SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended **JUNE 30, 2005**

or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number **1-3548**

ALLETE, Inc.

(Exact name of registrant as specified in its charter)

Minnesota	**41-0418150**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

30 West Superior Street
Duluth, Minnesota 55802-2093
(Address of principal executive offices)
(Zip Code)

(218) 279-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Yes __X__ No ____

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes __X__ No ____

Common Stock, no par value,
29,992,521 shares outstanding
as of June 30, 2005

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DEFINITIONS

The following abbreviations or acronyms are used in the text. References in this report to "we," "us" and "our" are to ALLETE, Inc. and its subsidiaries, collectively.

Abbreviation or Acronym	Term
2004 Form 10-K	ALLETE's Annual Report on Form 10-K for the Year Ended December 31, 2004
ADESA	ADESA, Inc.
AICPA	American Institute of Certified Public Accountants
ALLETE	ALLETE, Inc.
ALLETE Properties	ALLETE Properties, Inc.
APB	Accounting Principles Board
Aqua America	Aqua America, Inc.
BNI Coal	BNI Coal, Ltd.
Boswell	Boswell Energy Center
Company	ALLETE, Inc. and its subsidiaries
Constellation Energy Commodities	Constellation Energy Commodities Group, Inc.
Enventis Telecom	Enventis Telecom, Inc.
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Florida Landmark	Florida Landmark Communities, Inc.
Florida Water	Florida Water Services Corporation
FPSC	Florida Public Service Commission
FSP	Financial Accounting Standards Board Staff Position
GAAP	Accounting Principles Generally Accepted in the United States
Hibbard	Hibbard Energy Center
Laskin	Laskin Energy Center
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midwest Independent Transmission System Operator, Inc.
MPUC	Minnesota Public Utilities Commission
MW	Megawatt(s)
Note ___	Note ___ to the consolidated financial statements in this Form 10-Q
PSCW	Public Service Commission of Wisconsin
Rainy River Energy	Rainy River Energy Corporation
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards No.
Split Rock Energy	Split Rock Energy LLC
Square Butte	Square Butte Electric Cooperative
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
WDNR	Wisconsin Department of Natural Resources

SAFE HARBOR STATEMENT
UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are hereby filing cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) made by or on behalf of ALLETE in this Quarterly Report on Form 10-Q, in presentations, in response to questions or otherwise. Any statements that express, or involve discussions as to expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “will likely result,” “will continue,” “could,” “may,” “potential,” “target,” “outlook” or similar expressions) are not statements of historical facts and may be forward-looking.

Forward-looking statements involve estimates, assumptions, risks and uncertainties and are qualified in their entirety by reference to, and are accompanied by, the following important factors, in addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements, which are difficult to predict, contain uncertainties, are beyond our control and may cause actual results or outcomes to differ materially from those contained in forward-looking statements:

- our ability to successfully implement our strategic objectives;
- prevailing governmental policies and regulatory actions, including those of the United States Congress, state legislatures, the FERC, the MPUC, the FPSC, the PSCW, and various local and county regulators, and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, real estate development, operation and construction of plant facilities, recovery of purchased power and capital investments, present or prospective wholesale and retail competition (including but not limited to transmission costs), and zoning and permitting of land held for resale;
- effects of restructuring initiatives in the electric industry;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with environmental and safety laws and policies;
- weather conditions;
- natural disasters;
- war and acts of terrorism;
- wholesale power market conditions;
- population growth rates and demographic patterns;
- the effects of competition, including competition for retail and wholesale customers;
- pricing and transportation of commodities;
- changes in tax rates or policies or in rates of inflation;
- unanticipated project delays or changes in project costs;
- unanticipated changes in operating expenses and capital expenditures;
- global and domestic economic conditions;
- our ability to access capital markets;
- changes in interest rates and the performance of the financial markets;
- competition for economic expansion or development opportunities;
- our ability to manage expansion and integrate acquisitions; and
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this report are discussed in Item 7 under the heading “Factors that May Affect Future Results” beginning on page 36 of our 2004 Form 10-K. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which that statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all of these factors, nor can it assess the impact of each of these factors on the businesses of ALLETE or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement. Readers are urged to carefully review and consider the various disclosures made by us in our 2004 Form 10-K and in our other reports filed with the SEC that attempt to advise interested parties of the factors that may affect our business.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ALLETE
CONSOLIDATED BALANCE SHEET
Millions - Unaudited

	June 30, 2005	December 31, 2004
Assets		
Current Assets		
Cash and Cash Equivalents	$ 79.1	$ 44.9
Restricted Cash	–	30.3
Short-Term Investments	63.0	149.2
Accounts Receivable (Less Allowance of $2.0 and $2.0)	72.4	86.1
Inventories	36.2	34.0
Prepayments and Other	18.5	21.6
Deferred Income Taxes	25.8	–
Discontinued Operations	1.8	2.0
Total Current Assets	296.8	368.1
Property, Plant and Equipment – Net	883.0	883.1
Investments	123.3	124.5
Other Assets	48.1	52.8
Discontinued Operations	2.2	2.9
Total Assets	$1,353.4	$1,431.4
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	$ 29.4	$ 40.0
Accrued Taxes	22.3	23.3
Accrued Interest	7.7	6.9
Long-Term Debt Due Within One Year	1.7	1.8
Deferred Profit on Sales of Real Estate	7.7	1.1
Other	16.9	24.7
Discontinued Operations	6.5	12.0
Total Current Liabilities	92.2	109.8
Long-Term Debt	389.3	390.2
Deferred Income Taxes	136.1	143.9
Other Liabilities	153.4	151.4
Minority Interest	6.0	5.6
Total Liabilities	777.0	800.9
Commitments and Contingencies		
Shareholders' Equity		
Common Stock Without Par Value, 43.3 Shares Authorized 30.0 and 29.7 Shares Outstanding	412.9	400.1
Unearned ESOP Shares	(79.3)	(51.4)
Accumulated Other Comprehensive Loss	(11.4)	(11.4)
Retained Earnings	254.2	293.2
Total Shareholders' Equity	576.4	630.5
Total Liabilities and Shareholders' Equity	$1,353.4	$1,431.4

The accompanying notes are an integral part of these statements.

