ALLETE Inc (ALE)

Updated August 3rd, 2022 by Quinn Mohammed

Key Metrics

Current Price:	$63	**5 Year CAGR Estimate:**	10.9%	**Market Cap:**	$3.5 B
Fair Value Price:	$75	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date[1]:**	08/12/2022
% Fair Value:	84%	**5 Year Valuation Multiple Estimate:**	3.5%	**Dividend Payment Date[2]:**	09/01/2022
Dividend Yield:	4.1 %	**5 Year Price Target:**	$91	**Years of Dividend Growth:**	11
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 15 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 nearly 1,400 employees. ALLETE can trace its roots back to 1906, when it was built on the hydropower of Minnesota's St. Louis River and remains headquartered in Duluth, Minnesota. The utility company has a market capitalization of $3.5 billion and trades on the NYSE under the ticker symbol ALE.

On April 15th, 2022, ALLETTE 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 has a development pipeline of roughly 2 gigawatts across 26 states over the next three years.

ALLETTE released second quarter 2022 results on August 3rd. ALE reported consolidated earnings of $0.67 per share, a 26% increase over the $0.53 earned in Q2 2021. The corporation's regulated operations segment generated net income of $29.6 million, while the clean energy segment reported net income of $5.8 million.

Leadership reaffirmed their fiscal 2022 outlook for earnings to come in between $3.60 and $3.90, for a $3.75 mid-point.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.58	$2.63	$2.90	$3.38	$3.14	$3.13	$3.38	$3.33	$3.35	$3.23	***$3.75***	***$4.56***
DPS	$1.84	$1.90	$1.96	$2.02	$2.08	$2.14	$2.24	$2.35	$2.47	$2.57	***$2.60***	***$3.01***
Shares[3]	39.4	41.4	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5	***55.0***	***60.0***

ALETTE's earnings have been up and down in the last decade, but they have certainly trended up over the long term. The 9-year average growth rate of 2.5% is nothing impressive, but ALLETE has targeted a minimum average EPS growth of 5% to 7% percent annually going forward, all while maintaining the dividend which it has paid since 1948. We would estimate they can accomplish roughly 4% annual growth owing to rate increases in their regulated operations (Minnesota Power), expansion of the clean energy portfolio (200 MW of wind projects is scheduled to be in service in 2025, and 250 MW + of solar projects will come online between 2022 and 2026). 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 is planning for 75% or more of their investments over the next five years to be in renewable energy. ALE is the largest investor in wind and solar energy as a percent of market capitalization in North American regulated utilities with renewable assets and a $1 billion+ market cap.

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[1] Estimate

[2] Estimate

[3] 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	15.9	18.6	17.2	15.1	18.6	23.0	22.2	24.7	18.3	21.2	***16.8***	***20.0***
Avg. Yld.	4.5%	3.9%	3.9%	4.0%	3.6%	3.0%	3.0%	2.9%	4.0%	3.8%	***4.1%***	***3.3%***

The current P/E of 16.8 is a discount to ALE's historical PE ratio. In the past five years, the average PE was 19.5. In the past five years, this average PE has grown to be 21.9 as its renewable strategy may be tipping the valuation a little higher. We believe that shares earn a valuation of 20 times earnings in the intermediate term, which would result in valuation gains of 3.5% annually due to the expanding valuation. The yield is quite attractive at 4.1%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	71%	72%	68%	60%	66%	68%	66%	71%	74%	80%	***69%***	***66%***

