Investment Strategy

Key financial variables to consider in assessing the investment merits of a utility company are the following:

Revenue Growth: For regulated utility operations, it is important to understand variances that are determined by weather, customer growth, and the relative strength of the service area’s economy. For non-regulated businesses, it is important to know if the operations are high margin (i.e., independent power projects) or low margin (i.e., energy trading).

% Return on Equity: A low return on the regulated utility operations must be analyzed to determine if it is the result of milder weather, or operational inefficiencies. Too high a return, however, could result in regulators ordering a rate reduction. The general ROE range for most electric utilities is between 10% and 14%.

Dividend Payout Ratio: Most utilities would like to lower their dividend payout to less than 70% of their earnings. The lower the payout ratio the greater the financial flexibility for developing non-regulated businesses.

% LT Debt of Capitalization: What is the trend? While utilities have historically been highly leveraged, the typical debt to capital ratio has been trending lower due to cutbacks in capital spending and a higher level of equity financing. The majority of utilities want to get (or keep) their debt-to-capital ratios well below the 55% level.

Revenues/Earnings Data  Fiscal year ending Dec. 31

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1Q</td>
<td>193.3</td>
<td>209.0</td>
<td>422.9</td>
<td>373.0</td>
<td>377.3</td>
<td>323.0</td>
</tr>
<tr>
<td>2Q</td>
<td>174.4</td>
<td>186.2</td>
<td>409.9</td>
<td>376.7</td>
<td>405.5</td>
<td>327.0</td>
</tr>
<tr>
<td>3Q</td>
<td>177.4</td>
<td>177.6</td>
<td>397.1</td>
<td>390.0</td>
<td>363.3</td>
<td>323.5</td>
</tr>
<tr>
<td>4Q</td>
<td>192.3</td>
<td>178.6</td>
<td>388.9</td>
<td>366.3</td>
<td>361.6</td>
<td>358.8</td>
</tr>
<tr>
<td>Year</td>
<td>737.4</td>
<td>751.4</td>
<td>1,619</td>
<td>1,507</td>
<td>1,528</td>
<td>1,332</td>
</tr>
</tbody>
</table>

Earnings per Share ($)  
1Q 0.64 0.76 1.38 1.26 1.26 1.29
2Q -1.46 0.08 1.35 1.23 1.59 2.76
3Q 0.58 -0.02 1.41 1.41 1.29 1.50
4Q 0.88 0.55 1.02 0.48 0.90 0.81
Year 0.64 1.37 5.16 4.38 5.04 6.33

Next earnings report expected: Late April

Historical GAAP earnings are as reported.

Key Growth Rates and Averages

<table>
<thead>
<tr>
<th>Past Growth Rate (%)</th>
<th>1 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>9 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>-1.86</td>
<td>-25.26</td>
<td>-13.35</td>
<td>1.05</td>
</tr>
<tr>
<td>Net Income</td>
<td>-54.99</td>
<td>-50.50</td>
<td>-33.10</td>
<td>-7.68</td>
</tr>
</tbody>
</table>

Ratio Analysis (Average)

<table>
<thead>
<tr>
<th>% Return on Equity</th>
<th>2.85</th>
<th>5.71</th>
<th>7.94</th>
<th>9.69</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Margin</td>
<td>2.39</td>
<td>5.48</td>
<td>6.55</td>
<td>7.55</td>
</tr>
<tr>
<td>% LTD of Capitalization</td>
<td>39.15</td>
<td>37.08</td>
<td>39.10</td>
<td>43.32</td>
</tr>
</tbody>
</table>
## Wall Street Opinions/Average (Mean) Opinion: Hold

<table>
<thead>
<tr>
<th>No. of Ratings</th>
<th>% of Total</th>
<th>1 Mo. Prior</th>
<th>3 Mo. Prior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>4</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Buy/Hold</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Hold</td>
<td>3</td>
<td>75</td>
<td>2</td>
</tr>
<tr>
<td>Weak Hold</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Sell</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>No Opinion</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>4</td>
<td>100</td>
<td>4</td>
</tr>
</tbody>
</table>