ALLETE
CONSOLIDATED STATEMENT OF INCOME
Millions Except Per Share Amounts - Unaudited

	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Operating Revenue	$186.8	$186.2	$393.7	$395.2
Operating Expenses				
Fuel and Purchased Power	70.3	77.2	139.4	146.1
Operating and Maintenance	81.6	77.2	164.7	160.8
Kendall County Charge	77.9	–	77.9	–
Depreciation	12.7	12.5	25.3	24.9
Total Operating Expenses	242.5	166.9	407.3	331.8
Operating Income (Loss) from Continuing Operations	(55.7)	19.3	(13.6)	63.4
Other Income (Expense)				
Interest Expense	(6.7)	(9.1)	(13.5)	(18.2)
Other	1.5	(3.5)	(2.7)	(3.1)
Total Other Expense	(5.2)	(12.6)	(16.2)	(21.3)
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	(60.9)	6.7	(29.8)	42.1
Minority Interest	0.2	0.5	1.4	1.9
Income (Loss) from Continuing Operations Before Income Taxes	(61.1)	6.2	(31.2)	40.2
Income Tax Expense (Benefit)	(21.5)	3.8	(9.6)	16.4
Income (Loss) from Continuing Operations Before Change in Accounting Principle	(39.6)	2.4	(21.6)	23.8
Income (Loss) from Discontinued Operations – Net of Tax	(0.7)	34.3	(1.3)	65.6
Change in Accounting Principle – Net of Tax	–	–	–	(7.8)
Net Income (Loss)	$ (40.3)	$ 36.7	$ (22.9)	$ 81.6
Average Shares of Common Stock				
Basic	27.2	28.4	27.2	28.2
Diluted	27.2	28.5	27.2	28.4
Basic Earnings (Loss) Per Share of Common Stock				
Continuing Operations	$(1.45)	$0.08	$(0.79)	$0.85
Discontinued Operations	(0.03)	1.21	(0.05)	2.32
Change in Accounting Principle	–	–	–	(0.28)
	$(1.48)	$1.29	$(0.84)	$2.89
Diluted Earnings (Loss) Per Share of Common Stock				
Continuing Operations	$(1.45)	$0.08	$(0.79)	$0.84
Discontinued Operations	(0.03)	1.21	(0.05)	2.31
Change in Accounting Principle	–	–	–	(0.27)
	$(1.48)	$1.29	$(0.84)	$2.88
Dividends Per Share of Common Stock	$0.3150	$0.8475	$0.6150	$1.6950

The accompanying notes are an integral part of these statements.

ALLETE
CONSOLIDATED STATEMENT OF CASH FLOWS
Millions - Unaudited

	Six Months Ended June 30, 2005	2004
Operating Activities		
Income (Loss) from Continuing Operations	$(21.6)	$ 16.0
Change in Accounting Principle	–	7.8
Loss on Impairment of Investments	5.1	5.5
Depreciation	25.3	24.9
Deferred Income Taxes	(34.0)	0.7
Minority Interest	0.4	(0.5)
Changes in Operating Assets and Liabilities		
Short-Term Investments	(1.4)	–
Accounts Receivable	13.7	(8.0)
Inventories	(2.2)	(2.5)
Prepayments and Other	3.1	(5.4)
Accounts Payable	(10.6)	6.5
Other Current Liabilities	(1.4)	(19.5)
Other Assets	4.7	8.4
Other Liabilities	4.8	(1.4)
Net Operating Activities from (for) Discontinued Operations	(5.9)	54.5
Cash from (for) Operating Activities	(20.0)	87.0
Investing Activities		
Proceeds from Sale of Available-For-Sale Securities	271.1	1.6
Payments for Purchase of Available-For-Sale Securities	(183.5)	–
Changes to Investments	(3.4)	9.5
Additions to Property, Plant and Equipment	(24.2)	(34.7)
Other	(1.6)	(1.6)
Net Investing Activities from Discontinued Operations	–	64.9
Cash from Investing Activities	58.4	39.7
Financing Activities		
Issuance of Common Stock	12.8	34.9
Issuance of Long-Term Debt	–	5.6
Changes in Notes Payable – Net	–	(53.0)
Reductions of Long-Term Debt	(1.0)	(4.6)
Dividends on Common Stock	(16.0)	(46.8)
Net Financing Activities from (for) Discontinued Operations	(0.1)	328.9
Cash from (for) Financing Activities	(4.3)	265.0
Effect of Exchange Rate Changes on Cash – Discontinued Operations	–	(6.4)
Change in Cash and Cash Equivalents	34.1	385.3
Cash and Cash Equivalents at Beginning of Period ***(a)***	46.1	226.1
Cash and Cash Equivalents at End of Period ***(a)***	$ 80.2	$611.4
Supplemental Cash Flow Information		
Cash Paid During the Period for		
Interest – Net of Capitalized	$22.4	$26.4
Income Taxes	$13.6	$59.6

(a) Included $1.1 million of cash from Discontinued Operations at June 30, 2005 ($286.9 million at June 30, 2004) and $1.2 million at December 31, 2004 ($116.1 million at December 31, 2003).

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements and notes should be read in conjunction with our 2004 Form 10-K. In our opinion, all adjustments necessary for a fair statement of the results for the interim periods have been made. The results of operations for an interim period may not give a true indication of the results for the year.

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Real Estate Revenue and Expense Recognition. Full profit recognition is recorded on sales upon closing, provided cash collections are at least 20 percent of the contract price and the other requirements of SFAS 66, “Accounting for Sales of Real Estate,” are met. In certain cases, where there are obligations to perform significant development activities after the date of sale, we recognize profit on a percentage-of-completion basis in accordance with SFAS 66. Pursuant to this method of accounting, gross profit is recognized based upon the relationship of development costs incurred as of that date to the total estimated costs to develop the parcels, including all related amenities or common costs of the entire project. Revenue and cost of real estate sold in excess of the amount recognized based on the percentage-of-completion method is deferred and recognized as revenue and cost of real estate sold during the period in which the related development costs are incurred. Revenue and cost of real estate sold are recorded net as Deferred Profit on Sales of Real Estate on our consolidated balance sheet.

Land held for sale is recorded at the lower of cost or fair value determined by the evaluation of individual land parcels. Real estate costs include the cost of land acquired, subsequent development costs and costs of improvements, capitalized development period interest, real estate taxes, and payroll costs of certain employees devoted directly to the development effort. These real estate costs incurred are capitalized to the cost of real estate parcels based upon the relative sales value of parcels within each development project in accordance with SFAS 67, “Accounting for Costs and Initial Rental Operations of Real Estate Projects.” When real estate is sold, the cost of sales includes the actual costs incurred and the estimate of future completion costs allocated to the real estate sold based upon the relative sales value method.

Whenever events or circumstances indicate that the carrying value of the real estate may not be recoverable, impairment losses would be recorded and the related assets would be adjusted to their estimated fair value, less costs to sell.

