case such meeting shall be held on the next day thereafter which is not a legal holiday or a Sunday.

Section 2. Special meetings of the shareholders of this Corporation may be called for any purpose or purposes at any time by the Chairman of the Board, by the President, by the Board of Directors or any two or more members thereof, the Executive Committee, or, in the manner hereinafter provided, by one or more shareholders as permitted under Minnesota law. The place of such special meetings shall be at the registered office of this Corporation in Duluth, Minnesota, or at such other place in Duluth as the Directors may determine.

Upon request in writing, by registered mail or delivered in person to the Chairman of the Board, the President, a Vice-President or Secretary, by any person or persons entitled to call a meeting of shareholders, it shall be the duty of such officer forthwith to cause notice to be given to the shareholders entitled to vote of a meeting to be held at such time as such officer may fix, not less than ninety (90) days after the receipt of such request. If such notice shall not be given within sixty (60) days after delivery or the date of mailing of such request, the person or



persons requesting the meeting may fix the time of meeting and give notice in the manner hereinafter provided.

Notice of special meetings shall state the time, place and purpose thereof.

Section 3. Notice of every meeting of shareholders shall be mailed by the Secretary or the officer or other person performing the Secretary's duties, not more than sixty (60) days and not less than ten (10) days before the meeting, to each shareholder of record entitled to vote, at his or her post office address as shown by this Corporation's records; provided, however, that if a shareholder waives notice thereof before, at, or after the meeting, notice of the meeting to such shareholder is unnecessary. It shall not be necessary to publish notice of any meeting of shareholders.

Section 4. The presence in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting shall constitute a quorum for the transaction of business. In the absence of a quorum, any meeting may be adjourned from time to time.

Section 5. Meetings of the shareholders shall be presided over by the Chairman of the Board, if there be a Chairman of the Board present, otherwise by the President, or, if the President is not present, by a Vice-President, or if neither the President nor a Vice-President is present, by a Chairman to be elected at the meeting. The Secretary of this Corporation shall act as Secretary of such meetings, if present.

Section 6. Subject to the provisions of Article III of the Articles of Incorporation as amended, each shareholder entitled to vote shall be entitled to one vote for each share of voting stock held by the shareholder

and may vote and otherwise act in person or by proxy at each meeting of shareholders.

Section 7. Any unissued stock of this Corporation, not or hereafter authorized, may be issued and disposed of by the Board of Directors at any time and from time to time, to such persons, firms, corporations or associations, upon such terms and for such consideration as the Board of Directors may, in its discretion, determine, except as may be limited by law or by the Articles of Incorporation of this Corporation. Shares of the Corporation's stock may be certificated or uncertificated, as provided under Minnesota law. Certificates of stock shall be of such form and device as the Board of Directors may elect, and shall be signed by the Chairman of the Board or the President or a Vice-President and the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary of this Corporation, but when a certificate is signed by a Transfer Agent or Registrar the signature of any such corporate officer and the corporate seal, if any, upon such certificate may be facsimiles, engraved or printed.

Section 8. The stock of this Corporation shall be transferable or assignable on the books of this Corporation by the holders in person or by attorney, and in the case of stock represented by a certificate on surrender of the certificates therefor. The Board of Directors may appoint one or more transfer agents and registrars of the stock. The Board of Directors may fix a time not exceeding sixty (60) days and not less than ten (10) days preceding the date of any meeting of shareholders as the record date for the determination of the shareholders entitled to notice of and to vote at such meeting, and in such case only shareholders of record on the date so fixed or their legal representatives shall be entitled to notice of and to vote at such meeting, notwithstanding any transfer of

any shares on the books of the Corporation after any record date so fixed. The Board of Directors may close the books of the Corporation against transfer of shares during the whole or any part of such period.

Section 9. Subject to the provisions of Article III of the Articles of Incorporation of this Corporation, (1) the management of this Corporation shall be vested in a Board of Directors, the number of which shall be fixed from time to time exclusively by the Board of Directors pursuant to a resolution adopted by affirmative vote of the majority of the Disinterested Directors, as defined in Article VII of the Articles of Incorporation, but the number of Directors shall be no less than nine (9) and no greater than fifteen (15), but no decrease shall have the effect of shortening the term of any incumbent Director. Directors shall be elected annually by the shareholders by ballot by a majority of all the outstanding stock entitled to vote, to hold office until their successors are elected and qualify; (2) subject to any rights then existing by applicable law with respect to cumulative voting, the shareholders at any meeting by a majority vote of all the outstanding stock entitled to vote, at an election of Directors, may remove any Director and fill the vacancy; (3) subject to the rights of the holders of any class or series of the then outstanding shares of voting capital stock of this Corporation, newly created directorships resulting from an increase in the authorized number of Directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause may be filled only by the shareholders or by the affirmative vote of a majority of the Disinterested Directors then in office, although less than a quorum. Directors so elected shall hold office for a term expiring at the time of the next annual election of Directors by the shareholders and until their successors are duly elected and qualify.