## Insider Moves
- Insider Buys
- Insider Sells
- Price History

## Dividend Data
Dividend have been paid since 1945

<table>
<thead>
<tr>
<th>Amount($)</th>
<th>Date Decl.</th>
<th>Ex. Div. Date</th>
<th>Stock of Record</th>
<th>Payment Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.315</td>
<td>Apr.29</td>
<td>May.12</td>
<td>May.16</td>
<td>Jun.01 '05</td>
</tr>
<tr>
<td>0.315</td>
<td>Jul.29</td>
<td>Aug.11</td>
<td>Aug.15</td>
<td>Sep.01 '05</td>
</tr>
<tr>
<td>0.315</td>
<td>Oct.28</td>
<td>Nov.10</td>
<td>Nov.15</td>
<td>Dec.01 '05</td>
</tr>
<tr>
<td>0.363</td>
<td>Jan.26</td>
<td>Feb.13</td>
<td>Feb.15</td>
<td>Mar.01 '06</td>
</tr>
</tbody>
</table>

## Company Financials: Fiscal year ending Dec. 31

### Per Share Data ($)

### Tangible Book Value
- 20.03

### Earnings
- 0.64 (1.37)

### Dividends
- 1.25 (2.84)

### Payout Ratio
- 195% (207%)

### Prices
- High: 51.70 (110.14)
- Low: 35.85 (30.78)

### P/E Ratio: High
- 81 (80)

### P/E Ratio: Low
- 56 (22)

### Income Statement Analysis (Million $)
- **Depreciation**: 47.8 (48.7)
- **Maintenance**: NA
- **Fixed Charges Coverage**: NA (4.53)
- **Construction Credits**: NA (Nil)
- **Effective Tax Rate**: 30% (39%)
- **Net Income**: 17.6 (39.1)

### Balance Sheet & Other Financial Data (Million $)
- **Gross Property**: 1,648 (923)
- **Capital Expenditures**: 58.6 (63.0)
- **Net Property**: 860 (883)
- **Capitalization:Long Term Debt**: 388 (390)
- **Capitalization:Preferred**: Nil (Nil)
- **Capitalization:Common**: 603 (630)
- **Total Capital**: 1,135 (1,165)
- **% Operating Ratio**: 83.3 (89.0)
- **% Earned on Net Property**: 20.0 (19.8)
- **% Return on Revenue**: 2.4 (5.2)
- **% Return on Invested Capital**: 10.8 (4.2)
- **% Return on Common Equity**: 2.9 (3.6)

### Capitalization:
- **Common Equity**: 1,459 (1,765)

### Standard & Poor’s Fair Value Rank:
- **YTD Return (% Annualized)**: 53.8 (25.3)
- **One Year Return**: 20.6 (14.8)
- **Three Year Return**: 13.0 (21.0)
- **Five Year Return**: 6.4 (3.3)
- **Value of $10,000 Invested 5 Years Ago**: $13,650 ($11,766)

### Stock Performance

<table>
<thead>
<tr>
<th>Year</th>
<th>S&amp;P 1500</th>
<th>Electric Utilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2003</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2004</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2005</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2006</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

### Wall Street Opinion:
- **Hold**: 3 (75%)
- **Buy**: 4 (100%)
- **Sell**: Nil
- **No Opinion**: 4 (100%)

### Insider Buys
- Apr: 2, May: 25, Jun: 1, Jul: 1, Aug: 1, Sep: 0, Oct: 1, Nov: 0, Dec: 0, Jan: 0, Feb: 0

### Insider Sells
- Apr: 0, May: 0, Jun: 0, Jul: 0, Aug: 0, Sep: 0, Oct: 0, Nov: 0, Dec: 0, Jan: 0, Feb: 0

### Price History

<table>
<thead>
<tr>
<th>Year</th>
<th>Value of $10,000 Invested 5 Years Ago</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>100</td>
</tr>
<tr>
<td>2003</td>
<td>100</td>
</tr>
<tr>
<td>2004</td>
<td>100</td>
</tr>
<tr>
<td>2005</td>
<td>100</td>
</tr>
<tr>
<td>2006</td>
<td>100</td>
</tr>
</tbody>
</table>