Revision in the Classification of Certain Securities. In connection with the preparation of this report, we concluded that it was appropriate to reclassify our auction rate municipal bonds and variable rate municipal demand notes as short-term investments. Previously, such investments had been classified as cash and cash equivalents. Accordingly, we now report these securities as short-term investments in a separate line item on our Consolidated Balance Sheet as of December 31, 2004. As of June 30, 2004 and December 31, 2003, we had no investments in these types of securities. Accordingly, there was no impact to our Consolidated Statement of Cash Flows for the period ended June 30, 2004. This change in classification does not affect previously reported cash flows from operations or from financing activities in our previously reported Consolidated Statements of Cash Flows, or our previously reported Consolidated Statements of Income for any period.

For the year ended December 31, 2004, net cash used in investing activities related to these short-term investments of $149.2 million was included in cash and cash equivalents in our Consolidated Statement of Cash Flows.

Short-Term Investments. At June 30, 2005 and December 31, 2004, we held $61.6 million and $149.2 million, respectively, of short-term investments, consisting of auction rate municipal bonds and variable rate municipal demand notes classified as available-for-sale securities. Our investments in these securities are recorded at cost, which approximates fair market value due to their variable interest rates, which typically reset every 7 to 35 days. Despite the long-term nature of their stated contractual maturities, we have the ability to quickly liquidate these securities. As a result, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from our short-term investments. All income generated from these short-term investments was recorded as interest income.

Inventories. Inventories are stated at the lower of cost or market. Cost is determined by the average cost method.

Inventories	June 30, 2005	December 31, 2004
Millions		
Fuel	$13.4	$11.4
Materials and Supplies	22.0	20.4
Other	0.8	2.2
	$36.2	$34.0

Accounting for Stock-Based Compensation. We have elected to account for stock-based compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, we recognize expense for performance share awards granted and do not recognize expense for employee stock options granted. The after-tax expense recognized in net income for performance share awards was approximately $0.6 million for the six months ended June 30, 2005 ($0.8 million for the six months ended June 30, 2004). The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123, "Accounting for Stock-Based Compensation."

Effect of SFAS 123 Accounting for Stock-Based Compensation	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Millions Except Per Share Amounts				
Net Income (Loss)				
As Reported	$(40.3)	$36.7	$(22.9)	$81.6
Plus: Employee Stock Compensation Expense Included in Net Income (Loss) – Net of Tax	0.3	0.4	0.6	0.8
Less: Employee Stock Compensation Expense Determined Under SFAS 123 – Net of Tax	0.3	0.5	0.7	1.0
Pro Forma	$(40.3)	$36.6	$(23.0)	$81.4
Basic Earnings (Loss) Per Share				
As Reported	$(1.48)	$1.29	$(0.84)	$2.89
Pro Forma	$(1.48)	$1.29	$(0.85)	$2.89
Diluted Earnings (Loss) Per Share				
As Reported	$(1.48)	$1.29	$(0.84)	$2.88
Pro Forma	$(1.48)	$1.28	$(0.85)	$2.87

In the previous table, the expense for employee stock options granted determined under SFAS 123 was calculated using the Black-Scholes option pricing model and the following assumptions:

	2005	2004
Risk-Free Interest Rate	3.7%	3.3%
Expected Life – Years	5	5
Expected Volatility	20.0%	28.1%
Dividend Growth Rate	5%	2%

New Accounting Standards. *SFAS 123(R).* In December 2004, the FASB issued SFAS 123(R), "Share-Based Payment," which will be effective for enterprises as of the first interim or annual reporting period that begins after June 15, 2005. While the SEC has permitted delayed application of SFAS 123(R) until fiscal years beginning after June 15, 2005, we intend to adopt SFAS 123(R) in the third quarter of 2005. SFAS 123(R) replaces SFAS 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." The new standard requires that the compensation cost relating to share-based payment be recognized in financial statements at fair value. As such, reporting employee stock options under the intrinsic value-based method prescribed by APB Opinion No. 25 will no longer be allowed. Historically, we have elected to use the intrinsic value method and have not recognized expense for employee stock options granted. We estimate that the impact of adoption of SFAS 123(R) in 2005 will be an additional expense of approximately $0.2 million after tax.

Interpretation No. 47. In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations." Interpretation No. 47 clarifies that the term "conditional asset retirement obligation" as used in SFAS 143, "Accounting for Asset Retirement Obligations," refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. However, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Interpretation No. 47 requires that the uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation be factored into the measurement of the liability when sufficient information exists. Interpretation No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Interpretation No. 47 is effective for fiscal years ending after December 15, 2005 (December 31, 2005 for calendar-year enterprises). Retroactive application of interim financial information is permitted, but not required. We are evaluating the impact of this Interpretation, but do not expect it to have a material impact on our financial position, results of operations or cash flows.

SFAS 109. In July 2005, the FASB issued an exposure draft of an Interpretation of SFAS 109, "Accounting for Income Taxes." This proposed Interpretation clarifies the accounting for uncertain tax positions. An enterprise would be required to recognize, in its financial statements, the best estimate of the impact of a tax position only if that position is probable of being sustained, if audited by the taxing authorities, based solely on the technical merits of the position. In evaluating whether the probable recognition threshold has been met, this proposed Interpretation would require the presumption that the tax position will be evaluated during an audit by taxing authorities. The term probable is used in this proposed Interpretation consistent with its use in SFAS 5, "Accounting for Contingencies," to mean "the future event or events are likely to occur."

Individual tax positions that fail to meet the probable recognition threshold will generally result in the inability to recognize the benefit of such position in the financial statements. This proposed Interpretation also provides guidance on disclosure, accrual of interest and penalties, accounting in interim periods, and transition. If adopted as proposed, this Interpretation would impact financial statements effective as of the end of the first fiscal year ending after December 15, 2005. We do not anticipate this Interpretation, if adopted as proposed, will have a material impact on the Company.

SFAS 154. In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections" (SFAS 154) which replaces APB Opinion No. 20 "Accounting Changes" and SFAS 3, "Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28." SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We are currently evaluating the effect that the adoption of SFAS 154 will have on our consolidated results of operations and financial condition but do not expect it to have a material impact.

NOTE 2. BUSINESS SEGMENTS

In 2005, we began allocating corporate charges and interest expense to our business segments. For comparative purposes, segment information for 2004 has been restated to reflect the new allocation method used in 2005 for corporate charges and interest expense. This restatement had no impact on consolidated net income or earnings per share.

