

September 1, 2003

Give Stock as a Gift:

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Letter to Shareholders:

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ALLETE to Sell Seven Florida Water Systems:

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Energy Services:

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Automotive Services:

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Giving stock as a gift can pay educational dividends, too

It's never too early to begin planning a holiday gift of ALLETE stock for that special someone. For Harriet Hams, gift opportunities come year-around.

The 79-year-old Superior woman gives shares of ALLETE to relatives for graduations, birthdays, and weddings, as well as for Christmas gifts.

Mrs. Hams began giving shares of ALLETE stock to her children and grandchildren about 20 years ago – not long after her daughter, Donna Brown, went to work for ALLETE's electric utility, Minnesota Power.

"Donna told me 'why don't you start giving stock to the kids rather than dishing out money?'" Hams recalled. Before that suggestion, Hams said she'd give gifts of cash or savings bonds to her children and grandchildren. Now she realizes that giving a gift of stock provides something more than a gift of cash or bonds does.

"The difference, I think, is that it's more educational," Hams said. "This way, you're investing in a business and learning about it. You're supporting a company that operates your utilities." Many of Hams' seven children, 14 grandchildren and six great-grandchildren live in the service territory of Minnesota Power or Superior Water, Light and Power, another ALLETE subsidiary.

There are basically two ways to gift shares of stock in ALLETE. If you already own shares of ALLETE stock, you can transfer one or more shares into the name of the gift recipient. You'll need to send a letter of instruction or a stock power form that's available on the "investors" pages of the allete.com web site. All signatures from the account gifting the shares need to be "Medallion Guaranteed." If your stock is in certificates, they will need to be sent in with the Medallion Guaranteed instructions. If your ALLETE shares were purchased through a broker, consult the brokerage company to find out how to transfer shares.



You may want to open an Invest Direct account in the recipient's name if you don't already own shares of ALLETE. Invest Direct is a convenient, no-load way for investors to buy shares; an initial investment of \$250 is needed to open the account.

Transferring shares is not difficult, but different circumstances require different procedures. ALLETE has a variety of colorful gift cards available for you to send the recipient of your gift. In order to get a Christmas present of stock delivered on time, investors should start making plans by early November. To receive the forms needed or for more information about how to give the gift of ALLETE stock, call Shareholder Services at 218-723-3974 or 800-535-3056.

Dear Shareholder

ALLETE to sell seven Florida Water Services systems for \$296 million



I'm very pleased with the way this year is shaping up, both financially and strategically. Midway through 2003, ALLETE's net income and diluted earnings per share from continuing operations are up 12 percent and 11 percent, respectively, compared with 2002. We're on track to reach the 2003 financial targets we set for ourselves when the year began.

By signing an agreement to sell seven of our Florida Water Services systems for \$296 million, we moved another step closer to accomplishing a key strategic goal of exiting this business. We believe that we've served our water customers well.

Since the mid-1980s, we've made capital improvements to meet the service requirements of our water systems. As a result, we've left them in better shape than when we acquired them. Now we've reached a point when we can realize a fair return on a well-made investment. Once the sale is completed, we will have done well by our investors.

In closing, I'd like to express my heartfelt thanks to my friend and longtime colleague Donnie Crandell, who recently retired. Donnie held a number of key positions at ALLETE during a time of significant growth. He helped guide ALLETE through successful investments in communications, water, real estate and automotive services. All of us at ALLETE would like to wish Donnie the best in his future endeavors.

Sincerely,
David G. Gartzke
CEO

ALLETE, Inc. subsidiary Florida Water Services has agreed to sell seven of its Florida water and wastewater systems to governmental entities in Florida for \$296 million payable at closing, which is expected by the end of 2003 pending satisfaction of certain contingencies and regulatory approvals in Florida.

Cash proceeds after transaction costs, retirement of Florida Water debt, and payment of income taxes are estimated at \$158 million, and will be used to retire debt at ALLETE. The sale is expected to result in an after-tax gain to ALLETE of approximately \$55 million.

The water and wastewater systems to be sold through this purchase agreement include those serving the counties of Osceola, Hernando, Citrus, Lee, and Charlotte, and the communities of Marco Island and Palm Coast.

The purchase agreement was signed July 24 by representatives of Florida Water Services and the acquiring communities and represents about two-thirds of Florida Water's assets. Florida Water Services continues to seek buyers for its remaining water and wastewater systems. If interested governmental buyers cannot be found, the remaining systems will be sold to a private purchaser.

ENERGY Services

New BNI Coal dragline under construction in North Dakota

Once it's operational, the new dragline under construction at ALLETE's BNI Coal subsidiary will weigh 4,300 tons, scoop up 82 cubic yards of earth at a time, and be capable of "walking" about 35 steps a day to position itself over a coal deposit.

A dragline is a giant excavating machine that drags a large capacity shovel across soil covering a coal deposit so that other equipment can mine the coal.