### Insider Moves
- **No Opinion**
- **Sell**
- **Weak Hold**
- **Buy/Hold**
- **Buy**

### Sources
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Our fundamental outlook for electric utilities is neutral. After rising 11.7% in 2005, versus a 3.8% increase for the S&P 1500, the S&P Electric Utilities Index was up 1.0% year to date through February 10, versus a 1.9% increase for the S&P 1500. We think the outperformance in 2005 reflected a shift into stocks perceived as defensive, but we believe the sector is now fairly valued. We believe the repeal of the Public Utility Holding Company Act (PUHCA) could further stimulate the consolidation taking place within the industry, as well as open the industry up to acquisitions by non-utility investors, including foreign companies. The stocks of utilities with secure dividends and high yields have benefited from the tax cut on dividends, and with increased free cash flow seen, we expect more companies to increase their dividends.

We expect favorable EPS comparisons for 2005 and 2006, aided by much fewer dilutive issuances of new equity, an increased level of share buybacks, and the divestiture of underperforming non-core businesses. These positives should help offset the high pension-related costs utilities face, which have restricted earnings growth for many companies. The "back to basics" trend that has been taking place has, in our opinion, helped enhance the investment appeal of some companies. While the long-term trend of industry consolidation has slowed, we think the planned mergers of Exelon (EXC: buy, $56) with Public Service Enterprise Group (PEG: hold, $68); Duke Energy (DUK: strong buy, $28) with Cinergy (CIN: buy, $43); and FPL Group (FPL: strong buy, $41) with Constellation Energy (CEG: buy, $58) could revive it.

Given the lingering impact of the California power crisis and the Enron scandal, the deregulation of the industry has slowed to a standstill. We believe it will eventually resume, but in a more judicious manner. While power prices have rebounded significantly from their sharp decline in 2001 and 2002, the extremely high prices of 2000 led many states to adopt a go-slow approach to the separation of generation from transmission and distribution units. In states that required this separation, the utilities were generally allowed to recover their "stranded costs" (costs related to power generating plants that could not be recovered in a competitive market, or to long-term purchased-power contracts). We expect that the successful utilities will be those that pay down debt and provide stable earnings and dividend growth.

--Justin McCann

### Stock Performance

**GICS Sector:** Utilities  
**Sub-Industry:** Electric Utilities

Based on S&P 1500 Indexes  
Month-end Price Performance as of 01/31/06

![Stock Performance Chart](chart-url)

### Quantitative Stock Report

**ALLETE Inc**  
Earnings & Dividend (Quality) Rank: B+  
Standard & Poor’s Fair Value Rank : 1-

**NYSE SYMBOL:** ALE

---

**Sub-Industry : Electric Utilities Peer Group*: Electric & Gas - Mid-sized & Smaller**

<table>
<thead>
<tr>
<th>Peer Group</th>
<th>Stock Symbol</th>
<th>Stk. Mkt. Cap. (Mil. $)</th>
<th>Recent Stock Price</th>
<th>P/E Ratio</th>
<th>12-Mo. Trailing EPS</th>
<th>30-Day Price Chg(%)</th>
<th>1 Year Price Chg(%)</th>
<th>Beta</th>
<th>Yield (%)</th>
<th>Quality Ranking</th>
<th>Ret. on Equity (%)</th>
<th>Pretax Margin (%)</th>
<th>LTD to Cap (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALLETE, Inc.</td>
<td>ALE</td>
<td>1,404</td>
<td>46.56</td>
<td>97</td>
<td>0.48</td>
<td>5%</td>
<td>17%</td>
<td>0.44</td>
<td>3.1</td>
<td>B+</td>
<td>2.9</td>
<td>NM</td>
<td>NA</td>
</tr>
<tr>
<td>DPL Inc.</td>
<td>DPL</td>
<td>3,457</td>
<td>27.11</td>
<td>20</td>
<td>1.38</td>
<td>4%</td>
<td>7%</td>
<td>0.76</td>
<td>3.7</td>
<td>B+</td>
<td>NM</td>
<td>NM</td>
<td>NA</td>
</tr>
<tr>
<td>Sierra Pacific Resources</td>
<td>SRP</td>
<td>2,632</td>
<td>14.35</td>
<td>33</td>
<td>0.44</td>
<td>6%</td>
<td>42%</td>
<td>1.48</td>
<td>Nil</td>
<td>B</td>
<td>NM</td>
<td>NM</td>
<td>NA</td>
</tr>
<tr>
<td>UNTIL Corp</td>
<td>UTL</td>
<td>142</td>
<td>25.31</td>
<td>17</td>
<td>1.51</td>
<td>1%</td>
<td>-6%</td>
<td>0.14</td>
<td>5.5</td>
<td>B</td>
<td>10.4</td>
<td>5.8</td>
<td>51.9</td>
</tr>
</tbody>
</table>