	Consolidated	Regulated Utility	Nonregulated Energy Operations	Real Estate	Other
Millions					
For the Quarter Ended June 30, 2005					
Operating Revenue	$186.8	$137.8	$ 26.5	$10.0	$12.5
Fuel and Purchased Power	70.3	64.6	5.7	–	–
Operating and Maintenance	81.6	46.5	17.6	5.0	12.5
Kendall County Charge	77.9	–	77.9	–	–
Depreciation Expense	12.7	9.8	2.1	–	0.8
Operating Income (Loss) from Continuing Operations	(55.7)	16.9	(76.8)	5.0	(0.8)
Interest Expense	(6.7)	(4.4)	(1.6)	(0.2)	(0.5)
Other Income	1.5	0.4	–	–	1.1
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	(60.9)	12.9	(78.4)	4.8	(0.2)
Minority Interest	0.2	–	–	0.2	–
Income (Loss) from Continuing Operations Before Income Taxes	(61.1)	12.9	(78.4)	4.6	(0.2)
Income Tax Expense (Benefit)	(21.5)	5.1	(27.9)	1.8	(0.5)
Income (Loss) from Continuing Operations	(39.6)	$ 7.8	$(50.5)	$ 2.8	$ 0.3
Loss from Discontinued Operations – Net of Tax	(0.7)				
Net Income (Loss)	$ (40.3)				
For the Quarter Ended June 30, 2004					
Operating Revenue	$186.2	$136.8	$26.6	$6.8	$16.0
Fuel and Purchased Power	77.2	65.9	11.3	–	–
Operating and Maintenance	77.2	44.9	13.8	2.5	16.0
Depreciation Expense	12.5	9.9	1.9	–	0.7
Operating Income (Loss) from Continuing Operations	19.3	16.1	(0.4)	4.3	(0.7)
Interest Expense	(9.1)	(4.6)	(1.2)	–	(3.3)
Other Income (Expense)	(3.5)	0.1	1.4	–	(5.0)
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	6.7	11.6	(0.2)	4.3	(9.0)
Minority Interest	0.5	–	–	0.5	–
Income (Loss) from Continuing Operations Before Income Taxes	6.2	11.6	(0.2)	3.8	(9.0)
Income Tax Expense (Benefit)	3.8	4.2	(0.3)	1.7	(1.8)
Income (Loss) from Continuing Operations	2.4	$ 7.4	$ 0.1	$2.1	$ (7.2)
Income from Discontinued Operations – Net of Tax	34.3				
Net Income	$ 36.7				

NOTE 2. BUSINESS SEGMENTS (Continued)

Millions	Consolidated	Regulated Utility	Nonregulated Energy Operations	Real Estate	Other
For the Six Months Ended June 30, 2005					
Operating Revenue	$393.7	$285.4	$ 54.4	$27.7	$26.2
Fuel and Purchased Power	139.4	126.1	13.3	–	–
Operating and Maintenance	164.7	97.6	32.7	9.5	24.9
Kendall County Charge	77.9	–	77.9	–	–
Depreciation Expense	25.3	19.6	4.1	–	1.6
Operating Income (Loss) from Continuing Operations	(13.6)	42.1	(73.6)	18.2	(0.3)
Interest Expense	(13.5)	(8.7)	(2.9)	(0.2)	(1.7)
Other Income (Expense)	(2.7)	0.4	0.2	–	(3.3)
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	(29.8)	33.8	(76.3)	18.0	(5.3)
Minority Interest	1.4	–	–	1.4	–
Income (Loss) from Continuing Operations Before Income Taxes	(31.2)	33.8	(76.3)	16.6	(5.3)
Income Tax Expense (Benefit)	(9.6)	13.1	(27.4)	6.9	(2.2)
Income (Loss) from Continuing Operations	(21.6)	$ 20.7	$(48.9)	$ 9.7	$(3.1)
Loss from Discontinued Operations – Net of Tax	(1.3)				
Net Income (Loss)	$ (22.9)				
Total Assets	$1,353.4 *(a)*	$899.4	$178.6	$75.7	$195.7
Property, Plant and Equipment – Net	$883.0	$728.8	$115.5	–	$38.7
Accumulated Depreciation	$788.0	$733.6	$43.5	–	$10.9
Capital Expenditures	$24.2 *(a)*	$20.7	$1.9	–	$1.6
For the Six Months Ended June 30, 2004					
Operating Revenue	$395.2	$278.2	$55.6	$34.4	$27.0
Fuel and Purchased Power	146.1	123.0	23.1	–	–
Operating and Maintenance	160.8	94.6	28.3	10.2	27.7
Depreciation Expense	24.9	19.8	3.7	–	1.4
Operating Income (Loss) from Continuing Operations	63.4	40.8	0.5	24.2	(2.1)
Interest Expense	(18.2)	(9.3)	(2.4)	(0.1)	(6.4)
Other Income (Expense)	(3.1)	0.1	0.9	–	(4.1)
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	42.1	31.6	(1.0)	24.1	(12.6)
Minority Interest	1.9	–	–	1.9	–
Income (Loss) from Continuing Operations Before Income Taxes	40.2	31.6	(1.0)	22.2	(12.6)
Income Tax Expense (Benefit)	16.4	11.7	(0.9)	9.2	(3.6)
Income (Loss) from Continuing Operations	23.8	$ 19.9	$ (0.1)	$13.0	$ (9.0)
Income from Discontinued Operations – Net of Tax	65.6				
Change in Accounting Principle	(7.8)				
Net Income	$ 81.6				
Total Assets	$3,681.6 *(a)*	$930.2	$188.5	$76.1	$392.2
Property, Plant and Equipment – Net	$928.9	$734.2	$154.1	–	$40.6
Accumulated Depreciation	$756.6	$709.2	$39.2	–	$8.2
Capital Expenditures	$43.4 *(a)*	$24.7	$6.8	–	$3.2

(a) Discontinued Operations represented $4.0 million of total assets in 2005 ($2,094.6 million in 2004) and $0 of capital expenditures in 2005 ($8.7 million in 2004).

NOTE 3. INVESTMENTS

At June 30, 2005, Investments included the real estate assets of ALLETE Properties, debt and equity securities consisting primarily of securities held to fund employee benefits, and our emerging technology investments.

Investments	June 30, 2005	December 31, 2004
Millions		
Real Estate Assets	$ 75.7	$ 75.1
Debt and Equity Securities	38.9	35.8
Emerging Technology Investments	8.7	13.6
	$123.3	$124.5

Real Estate. At June 30, 2005, real estate assets included land of $45.3 million ($47.2 million at December 31, 2004), long-term finance receivables of $12.5 million ($9.7 million at December 31, 2004) and $17.9 million ($18.2 million at December 31, 2004) of other assets, which consisted primarily of a shopping center. Finance receivables have maturities ranging up to ten years, accrue interest at market-based rates and are net of an allowance for doubtful accounts of $0.6 million at June 30, 2005 ($0.7 million at December 31, 2004).