The mammoth Bucyrus 8200 dragline will be built to last a quarter-century. Buying a machine with such large capabilities and a \$38 million price tag is not a decision to



be taken lightly, says Mike Hummel, president and general manager of BNI. Hummel expects the new dragline to be uncovering coal for even longer than 25 years.

"Planning for this goes all the way back to the beginning of the mine," Hummel said from the mine site near Center, N.D. "When we designed our initial capacity, we consciously designed to include replacement of an existing smaller dragline midway through the 50-year contract."

ALLETE (then Minnesota Power) purchased Baukol-Noonan Inc. in 1988 and changed the name to BNI Coal Ltd. Operations at the open-pit lignite mine began in 1970. Today, BNI mines about 4.5 million tons per year of lignite to fuel the nearby Milton R. Young steam electric generating stations. Lignite is a soft coal abundant in North Dakota. Hummel said the purchasing process for the new dragline began in 1998. First, he said, "we scoured the used dragline market."

Moving an existing dragline was a mammoth task, and BNI planners wanted to be sure the equipment lasted the full 25 years of expected operation. In August of 2002 the decision was made to sign a purchase agreement with Bucyrus International, located in Milwaukee, Wis. It's one of only two firms that manufacture the huge draglines.

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Minserco employees supervise construction of a new dragline at the BNI mine in Center, N.D.

The machine is so big it will take until at least August of 2004 to erect it at the Center Mine. More than 30 employees of a Bucyrus subsidiary called Minserco are now working on building it. When complete, it will have a boom 355 feet long and a shovel capacity of 125 tons. Fourteen electric motors rated at 1,045 horsepower each will run the hoist, drag, swing and propel functions. A power cable 4 1/2 inches thick will deliver electricity from the Young Generating Station to operate the dragline.

"The mining operation gradually moves away from the (power) plant," explains Mark Moberg, manager of purchasing and maintenance for BNI. The Bucyrus 8200 utilizes a mechanism that allows it to "walk," thereby positioning itself over the coal deposit. Moberg said the dragline typically walks about 35 steps in a 24-hour period. Each step is approximately six feet; BNI operates the mine around the clock.

Two electric generation cooperatives, Minnkota Power and Square Butte, consume virtually all of the lignite mined by BNI. Through a long-term agreement, Minnesota Power purchases from Square Butte about 71 percent of the electricity generated by a 435-megawatt generating unit operated by Minnkota Power at the Young Station.

This synergy is crucial to maintaining Minnesota Power's position as one of the lowest-cost providers of electricity in the Midwest. Besides the added efficiency the mammoth new dragline will bring, its capacity will also allow BNI to perhaps serve additional lignite customers in the future, Hummel said.

AUTOMOTIVE Services

AFC president talks about his customers and growth in dealer financing

Brad Todd, president of Automotive Finance Corporation, answers some fundamental questions about this key ALLETE subsidiary.



AFC President and CEO Brad Todd

Q: Who are AFC's customers?

A: Basically any used vehicle dealer throughout North America. We do business in every state and every province in Canada. Our dealers' credit lines range from \$5,000 to \$45 million. We have more than 17,000 dealers with credit lines who purchase vehicles at more at more than 500 auto

Q: How has zero-percent financing on new vehicles affected AFC?

A: Zero percent has had both a positive and negative effect. It causes consumers who wouldn't otherwise purchase a vehicle to come into the marketplace. It also allows the consumer who planned to purchase a used vehicle the chance to buy a new one. What affects us more than zero percent financing is the economy itself — along with the slowdown of used vehicle sales. It's similar to the housing industry. When the economy is strong, people who wouldn't necessarily buy a house do so, and the same is true with a vehicle. When the economy is sluggish, people who would have bought a nicer home might have to drop a tier or two. But a vehicle is not a necessity. You don't have to have a new vehicle. So consumers keep their vehicles longer and our dealers don't need to floorplan as much inventory.

Q: How has AFC managed to produce steady earnings, year-in and year-out?

A: The secret is the great employee base — hiring the right individual for the job. Then we train them on our processes and additional management skills. Another plus is we stick

auctions and hundreds of non-auction locations. About 30 percent of the vehicles purchased by our dealers are bought at Adesa sales.

Q: What is floorplanning?

A: Floorplanning is providing financing, per vehicle, for a short period — usually 30 to 90 days. We charge an administrative fee and an interest rate for each term. Floorplanning allows the dealer to purchase a car or truck at auction, house it on his lot and sell it to the ultimate consumer. We don't actually own the vehicle and we don't finance the vehicles for retail customers.

Q: How much business do you do?

A: In 1997 we averaged about \$170 million dollars per month, or a little more than \$2 billion per year, in floorplan receivables. This year we are averaging more than \$475 million dollars per month, which annualizes to more than \$5 billion in floorplan receivables. This equates to about one million financial transactions per year at AFC.

to our niche. We don't try to build vehicles. We know we're good at financing vehicles. When the economy started having a few glitches, we focused on the collection side or the back-end functions and this helped the loan portfolio performance. Lastly, our computer system is state-of-the-art and has allowed us to expand and better manage the portfolio over the last three years.