



ALLETE Inc (ALE)

Updated August 6th, 2024 by Quinn Mohammed

Key Metrics

Current Price:	\$64	5 Year CAGR Estimate:	10.2%	Market Cap:	\$3.7 B
Fair Value Price:	\$65	5 Year Growth Estimate:	6.5%	Ex-Dividend Date¹:	08/15/2024
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.3%	Dividend Payment Date¹:	09/01/2024
Dividend Yield:	4.4%	5 Year Price Target:	\$89	Years of Dividend Growth:	13
Dividend Risk Score:	C	Retirement Suitability Score:	B	Rating:	Buy

Overview & Current Events

ALLETE is an electric services company which operates primarily in the upper Midwest and invests in transmission infrastructure and other energy-related businesses. ALLETE owns Minnesota Power electric utility which serves over 145,000 residents in 14 municipalities and certain large industrial customers. ALLETE's other businesses include BNI Energy, ALLETE Clean Energy, Superior Water, Light and Power and ALLETE Renewable Resources. The corporation has over 1,500 employees. The company can trace its roots back to 1906, when it was built on the hydropower of Minnesota's St. Louis River, and it remains headquartered in Duluth, Minnesota. The utility company has a market capitalization of \$3.7 billion and trades on the NYSE under the ticker symbol ALE.

On April 15th, 2022, ALLETE completed its acquisition of New Energy Equity, a top distributed solar developer in the U.S., for roughly \$166 million. New Energy has completed more than 250 distributed solar projects totaling over 330 megawatts across the U.S. Additionally, New Energy had a development pipeline of roughly 2 gigawatts across 26 states over the following three years.

On January 26th, 2024, ALLETE announced a 4% increase to the dividend to \$2.82 per share annually.

On May 6th, 2024, ALLETE announced that it entered into an agreement to be acquired by a partnership of Canada Pension Plan Investment Board and Global Infrastructure Partners for \$67.00 per share cash. Closing of the deal is expected in mid-2025, at which point ALLETE will become a private company.

ALLETE reported second quarter 2024 results on August 1st, 2024. The company reported consolidated earnings of \$0.57 per share, a 37% decrease compared to \$0.90 earned in Q2 2023. The corporation's regulated operations segment generated net income of \$33.7 million, while the clean energy segment reported net income of \$2.4 million.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$2.90	\$3.38	\$3.14	\$3.13	\$3.38	\$3.33	\$3.35	\$3.23	\$3.38	\$4.30	\$3.82	\$5.23
DPS	\$1.96	\$2.02	\$2.08	\$2.14	\$2.24	\$2.35	\$2.47	\$2.52	\$2.60	\$2.71	\$2.82	\$3.27
Shares²	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5	56.0	57.4	57.7	65.0

ALLETE's earnings have been up and down in the last decade, but they have certainly trended upwards over the long term. The 9-year and 5-year average growth rate of 4.5% and 4.9% are consistent, but ALLETE has targeted average EPS growth of 5% to 7% annually from 2025 through 2028, all while maintaining the dividend which it has paid since 1948. We would estimate it can accomplish approximately 6.5% annual growth over the next five years, owing to rate increases in its regulated operations (Minnesota Power), and the expansion of the clean energy portfolio.

The company will both develop renewable projects in-house or purchase assets through acquisitions to build growth. A recent example would be the acquisition of New Energy Equity, which has a strong development pipeline. The company increased its 5-year capital plan by \$1 billion, now up to a total of \$4.3 billion of investments going towards transmission and clean energy initiatives. ALLETE is one of the largest investors in renewable energy based on market capitalization.

¹ Estimate

² In millions

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Renewables have become more cost-competitive over the years and many U.S. states and corporations have clean energy goals, which should prove to be another tailwind for ALE. Additionally, federal tax policy encourages the expansion of renewable energy through tax credits.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	17.2	15.1	18.6	23.0	22.2	24.7	18.3	21.2	17.5	17.0	16.8	17.0
Avg. Yld.	3.9%	4.0%	3.6%	3.0%	3.0%	2.9%	4.0%	3.8%	4.0%	4.5%	4.4%	3.7%

The current P/E of 16.8 is a discount to ALE's historical PE ratio. In the past nine years and five years, the average PE was 19.5 and 19.7, respectively. We believe that shares earn a valuation of 17.0 times earnings in the intermediate term, which implies a valuation tailwind. The yield is fairly attractive at 4.4%, which is more than three times the yield of the S&P 500 Index.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	68%	60%	66%	68%	66%	71%	74%	78%	77%	63%	74%	62%