Emerging Technology Investments. In March 2005, we recorded $5.1 million ($3.3 million after tax) of impairment losses related to certain investments in privately-held, start-up companies whose future business prospects have diminished significantly. Recent developments at these companies indicated that future commercial viability is unlikely, as is new financing necessary to continue development. The total carrying value of our direct investments in privately-held, start-up companies at June 30, 2005, was zero. Our remaining emerging technology investments consist of our interests in certain venture capital funds. We account for these investments under the equity method.

NOTE 4. SHORT-TERM AND LONG-TERM DEBT

On March 16, 2005, Florida Landmark, a wholly-owned subsidiary of Lehigh Acquisition Corporation, which is an 80 percent owned subsidiary of ALLETE, entered into an $8.5 million revolving development loan with CypressCoquina Bank. The revolving development loan has an interest rate equal to the prime rate, with an initial term of 36 months. The term of the loan may be extended 24 months, if certain conditions are met. The loan is guaranteed by Lehigh Acquisition Corporation. No funds were drawn under this loan agreement at June 30, 2005.

On March 31, 2005, ALLETE executed a bond purchase agreement with certain institutional buyers in the private placement market to sell $35 million of ALLETE's first mortgage bonds. When issued, on or about August 1, 2005, the bonds will carry an interest rate of 5.28% and will have a term of 15 years. In June 2005, ALLETE called for redemption on August 1, 2005, $35 million in principal amount of First Mortgage Bonds, 7 1/2% Series due 2007.

NOTE 5. KENDALL COUNTY CHARGE

On April 1, 2005, Rainy River Energy, a wholly-owned subsidiary of ALLETE, completed the assignment of its power purchase agreement with LSP-Kendall Energy, LLC, the owner of an energy generation facility located in Kendall County, Illinois, to Constellation Energy Commodities. Rainy River Energy paid Constellation Energy Commodities $73 million in cash to assume the power purchase agreement, which is in effect through mid-September 2017. The payment resulted in a charge to our operating income in the second quarter of 2005. The tax benefits of the payment will be realized through a capital loss carry-back for federal income tax purposes and have been recorded as current deferred income tax assets. The tax benefits are expected to be realized in the first half of 2006. In addition, consent, advisory and closing costs of $4.9 million were incurred to complete the transaction. As a result of this transaction, ALLETE incurred a charge to operating expenses totaling $77.9 million ($50.4 million after tax, or $1.84 per diluted share) in the second quarter of 2005.

NOTE 6. OTHER INCOME (EXPENSE)

	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Millions				
Gain (Loss) on Emerging Technology Investments	$ 0.1	$(5.4)	$(5.8)	$(5.9)
Investment and Other Income	1.4	1.9	3.1	2.8
	$ 1.5	$(3.5)	$(2.7)	$(3.1)

NOTE 7. INCOME TAX EXPENSE

	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Millions				
Current Tax Expense				
Federal	$ 7.5 *(a)*	$ 2.6	$ 19.9 *(a)*	$11.3
State	1.3 *(a)*	1.3	4.5 *(a)*	4.4
	8.8	3.9	24.4	15.7
Deferred Tax Expense (Benefit)				
Federal	(29.5) *(a)*	0.1	(32.6) *(a)*	1.7
State	(0.4)	–	(0.7)	(0.2)
	(29.9)	0.1	(33.3)	1.5
Deferred Tax Credits	(0.4)	(0.2)	(0.7)	(0.8)
Income Tax Expense (Benefit) on Continuing Operations	(21.5)	3.8	(9.6)	16.4
Income Tax Expense (Benefit) on Discontinued Operations	(0.1)	28.1	(0.5)	49.3
Income Tax Benefit on Change in Accounting Principle	–	–	–	(5.5)
Total Income Tax Expense (Benefit)	$(21.6)	$31.9	$(10.1)	$60.2

(a) Included a current federal tax benefit of $1.3 million; current state tax benefit of $0.4 million and deferred federal tax benefit of $25.8 million related to the Kendall County Charge. (See Note 5.)

For the quarter and six months ended June 30, 2005, the effective rate for income taxes deviated from the statutory rate, primarily as a result of the emerging technology investment impairment losses recorded in March 2005 and the Kendall County capital loss recorded in April 2005. The current benefit for these items was limited to a federal benefit for income tax purposes. The state tax benefit from these items is not expected to be realized currently or in future periods. These state net capital loss carry forwards are entirely reserved. Current taxes also increased in 2005, due to the expiration of the accelerated depreciation deduction allowed by the Jobs and Growth Tax Relief Act of 2003, which expired December 31, 2004. The effective rate for income taxes for the six months ended June 30, 2004, increased due to nondeductible spin-off costs related to the ADESA transaction.

NOTE 8. DISCONTINUED OPERATIONS

Automotive Services. On September 20, 2004, the spin-off of our Automotive Services business was completed by distributing to ALLETE shareholders all of ALLETE's shares of ADESA common stock. One share of ADESA common stock was distributed for each outstanding share of ALLETE common stock held at the close of business on the September 13, 2004, record date.

Water Services. In June 2004, we essentially concluded our strategy to exit our Water Services businesses when we completed the sale of our North Carolina water assets and the sale of the remaining 72 water and wastewater systems in Florida. Aqua America purchased our North Carolina water assets for $48 million and assumed approximately $28 million in debt, and also purchased 63 of our water and wastewater systems in Florida for $14 million. Seminole County purchased the remaining 9 Florida

NOTE 8. DISCONTINUED OPERATIONS (Continued)

systems for a total of $4 million. The FPSC approved the Seminole County transaction in September 2004. The transaction relating to the sale of 63 water and wastewater systems in Florida to Aqua America remains subject to regulatory approval by the FPSC. The approval process may result in an adjustment to the final purchase price, based on the FPSC's determination of plant investment for the systems. We anticipate a decision in late 2005. Gains in 2004 from the sale of our North Carolina assets and the remaining systems in Florida were offset by an adjustment to gains reported in 2003, resulting in an aggregate net loss of $0.5 million in 2004 ($0.4 million loss first quarter; $5.8 million gain second quarter; $0.2 million loss third quarter; $5.7 million loss fourth quarter).

In February 2005, we sold our wastewater assets in Georgia for an immaterial gain. Florida Water continues to incur administrative expenses to support transfer proceedings with the FPSC.