The Board of Directors, as soon as may be after the election in each year, shall elect from their number a Chairman of the Board and shall elect one of their number President of the Corporation, one of whom shall be designated the Chief Executive Officer of the Corporation, and shall also elect one or more Vice-President, a Secretary and Treasurer and shall from time to time appoint such other officers as they may deem proper. The same person may hold more than one office, except those of President and Vice-President. The Board of Directors also may designate, from time to time, former Directors of this Corporation as Directors Emeritus, in recognition of their long and faithful service to this Corporation. Directors Emeritus shall have no duties or responsibilities in connection with the management of the Corporation.

The officers of the Corporation shall have such powers and duties, except as modified by the Board of Directors, as generally pertain to their offices respectively, as well as such powers and duties as from time to time may be conferred upon them by the Board of Directors.

The Board of Directors may, by unanimous affirmative action of the entire Board, designate two or more of their number to constitute an Executive Committee which, to the extent determined by unanimous affirmative action of the entire Board, shall have and exercise the authority of the Board in the management of the business of the Corporation, except the power to fill vacancies in the Board and the power to change the membership of or fill vacancies in said Committee. Any such Executive Committee shall act only in the interval between meetings of the Board, and shall be subject at all times to control and direction of the Board. By unanimous vote, the Board shall have the power at any time to change the membership of such Committee and to fill vacancies in it. The Executive Committee may make such rules for the

conduct of its business and may appoint such Chairman and committees and assistants as it may deem necessary. A majority of the members of said Committee shall constitute a quorum.

Section 10. Meetings of the Board of Directors shall be held at the times fixed by resolution of the Board, or upon call of the Chairman of the Board, the President, or a Vice-President, or any two Directors. The Secretary or officer performing his or her duties shall give two days' notice of all meetings of Directors, provided that a meeting may be held without notice immediately after the annual election, and notice need not be given of regular meetings held at times fixed by resolution of the Board. Meetings may be held at any time without notice if all of the Directors are present, or if those not present waive notice, either before or after the meeting. Notice by mailing to the usual business or residence address of the Director not less than the time above specified before the meeting shall be sufficient. A majority of the Board shall constitute a quorum. Less than such a quorum shall have power to adjourn any meeting from time to time without notice.

Section 11. Any and all officers of this Corporation may be required at any time to give bonds for the faithful discharge of their duties in such sum, or sums, and with such sureties, as the Board of Directors may determine.

Section 12. The term of office of all officers shall be until the next election of Directors and until their respective successors are chosen and qualify, but any officer may be removed from office at any time by the Board of Directors, unless otherwise agreed by agreement in writing duly authorized by the Board of Directors; and no agreement for the employment of any officer for a longer period than one year shall be so authorized.

Section 13. The officers of this Corporation shall have such powers and duties as generally pertain to their offices, respectively, as well as such powers and duties as from time to time shall be conferred upon them by the Board of Directors or the Executive Committee.

In case any officer of the Corporation who shall have signed any bonds or certificates of stock heretofore or hereafter issued by the Corporation, or attested the seal thereon, or whose facsimile signature appears on any bond coupon or stock certificates shall cease to be such officer of the Corporation before the bonds or stock certificates so signed or sealed shall have been authenticated, delivered or issued, such bonds or stock certificates nevertheless may be authenticated, delivered or issued with the same force and effect as though the person or persons who had signed same or attested the seal thereon, or whose facsimile signature appears thereon, had not ceased to be such officer of the Corporation.

The Corporation shall reimburse or indemnify each present and future Director and officer of the Corporation (and his or her heirs, executors and administrators) for or against all expenses reasonably incurred by such Director or officer in connection with or arising out of any action, suit or proceeding in which such Director or officer may be involved by reason of being or having been a Director or officer of the Corporation. Such indemnification for reasonable expenses is to be to the fullest extent permitted by the Minnesota Business Corporation Act, Minnesota Statutes Chapter 302A. By affirmative vote of the Board of Directors or with written approval of the Chairman and Chief Executive Officer, such indemnification may be extended to include agents and employees who are not Directors or officers of the Corporation, but who would otherwise be indemnified for acts and omissions under Chapter

302A of the Minnesota Business Corporation Act, if such agent or employee were an officer of the Corporation.

Reasonable expenses may include reimbursement of attorneys' fees and disbursements, including those incurred by a person in connection with an appearance as a witness.