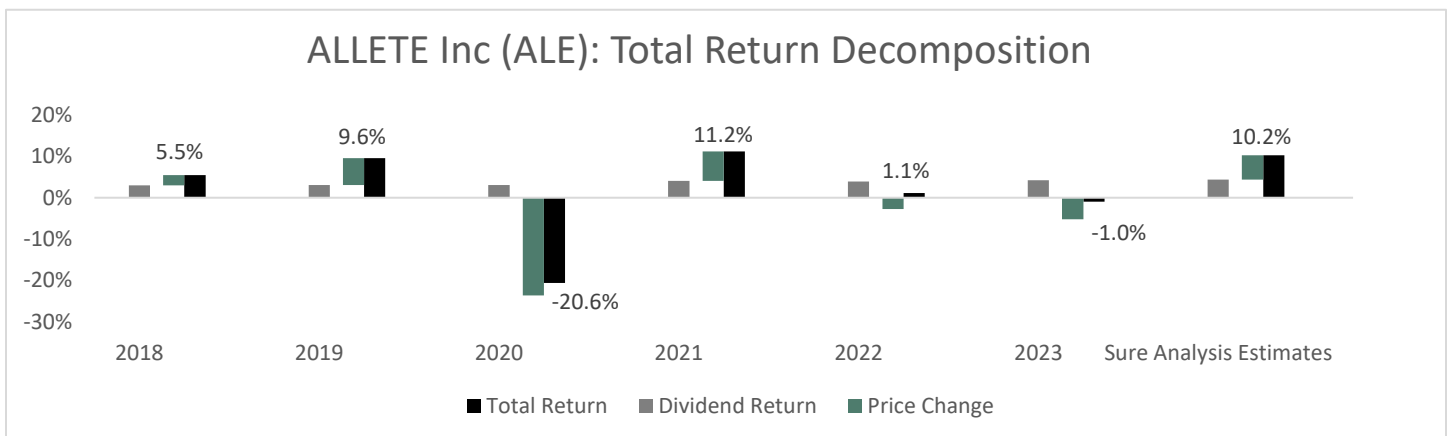
ALLETE maintains a target payout ratio in the range of 60% to 65%. The estimated payout ratio for 2024 of 74% is just above its target of 60% to 70%, but we don't see this as a threat to the dividend as utilities generate a solid stream of recurring, predictable revenue. We expect that the payout ratio will come back down in the years ahead.

The company's business was negatively affected by the financial crisis, as it saw earnings fall 39% from 2007 to 2009. In fact, it took until 2015 for the company to exceed its prior earnings achieved in 2007. However, despite these significant drops, the dividend was maintained, and the payout ratio grew to 93% at its peak. Since the crisis, the company has raised the dividend for thirteen consecutive years. We don't believe ALE has a significant competitive advantage over other energy services companies or renewable companies, but it does boast about its investment spend in renewable energy, particularly among regulated utilities with renewable assets.

Final Thoughts & Recommendation

ALLETE has a promising growth strategy in renewable assets, and large investment plans. The corporation has raised its dividend for thirteen consecutive years and has paid it since 1948. We estimate the company could produce 10.2% annualized total returns over the next five years. The 4.4% yield and 6.5% earnings-per-share growth rate are accompanied by the potential for 0.3% P/E multiple expansion. ALE maintains its buy rating. Furthermore, the current price represents a 5% discount on the acquisition price, which is expected to close in about one year.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	1,137	1,486	1,340	1,419	1,499	1,241	1,169	1,419	1,571	1,880
Gross Profit	370	468	456	460	463	435	425	454	447	490
Gross Margin	32.6%	31.5%	34.1%	32.4%	30.9%	35.1%	36.3%	32.0%	28.4%	26.1%
D&A Exp.	136	172	201	182	210	212	228	242	250	259
Operating Profit	189	247	207	225	199	180	151	151	134	181
Op. Margin	16.6%	16.6%	15.4%	15.9%	13.3%	14.5%	12.9%	10.7%	8.5%	9.6%
Net Profit	125	141	155	172	174	186	174	169	189	247
Net Margin	11.0%	9.5%	11.6%	12.1%	11.6%	15.0%	14.9%	11.9%	12.1%	13.1%
Free Cash Flow	-329	53	69	194	119	-350	-418	-210	0.8	314
Income Taxes	37	25	20	15	-16	-7	-40	-27	-31	28

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	4,361	4,895	4,877	5,080	5,165	5,483	6,085	6,435	6,846	6,656
Cash & Equivalents	146	97	28	99	69	69	44	45	36	72
Accts Receivable	86	105	107	113	122	77	94	101	107	107
Inventories	81	117	104	96	87	73	74	98	456	175
Total Liabilities	2,750	3,072	2,984	3,012	3,009	3,147	3,284	3,489	3,497	3,250
Accounts Payable	134	89	74	136	150	165	110	111	103	102
Long-Term Debt	1,377	1,594	1,558	1,503	1,486	1,614	1,797	1,977	1,921	1,791
Total Equity	1,609	1,820	1,893	2,068	2,156	2,232	2,295	2,413	2,692	2,810
LTD/E Ratio	0.86	0.88	0.82	0.73	0.69	0.72	0.78	0.82	0.71	0.64

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.2%	3.0%	3.2%	3.5%	3.4%	3.5%	3.0%	2.7%	2.9%	3.7%
Return on Equity	8.5%	8.2%	8.4%	8.7%	8.2%	8.5%	7.7%	7.2%	7.4%	7.3%
ROIC	4.6%	4.4%	4.5%	4.9%	4.8%	4.9%	4.1%	3.6%	3.7%	4.7%
Shares Out.	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5	56.0	57.4
Revenue/Share	26.38	30.71	27.06	27.83	29.10	23.99	22.53	27.03	28.05	32.75
FCF/Share	-7.63	1.10	1.40	3.81	2.31	-6.77	-8.05	-4.00	0.01	5.47

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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