Summary of Discontinued Operations

Millions

Income Statement	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Operating Revenue				
Automotive Services	–	$232.1	–	$479.8
Water Services	–	7.5	–	15.1
	–	$239.6	–	$494.9
Pre-Tax Income (Loss) from Operations				
Automotive Services	–	$53.5	–	$107.0
Water Services	–	0.2	–	(0.2)
	–	53.7	–	106.8
Income Tax Expense				
Automotive Services	–	21.0	–	42.6
Water Services	–	0.2	–	–
	–	21.2	–	42.6
Total Net Income from Operations	–	32.5	–	64.2
Gain (Loss) on Disposal				
Automotive Services	–	(6.6)	–	(6.6)
Water Services	$(0.8)	15.3	$(1.8)	14.7
	(0.8)	8.7	(1.8)	8.1
Income Tax Expense (Benefit)				
Automotive Services	–	(2.6)	–	(2.6)
Water Services	(0.1)	9.5	(0.5)	9.3
	(0.1)	6.9	(0.5)	6.7
Net Gain (Loss) on Disposal	(0.7)	1.8	(1.3)	1.4
Income (Loss) from Discontinued Operations	$(0.7)	$34.3	$(1.3)	$ 65.6

Balance Sheet Information	June 30, 2005	December 31, 2004
Assets of Discontinued Operations		
Cash and Cash Equivalents	$1.1	$1.2
Other Current Assets	$0.7	$0.8
Property, Plant and Equipment	$2.2	$2.9
Liabilities of Discontinued Operations		
Current Liabilities	$6.5	$12.0

NOTE 9. COMPREHENSIVE INCOME (LOSS)

For the quarter ended June 30, 2005, total comprehensive income (loss), net of tax, was a $40.4 million loss ($32.7 million of comprehensive income, net of tax, for the quarter ended June 30, 2004). For the six months ended June 30, 2005, total comprehensive income (loss), net of tax, was a $22.9 million loss ($75.5 million of comprehensive income, net of tax, for the six months ended June 30, 2004). Total comprehensive income (loss) includes net income (loss), unrealized gains and losses on securities classified as available-for-sale and interest rate swaps, additional pension liability and foreign currency translation adjustments.

Accumulated Other Comprehensive Income (Loss) – Net of Tax	**June 30, 2005**	**2004**
Millions		
Unrealized Gain on Securities	$ 1.5	$ 1.1
Additional Pension Liability	(12.9)	(9.8)
Interest Rate Swap	–	(0.3)
Foreign Currency Translation – Discontinued Operations	–	17.4
	$(11.4)	$ 8.4

NOTE 10. EARNINGS PER SHARE

The difference between basic and diluted earnings per share arises from outstanding stock options and performance share awards granted under our Executive and Director Long-Term Incentive Compensation Plans. In accordance with SFAS 128, “Earnings Per Share,” in 2005, 0.1 million dilutive securities were excluded in the computation of diluted earnings per share because a loss from continuing operations existed for the quarter ended June 30, 2005 (0.2 million for the six months ended June 30, 2005). At June 30, 2004, no options to purchase shares of common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive due to the option exercise prices being greater than the average market price of the common stock.

	2005			**2004**		
Reconciliation of Basic and Diluted Earnings Per Share	**Basic**	**Dilutive Securities**	**Diluted**	**Basic**	**Dilutive Securities**	**Diluted**
Millions Except Per Share Amounts						
For the Quarter Ended June 30,						
Income (Loss) from Continuing Operations Before Change in Accounting Principle	$(39.6)	–	$(39.6)	$2.4	–	$2.4
Common Shares	27.2	–	27.2	28.4	0.1	28.5
Per Share from Continuing Operations	$(1.45)	–	$(1.45)	$0.08	–	$0.08
For the Six Months Ended June 30,						
Income (Loss) from Continuing Operations Before Change in Accounting Principle	$(21.6)	–	$(21.6)	$23.8	–	$23.8
Common Shares	27.2	–	27.2	28.2	0.2	28.4
Per Share from Continuing Operations	$(0.79)	–	$(0.79)	$0.85	–	$0.84

NOTE 11. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Components of Periodic Benefit Expense	Pension 2005	Pension 2004	Postretirement Health and Life 2005	Postretirement Health and Life 2004
Millions				
For the Quarter Ended June 30,				
Service Cost	$2.2	$2.1	$1.0	$1.0
Interest Cost	5.3	5.2	1.6	1.6
Expected Return on Plan Assets	(7.1)	(6.9)	(1.2)	(1.1)
Amortization of Prior Service Costs	0.2	0.2	–	–
Amortization of Net Loss	0.8	0.4	0.2	0.1
Amortization of Transition Obligation	–	–	0.7	0.6
Periodic Benefit Expense	$1.4	$1.0	$2.3	$2.2
For the Six Months Ended June 30,				
Service Cost	$ 4.4	$ 4.2	$2.0	$2.1
Interest Cost	10.6	10.4	3.3	3.4
Expected Return on Plan Assets	(14.2)	(13.8)	(2.4)	(2.2)
Amortization of Prior Service Costs	0.4	0.4	–	–
Amortization of Net Loss	1.6	0.8	0.4	0.3
Amortization of Transition Obligation	0.1	0.1	1.3	1.2
Periodic Benefit Expense	$ 2.9	$ 2.1	$4.6	$4.8

In May 2004, the FASB issued FSP 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," (Act) which provides accounting and disclosure guidance for employers that sponsor postretirement health care plans that provide prescription drug benefits. FSP 106-2 requires that the accumulated postretirement benefit obligation and postretirement benefit cost reflect the impact of the Act upon adoption. We provide postretirement health benefits that include prescription drug benefits and have concluded that our prescription drug benefits will qualify us for the federal subsidy to be provided for under the Act. We adopted FSP 106-2 in the third quarter of 2004. The adoption of FSP 106-2 reduced our after-tax postretirement medical expense by $0.5 million for the quarter ended June 30, 2005 and $1.0 million for the six months ended June 30, 2005.

NOTE 12. EMPLOYEE STOCK AND INCENTIVE PLANS

We sponsor a leveraged ESOP as part of our Retirement Savings and Stock Ownership Plan (RSOP). As a result of the September 2004 spin-off of ADESA, the ESOP received 3.3 million shares of ADESA common stock related to unearned ESOP shares that have not been allocated to participants. The ESOP was required to sell the ADESA common stock and use the proceeds to purchase ALLETE common stock on the open market. At December 31, 2004, the ESOP had sold all of these ADESA shares. The 3.3 million ADESA shares sold by the ESOP in 2004 resulted in total proceeds of $65.9 million and an after-tax gain of $11.5 million, which we recognized in the fourth quarter of 2004. Under the direction of an independent trustee, the ESOP began using the proceeds to purchase shares of ALLETE common stock in October 2004. As of February 15, 2005, the remaining proceeds ($30.3 million classified as Restricted Cash at December 31, 2004) had been used to purchase ALLETE common stock, which were recorded using the treasury method as Unearned ESOP Shares within Shareholders' Equity as presented on our consolidated balance sheet.