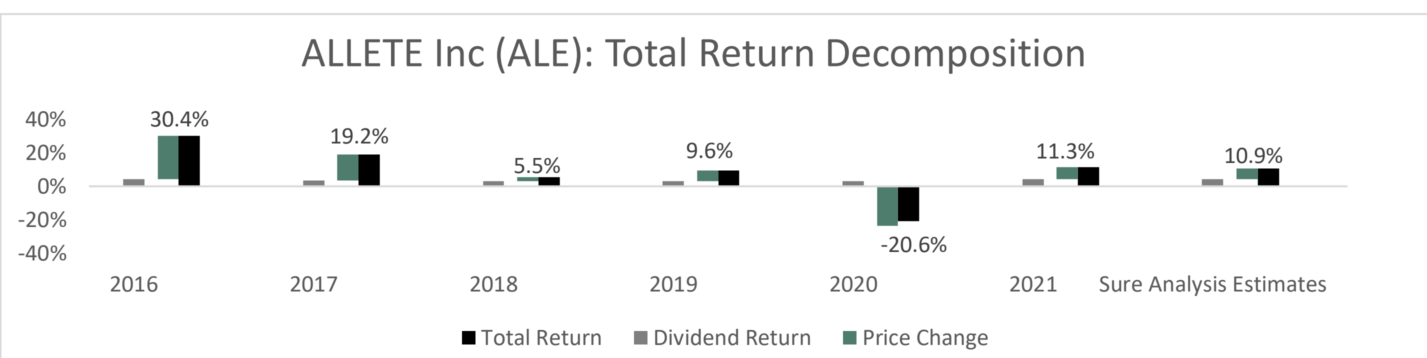
ALLETE maintains a target payout ratio in the range of 60% to 65%, and they are now eclipsing this, and meaningfully so in 2021. The estimated payout ratio of 69% is higher than target, but we don't see this as a significant threat to the dividend as utilities often have a solid stream of recurring, predictable revenue. Nevertheless, this should be noted. We expect that the payout ratio will come back down in the years to come.

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 eclipse their 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 eleven consecutive years. We don't believe ALE has a significant competitive advantage over other energy services companies or renewable companies, but they do boast about their 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 the dividend for eleven consecutive years and has paid it since 1948. We estimate the company could produce 10.9% in annualized total returns on average over the next five years. The 4.1% yield and 4% earnings growth are accompanied by the potential for a 3.5% valuation expansion. Shares are trading at the lower end of their average valuation, at around 84% fair value according to our estimates. We rate shares a buy today.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	961	1,018	1,137	1,486	1,340	1,419	1,499	1241	1,169	1419
Gross Profit	255	312	370	468	456	460	463	435	425	454
Gross Margin	26.6%	30.7%	32.6%	31.5%	34.1%	32.4%	30.9%	35.1%	36.3%	32.0%
D&A Exp.	101	118	136	172	201	182	210	212	228	242
Operating Profit	155	154	189	247	207	225	199	180	151	151
Op. Margin	16.1%	15.1%	16.6%	16.6%	15.4%	15.9%	13.3%	14.5%	12.9%	10.7%
Net Profit	97	105	125	141	155	172	174	186	174	169
Net Margin	10.1%	10.3%	11.0%	9.5%	11.6%	12.1%	11.6%	15.0%	14.9%	11.9%
Free Cash Flow	-166	-89	-329	53	69	194	119	-350	-418	-210
Income Taxes	38	29	37	25	20	15	-16	-7	-40	-27

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	3,253	3,477	4,361	4,895	4,877	5,080	5,165	5,483	6,085	6,435
Cash & Equivalents	81	97	146	97	28	99	69	69	44	45
Accts Receivable	70	79	86	105	107	113	122	77	94	101
Inventories	70	59	81	117	104	96	87	73	74	98
Total Liabilities	2,052	2,134	2,750	3,072	2,984	3,012	3,009	3,147	3,284	3,489
Accounts Payable	91	100	134	89	74	136	150	165	110	111
Long-Term Debt	1,018	1,110	1,377	1,594	1,558	1,503	1,486	1,614	1,797	1,977
Total Equity	1,201	1,343	1,609	1,820	1,893	2,068	2,156	2,232	2,295	2,413
LTD/E Ratio	0.85	0.83	0.86	0.88	0.82	0.73	0.69	0.72	0.78	0.82

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	3.2%	3.1%	3.2%	3.0%	3.2%	3.5%	3.4%	3.5%	3.0%	2.7%
Return on Equity	8.5%	8.2%	8.5%	8.2%	8.4%	8.7%	8.2%	8.5%	7.7%	7.2%
ROIC	4.7%	4.5%	4.6%	4.4%	4.5%	4.9%	4.8%	4.9%	4.1%	3.6%
Shares Out.	39.4	41.4	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5
Revenue/Share	25.56	25.59	26.38	30.71	27.06	27.83	29.10	23.99	22.53	27.03
FCF/Share	-4.42	-2.24	-7.63	1.10	1.40	3.81	2.31	-6.77	-8.05	-4.00

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