NA-Not Available  
NM-Not Meaningful  
NR-Not Rated.  
*For Peer Groups with more than 15 companies or stocks, selection of issues is based on market capitalization.

Source: S&P

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S&P Analyst Research Notes and other Company News

February 16, 2006
Dec. 15, 2005--ALLETE, Inc. (NYSE:ALE) announced that it named its president and chief executive officer, Donald J. Shippar, to the additional post of chairman, effective Jan. 1, 2006. Mr. Shippar will succeed Bruce Stender, who will remain on the board as lead director.

October 28, 2005
NEW YORK (Standard & Poor’s)--Oct 28, 2005, ALLETE Inc., announced 3Q EPS $0.58 vs. loss of $0.02 and 9 mos. loss per share of $0.21 vs. EPS $0.82. Results exclude a loss of $0.02 & $0.07 for the 3 & 9 mos. of 2005 and income of $0.47 & $2.78 for the 3 & 9 mos. of 2004, fr. discontinued opers. Results for the 9 mos. of 2004 exclude a charge $0.27 fr. an acctg. change.

July 29, 2005
NEW YORK (Standard & Poor’s)--Jul 29, 2005, ALLETE Inc., announced 2Q loss per share of $1.45 vs. EPS $0.08 and 6 mos. loss per share of $0.79 vs. EPS $0.84. Results for 2004 are restated. Share earns. are adjusted for Sep. ’04 1-for-3 reverse stock split. Results exclude losses of $0.03 & $0.05 for the 3 & 6 mos. 2005 and income of $1.21 & $2.31 for the like periods of 2004 all related to discontinued opers. Results for the 6 mos. 2004 also exclude loss of $0.27 related to acctg. change.

April 29, 2005
NEW YORK (Standard & Poor’s)--Apr 29, 2005, ALLETE Inc., announced 1Q EPS $0.66 vs. $0.76. Results exclude loss of $0.02 for 2005 and income of $1.11 for 2004 all from discontinued opers. Results for 2004 also exclude loss of $0.27 related to acctg. change.

February 10, 2005
NEW YORK (Standard & Poor’s)--Feb 10, 2005, ALLETE Inc., announced 4Q EPS $0.55 vs. $0.15 and annual EPS $1.37 vs. $1.08. Results exclude a loss of $0.21 & income of $2.57 for the 2004 4Q & year and income of $3.44 & $7.44 for the like periods of 2003, from discontinued operations. Results for the 2004 year exclude a charge of $0.27 from an accounting change. Results are adjusted for Sept. ’04 1-for-3 reverse stock split.

October 22, 2004
NEW YORK (Standard & Poor’s)--Oct 22, 2004, ALLETE Inc., announced 3Q loss per share of $0.02 vs. EPS $0.40 and 9 mos. EPS $0.82 vs. $0.93. Results for 2004 exclude income of $0.47 and $2.78 per share for the 3 & 9 mos. and income of $1.31 and $4.00 for the 3 & 9 mos. of 2003 all from discontinued operations. Results for the 9 mos of 2004 exclude net charge of $0.27 per share from accounting charges.
Of the total 5 companies following ALE, 4 analysts currently publish recommendations.