Summary of ALLETE Common Stock Purchases		**Shares**	**Amount**
Millions Except Shares			
2004	October	80,600	$ 2.7
	November	669,578	23.5
	December	262,600	9.4
2005	January	544,797	21.4
	February	214,928	8.9
		1,772,503	$ 65.9

Unallocated Shares. As of June 30, 2005, there were 2,649,973 unallocated shares of ALLETE common stock in the ESOP (2,001,505 shares at December 31, 2004), which reflects 759,725 shares purchased and 111,257 shares allocated or used for plan expenses in 2005. Pursuant to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans," unallocated ALLETE common stock currently held by the ESOP is treated as unearned ESOP shares and not considered outstanding for earnings per share computations. ESOP shares are included in earnings per share computations only after they are allocated to participants.

Allocated Shares. As of June 30, 2005, participants in the RSOP had $38.7 million, or 1.8 million shares, invested in ADESA common stock through an ADESA common stock fund in the RSOP. Participants may transfer out of the ADESA common stock fund at any time. If a participant chooses to transfer out of the ADESA common stock fund, ADESA common stock is sold and the proceeds are reinvested in a fund available in the RSOP as selected by the participant. One of the funds available is an ALLETE common stock fund. Beginning in September 2005, the RSOP is expected to start selling the ADESA common stock remaining in the RSOP as of that date. An independent trustee will be directing the sale of the ADESA common stock and will use the proceeds to purchase ALLETE common stock as required by terms of the RSOP. We are unable to predict the date on which this process will be complete.

NOTE 13. COMMITMENTS, GUARANTEES AND CONTINGENCIES

Square Butte Power Purchase Agreement. Minnesota Power has a power purchase agreement with Square Butte that extends through 2026 (Agreement). It provides a long-term supply of low-cost energy to customers in our electric service territory and enables Minnesota Power to meet power pool reserve requirements. Square Butte, a North Dakota cooperative corporation, owns a 455-MW coal-fired generating unit (Unit) near Center, North Dakota. The Unit is adjacent to a generating unit owned by Minnkota Power, a North Dakota cooperative corporation whose Class A members are also members of Square Butte. Minnkota Power serves as the operator of the Unit and also purchases power from Square Butte.

Minnesota Power is entitled to approximately 71 percent of the Unit's output under the Agreement. After 2005, and upon compliance with a two-year advance notice requirement, Minnkota Power has the option to reduce Minnesota Power's entitlement by approximately 5 percent annually, to a minimum of 50 percent. In December 2004 and 2003, we received notices from Minnkota Power that they will reduce our output entitlement by approximately 5 percent beginning January 1, 2006 and 2007, to 66 percent and 60 percent, respectively. Minnesota Power is obligated to pay its pro rata share of Square Butte's costs based on Minnesota Power's entitlement to Unit output. Minnesota Power's payment obligation will be suspended if Square Butte fails to deliver any power, whether produced or purchased, for a period of one year. Square Butte's fixed costs consist primarily of debt service. At June 30, 2005, Square Butte had total debt outstanding of $311.5 million. Total annual debt service for Square Butte is expected to be approximately $25 million in each of the years 2005 through 2009. Variable operating costs include the price of coal purchased from BNI Coal, our subsidiary, under a long-term contract. Minnesota Power's payments to Square Butte are approved as a purchased power expense for ratemaking purposes by both the MPUC and the FERC.

Leasing Agreements. In September 2004, BNI Coal entered into an operating lease agreement for a new dragline that was placed in service at BNI Coal's mine on September 30, 2004. BNI Coal is obligated to make lease payments totaling $2.8 million annually for the lease term which expires in 2027. BNI Coal has the option at the end of the lease term to renew the lease at a fair market rental, to purchase the dragline at fair market value, or to surrender the dragline and pay a $3.0 million termination fee.

We lease other properties and equipment under operating lease agreements with terms expiring through 2013. The aggregate amount of minimum lease payments for all of these other operating leases is $3.5 million in 2005, $3.3 million in 2006, $2.8 million in 2007, $2.1 million in 2008, $1.7 million in 2009 and $2.4 million thereafter.

Coal and Shipping Contracts. We have three coal supply agreements with various expiration dates ranging from December 2006 to December 2009. We also have rail and shipping agreements for transportation of all of our coal, with various expiration dates ranging from December 2005 to December 2011. Our minimum annual payment obligations under these coal and shipping agreements are $38.7 million in 2005, $12.3 million in 2006, $9.7 million in 2007, $10.1 million in 2008 and $6.1 million in 2009.

Emerging Technology Portfolio. We have investments in emerging technologies through minority investments in venture capital funds structured as limited liability companies, and direct investments in privately-held, start-up companies. The carrying value of our direct investments in privately-held, start-up companies was zero at June 30, 2005 ($4.5 million at December 31, 2004). We have committed to make additional investments in certain emerging technology venture capital funds. The total future commitment was $3.8 million at June 30, 2005, ($4.5 million at December 31, 2004) and is expected to be invested at various times through 2007. We do not have plans to make any additional investments beyond this commitment.

Environmental Matters. Our businesses are subject to regulation by various federal, state and local authorities concerning environmental matters. We anticipate that potential expenditures for environmental matters will be material in the future, due to stricter environmental requirements through legislation and/or rulemakings that are expected to require significant capital investments. We are unable to predict if and when any such stricter environmental requirements will be imposed and the impact they will have on the Company. We review environmental matters on a quarterly basis. Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. These accruals are adjusted periodically as assessment and remediation efforts progress or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense unless recoverable in rates from customers.

SWL&P Manufactured Gas Plant. In May 2001, SWL&P received notice from the WDNR that the City of Superior had found soil contamination on property adjoining a former Manufactured Gas Plant (MGP) site owned and operated by SWL&P's predecessors from 1889 to 1904. The WDNR requested SWL&P to initiate an environmental investigation. The WDNR also issued SWL&P a Responsible Party letter in February 2002. The environmental investigation is under way. In February 2003, SWL&P submitted a Phase II environmental site investigation report to the WDNR. This report identified some MGP-like chemicals that were found in the soil near the former plant site. During March and April 2003, sediment samples were taken from nearby Superior Bay. The report on the results of this sampling was completed and sent to the WDNR during the first quarter of 2004. The next phase of the investigation was to determine any impact to soil or ground water between the former MGP site and Superior Bay. The site work for this phase of the investigation was performed during October 2004, and the final report was sent to the WDNR in March 2005. Additional site investigation will be needed during 2005. A work plan for the additional investigation will be filed with the WDNR during the third quarter of 2005. Although it is not possible to quantify the potential cleanup cost until the investigation is completed, a $0.5 million liability was recorded in December 2003 to address the known areas of contamination. We have recorded a corresponding dollar amount as a regulatory asset to offset this liability. The PSCW has approved SWL&P's deferral of these MGP environmental investigation and potential cleanup costs for future recovery in rates, subject to a regulatory prudency review. In May 2005, the PSCW approved the collection through rates of $150,000 of site investigation costs that had been incurred by the time SWL&P filed their most recent rate request. ALLETE maintains pollution liability insurance coverage that includes coverage for SWL&P. A claim has been filed with respect to this matter. The insurance carrier has issued a reservation of rights letter and we continue to work with the insurer to determine the availability of insurance coverage.