Upon written request to the Corporation and approval by the Chairman and Chief Executive Officer, an agent or employee for whom indemnification has been extended, or an officer or Director may receive an advance for reasonable expenses if such agent, employee, officer or Director is made or threatened to be made a party to a proceeding involving a matter for which indemnification is believed to be available under Minnesota Statutes Chapter 302A.

The foregoing rights shall not be exclusive of other rights to which any Director or officer may otherwise be entitled and shall be available whether or not the Director or officer continues to be a Director or officer at the time of incurring such expenses and liabilities.

Section 14. A Director of this Corporation shall not be disqualified by his or her office from dealing or contracting with this Corporation, either as vendor, purchaser or otherwise, nor shall any transaction or contract of this Corporation be void or voidable by reason of the fact that any Director, or any firm of which any Director is a member, or any corporation of which any Director is a shareholder or director, is in any way interested in such transaction or contract, provided that such transaction or contract is or shall be authorized, ratified or approved either (1) by vote of a majority of a quorum of the Board of Directors or of the Executive Committee, without counting in such majority of quorum any Director so interested, or being a member of a firm so interested, or

shareholder or a director of a corporation so interested, or (2) by vote at a shareholders' meeting of the holders of a majority of all the outstanding shares of the stock of this Corporation entitled to vote, or by a writing or writings signed by a majority of such holders, nor shall any Director be liable to account to this Corporation for any profit realized by the Director from or through any transaction or contract of this Corporation, authorized, ratified or approved as aforesaid, by reason of the fact that the Director, or any firm of which the Director is a member, or any corporation of which the Director is a shareholder or director, was interested in such transaction or contract; provided however, that this Corporation shall not lend any of its assets to any of its officers or Directors, nor to any of its shareholders on the security of its own shares. Nothing herein contained shall create any liability in the events above described or prevent the authorization, ratification or approval of such contracts or transactions in any other manner provided by law.

Section 15. The Board of Directors is authorized to select such depository or depositories as they shall deem proper for the funds of this Corporation. All checks and drafts against such deposited funds shall be signed by persons to be specified by the Chairman of the Board, by the President or a Vice-President of the Corporation with the concurrence of its Treasurer.

Section 16. The Board of Directors shall have power to authorize the payment of compensation to the Directors for services to this Corporation, including fees for attendance at meetings of the Board of Directors, and to determine the amount of such compensation and fees.

Section 17. The corporate seal of this Corporation shall be in such form as the Board of Directors shall prescribe.



Section 18. The shareholders may alter or amend these Bylaws by a majority vote of all the outstanding stock of this Corporation entitled to vote at any meeting duly held as above provided, the notice of which includes notice of the proposed alteration or amendment. The Board of Directors may also alter or amend these Bylaws at any time by affirmative vote of a majority of the Board of Directors given at a duly convened meeting of the Board of Directors, the notice of which includes notice of the proposed alteration or amendment, subject to the power of the shareholders to change or repeal such Bylaws; provided that the Board of Directors shall not make or alter any Bylaws fixing their number, qualifications, classifications, or term of office, or changing the number of shares required to constitute a quorum for a shareholders' meeting.

---

The undersigned, Secretary of ALLETE, Inc., does hereby certify that the foregoing is a correct and complete copy of the Bylaws of ALLETE, Inc. effective as of March 8, 2004.

/s/ Deborah A. Amberg

Secretary

**RULE 13a-14(a)/15d-14(a) CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald J. Shippar, President and Chief Executive Officer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended March 31, 2004 of ALLETE;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2004

/s/ Donald J. Shippar

Donald J. Shippar  
President and Chief Executive Officer

**RULE 13a-14(a)/15d-14(a) CERTIFICATION BY THE CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James K. Vizanko, Senior Vice President, Chief Financial Officer and Treasurer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended March 31, 2004 of ALLETE;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2004

/s/ James K. Vizanko

James K. Vizanko  
Senior Vice President, Chief Financial Officer  
and Treasurer

**SECTION 1350 CERTIFICATION OF PERIODIC REPORT  
BY THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, each of the undersigned officers of ALLETE, Inc. (ALLETE), does hereby certify that:

1. The Quarterly Report on Form 10-Q of ALLETE for the quarterly period ended March 31, 2004 (Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of ALLETE.

Date: April 29, 2004

/s/ Donald J. Shippar

Donald J. Shippar  
President and Chief Executive Officer

Date: April 29, 2004

/s/ James K. Vizanko

James K. Vizanko  
Senior Vice President, Chief Financial Officer  
and Treasurer

This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability pursuant to that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that ALLETE specifically incorporates it by reference.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to ALLETE and will be retained by ALLETE and furnished to the Securities and Exchange Commission or its staff upon request.