Wall Street Consensus Estimates

Fiscal Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Avg Est.</th>
<th>High Est.</th>
<th>Low Est.</th>
<th># of Est.</th>
<th>Est. P/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2.88</td>
<td>2.95</td>
<td>2.80</td>
<td>4</td>
<td>16.2</td>
</tr>
<tr>
<td>2006</td>
<td>2.66</td>
<td>2.70</td>
<td>2.63</td>
<td>4</td>
<td>17.5</td>
</tr>
<tr>
<td>2007 vs. 2006</td>
<td>▲ 8%</td>
<td>▲ 9%</td>
<td>▲ 6%</td>
<td>0%</td>
<td>▼ -7%</td>
</tr>
</tbody>
</table>

Q1'07

|        | 0.88     | 0.88      | 0.88     | 1         | 52.9    |
|        | 0.79     | 0.84      | 0.72     | 4         | 58.9    |
| Q1'07 vs. Q1'06 | ▲ 11% | ▲ 5% | ▲ 22% | ▼ -75% | ▼ -10% |

A company’s earnings outlook plays a major part in any investment decision. Standard & Poor’s organizes the earnings estimates of over 2,300 Wall Street analysts, and provides their consensus of earnings over the next two years. This graph shows the trend in analyst estimates over the past 15 months.
Glossary

S&P Earnings & Dividend (Quality) Rank - Growth and stability of earnings and dividends are deemed key elements in establishing S&P’s earnings and dividend rankings for common stocks, which are designed to capitalize the nature of this record in a single symbol. It should be noted that, however, that the process also takes into consideration certain adjustments and modifications deemed desirable in establishing such rankings. The final score for each stock is measured against a scoring matrix determined by analysis of the scores of a large and representative sample of stocks. The range of scores in the array of this sample has been aligned with the following ladder of rankings:

A+ Highest
A High
A- Above Average
B+ Average
B Below Average
B- Lower
NR Not Ranked

S&P Fair Value Rank - Using S&P’s exclusive proprietary quantitative model, stocks are ranked in one of five groups, ranging from Group 5, listing the most undervalued stocks, to Group 1, the most overvalued issues. Group 5 stocks are expected to generally outperform all others. A positive (+) or negative (-) Timing Index is placed next to the Fair Value ranking to further aid the selection process. A stock with a (+) added to the Fair Value Rank simply means that this stock has a somewhat better chance to outperform other stock with the same Fair Value Rank. A stock with a (-) has a somewhat lesser chance to outperform other stocks with the same Fair Value Rank. The Fair Value rankings imply the following: 5-Stock is significantly undervalued; 4-Stock is moderately undervalued; 3-Stock is fairly valued; 2-Stock is modestly overvalued; 1-Stock is significantly overvalued.

Fair Value Calculation - The current price at which a stock should sell today as calculated by S&P’s computers using our quantitative model based on the company’s earnings, growth potential, return on equity relative to the S&P 500 and its industry group, price to book ratio history, current yield relative to the S&P 500, and other factors.

Investability Quotient (IQ) - The IQ is a measure of investment desirability. It serves as an indicator of potential medium-to-long-term return and as a caution against downside risk. The measure takes into account variables such as technical indicators, earnings estimates, liquidity, financial ratios and selected S&P proprietary measures.

Standard & Poor’s IQ Rationale:

ALLETE Inc

Technical Evaluation - In researching the past market history of prices and trading volume for each company, S&P’s computer models apply special technical methods and formulas to identify and project price trends for the stock.

Relative Strength Rank - Shows, on a scale of 1 to 99, how the stock has performed versus all other companies in S&P’s universe on a rolling 13-week basis.

Global Industry Classification Standard (GICS) - An industry classification standard, developed by Standard & Poor’s in collaboration with Morgan Stanley Capital International (MSCI). GICS is currently comprised of 10 Sectors, 24 Industry Groups, 64 Industries, and 139 Sub-Industries.

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Additional information is available upon request.

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