



ALLETE Inc (ALE)

Updated August 10th, 2023 by Quinn Mohammed

Key Metrics

Current Price:	\$57	5 Year CAGR Estimate:	12.2%	Market Cap:	\$3.3 B
Fair Value Price:	\$65	5 Year Growth Estimate:	6.0%	Ex-Dividend Date¹:	08/14/2023
% Fair Value:	88%	5 Year Valuation Multiple Estimate:	2.5%	Dividend Payment Date²:	09/01/2023
Dividend Yield:	4.7%	5 Year Price Target:	\$87	Years of Dividend Growth:	12
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 over 1,500 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 \$3.3 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 February 3rd, 2023, ALLETE announced a 4% increase to the dividend to \$2.71 per share annually.

ALLETE reported second quarter 2023 results on August 8th, 2023. ALLETE reported consolidated earnings of \$0.90 per share, a 34% increase compared to \$0.67 earned in Q2 2022. The corporation's regulated operations segment generated net income of \$37.8 million, while the clean energy segment reported net income of just \$3.1 million.

Leadership reaffirmed their fiscal 2023 outlook for EPS to come in between \$3.55 to \$3.85, for a \$3.70 mid-point.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$2.63	\$2.90	\$3.38	\$3.14	\$3.13	\$3.38	\$3.33	\$3.35	\$3.23	\$3.38	\$3.70	\$4.95
DPS	\$1.90	\$1.96	\$2.02	\$2.08	\$2.14	\$2.24	\$2.35	\$2.47	\$2.52	\$2.60	\$2.71	\$3.14
Shares³	41.4	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5	56.0	58.0	65.0

ALLETE'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 2.8% is nothing impressive, but ALLETE has targeted average EPS growth of 5% to 7% annually going forward, all while maintaining the dividend which it has paid since 1948. We would estimate they can accomplish roughly 6.0% annual growth, owing to rate increases in their 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 is planning for 75% or more of their investments over the next five years to be in renewable energy. ALLETE is one of the largest investors in renewable energy based on market capitalization.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	18.6	17.2	15.1	18.6	23.0	22.2	24.7	18.3	21.2	17.5	15.4	17.5
Avg. Yld.	3.9%	3.9%	4.0%	3.6%	3.0%	3.0%	2.9%	4.0%	3.8%	4.0%	4.7%	3.6%

The current P/E of 15.4 is a discount to ALE's historical PE ratio. In the past nine years, the average PE was 19.6. In the past five years, this average PE has grown to be 20.8 as its renewable strategy may be tipping the valuation a little higher. We believe that shares earn a valuation of 17.5 times earnings in the intermediate term, which implies a valuation tailwind. The yield is fairly attractive at 4.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	72%	68%	60%	66%	68%	66%	71%	74%	78%	77%	73%	63%

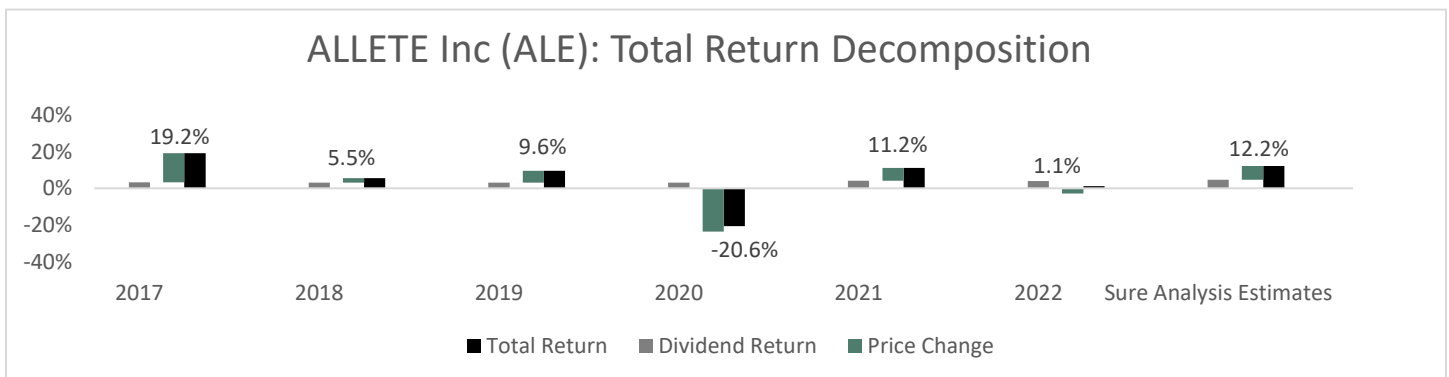
ALLETE maintains a target payout ratio in the range of 60% to 65%, and they are now eclipsing this, and meaningfully so. The estimated payout ratio of 73% is higher than target, but we don't see this as a significant threat to the dividend as utilities often have a solid stream of recurring, predictable 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 exceed 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 twelve 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 twelve consecutive years and has paid it since 1948. We estimate the company could produce 12.2% annualized total returns over the next five years. The 4.7% yield and 6.0% earnings-per-share growth are accompanied by the potential for a 2.5% valuation expansion. Shares are trading at the lower end of their average valuation, at around 88% of our fair value estimate. We rate shares a buy today.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,018	1,137	1,486	1,340	1,419	1,499	1,241	1,169	1,419	1,571
Gross Profit	312	370	468	456	460	463	435	425	454	447
Gross Margin	30.7%	32.6%	31.5%	34.1%	32.4%	30.9%	35.1%	36.3%	32.0%	28.4%
D&A Exp.	118	136	172	201	182	210	212	228	242	250
Operating Profit	154	189	247	207	225	199	180	151	151	134
Op. Margin	15.1%	16.6%	16.6%	15.4%	15.9%	13.3%	14.5%	12.9%	10.7%	8.5%
Net Profit	105	125	141	155	172	174	186	174	169	189
Net Margin	10.3%	11.0%	9.5%	11.6%	12.1%	11.6%	15.0%	14.9%	11.9%	12.1%
Free Cash Flow	-89	-329	53	69	194	119	-350	-418	-210	0.8
Income Taxes	29	37	25	20	15	-16	-7	-40	-27	-31

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	3,477	4,361	4,895	4,877	5,080	5,165	5,483	6,085	6,435	6,846
Cash & Equivalents	97	146	97	28	99	69	69	44	45	36
Accts Receivable	79	86	105	107	113	122	77	94	101	107
Inventories	59	81	117	104	96	87	73	74	98	456
Total Liabilities	2,134	2,750	3,072	2,984	3,012	3,009	3,147	3,284	3,489	3,497
Accounts Payable	100	134	89	74	136	150	165	110	111	103
Long-Term Debt	1,110	1,377	1,594	1,558	1,503	1,486	1,614	1,797	1,977	1,921
Total Equity	1,343	1,609	1,820	1,893	2,068	2,156	2,232	2,295	2,413	2,692
LTD/E Ratio	0.83	0.86	0.88	0.82	0.73	0.69	0.72	0.78	0.82	0.71

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	3.1%	3.2%	3.0%	3.2%	3.5%	3.4%	3.5%	3.0%	2.7%	2.9%
Return on Equity	8.2%	8.5%	8.2%	8.4%	8.7%	8.2%	8.5%	7.7%	7.2%	7.4%
ROIC	4.5%	4.6%	4.4%	4.5%	4.9%	4.8%	4.9%	4.1%	3.6%	3.7%
Shares Out.	41.4	45.9	49.1	49.6	51.1	51.2	51.7	52.1	52.5	56.0
Revenue/Share	25.59	26.38	30.71	27.06	27.83	29.10	23.99	22.53	27.03	28.05
FCF/Share	-2.24	-7.63	1.10	1.40	3.81	2.31	-6.77	-8.05	-4.00	0.01

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

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