Square Butte Generating Facility. In June 2002, Minnkota Power, the operator of Square Butte, received a Notice of Violation from the EPA regarding alleged New Source Review violations at the M.R. Young Station, which includes the Square Butte generating unit. The EPA claims certain capital projects completed by Minnkota Power should have been reviewed pursuant to the New Source Review regulations, potentially resulting in new air permit operating conditions. Minnkota Power has held several meetings with the EPA to discuss the alleged violations. Discussions between Minnkota Power and the EPA are ongoing and we are unable to predict the outcome or cost impacts. If Square Butte is required to make significant capital expenditures to comply with EPA requirements, we expect such capital expenditures to be debt financed. Our future cost of purchased power would include our pro rata share of this additional debt service.

Clean Water Act – Aquatic Organisms. In July 2004, the EPA issued Section 316(b) Phase II Rule of the Clean Water Act to ensure that the location, design, construction and capacity of cooling water intake structures at electric generating facilities reflect the best technology available to reduce fish mortality due to impingement (being pinned against screens or other parts of a cooling water intake structure) or entrainment (being drawn into cooling water systems and subjected to thermal, physical or chemical stresses). The new rule for fish impingement requirements apply to the Boswell, Laskin, Hibbard and Square Butte generating facilities. The impingement and entrainment requirements apply to Taconite Harbor because it is located on Lake Superior. The rule requires biological studies and engineering analyses to be performed within the 2005 to 2008 time frame. The estimated total cost of these studies for our facilities is expected to be in the range of $0.5 million to $1.0 million. We cannot yet estimate the capital expenditures that may be required as a result of the study.

EPA Clean Air Interstate Rule and Clean Air Mercury Rule. In March 2005, the EPA announced the final Clean Air Interstate Rule (CAIR) that reduces and permanently caps emissions of sulfur dioxide (SO_2), nitrogen oxides (NO_X) and particulates in the eastern United States. The CAIR includes Minnesota as one of the 28 states it considers as "eastern" states. The EPA also announced the final Clean Air Mercury Rule (CAMR) that reduces and permanently caps emissions of electric utility mercury emissions in the continental United States. Together, the two rules address at least some of the emission reductions that were targeted by the Clear Skies Act legislation that was not enacted in 2004. The CAIR and the CAMR have been challenged in the court system, which may delay implementation or modify provisions in the rules. Minnesota Power is participating in a legal challenge to the CAIR but is not challenging the CAMR. However, if the CAMR and the CAIR do go into effect, Minnesota Power expects to be required to (1) make emissions reductions, (2) purchase mercury, SO_2 and NO_X allowances through the EPA's cap-and-trade system, and/or (3) use a combination of both. The Clear Skies legislation is being revisited and, if enacted, will likely displace implementation of these rules.

We believe that CAIR contains flaws in its methodology and application, which will cause Minnesota Power to incur significantly higher compliance costs. Consequently, on July 11, 2005, Minnesota Power filed a Petition for Review with the U.S. Court of Appeals for the District of Columbia Circuit. We also expect to file a Petition for Reconsideration with the EPA. If the litigation and/or the Petition for Reconsideration are successful, we expect to incur lower compliance costs, consistent with the rules applicable to those states considered as "western" states under the CAIR.

Guarantee. Minnesota Power guarantees $1.0 million of Northwest Airlines, Inc.'s (NAI) payments of principal and interest on $24.7 million of "Duluth Airport Lease Revenue Bonds" (to be paid out of lease revenues from NAI to the Duluth Economic Development Authority). If NAI is delinquent in their rent payments, the bond trustee may draw on the collateral of Minnesota Power to make the payment. Minnesota Power's collateral is a Letter of Credit in favor of the State of Minnesota. Minnesota Power would be entitled to reimbursement for any draws on the collateral and such reimbursement obligation is secured by NAI's Detroit to Paris international air route. Minnesota Power shares this security interest with the State of Minnesota, St. Louis County and the City of Duluth.

Other. We are involved in litigation arising in the normal course of business. Also in the normal course of business, we are involved in tax, regulatory and other governmental audits, inspections, investigations and other proceedings that involve state and federal taxes, safety, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to change materially our present liquidity position, nor have a material adverse effect on our financial condition.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and notes to those statements and the other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this report contain forward-looking information that involves risks and uncertainties.

EXECUTIVE SUMMARY

ALLETE's operations are comprised of four business segments. **Regulated Utility** includes retail and wholesale rate-regulated electric, water and gas services in northeastern Minnesota and northwestern Wisconsin under the jurisdiction of state and federal regulatory authorities. **Nonregulated Energy Operations** includes nonregulated generation (non-rate base generation sold at market-based rates to the wholesale market) from Taconite Harbor in northern Minnesota and our coal mining activities in North Dakota. Nonregulated Energy Operations also included generation secured through the Kendall County power purchase agreement, which was transferred in April 2005 to Constellation Energy Commodities. (See Note 5.) **Real Estate** includes our Florida real estate operations. **Other** includes our telecommunications activities, investments in emerging technologies and earnings on cash, cash equivalents and short-term investments. **Discontinued Operations** includes our Automotive Services business, our Water Services businesses, and spin-off costs incurred by ALLETE.

During the first six months of 2005, our core energy and real estate businesses continued to perform strongly. We completed the assignment of our Kendall County power purchase agreement to Constellation Energy Commodities, which was a key strategic accomplishment for the Company. As a result of this assignment, we incurred a charge to our operating expenses totaling $77.9 million ($50.4 million after tax, or $1.84 per diluted share) in the second quarter of 2005 (Kendall County Charge). The assignment of the Kendall County power purchase agreement has eliminated anticipated annual losses of approximately $8 million after tax.

Since the Kendall County Charge significantly impacted the financial results from continuing operations for the quarter and six months ended June 30, 2005, we maintain that for comparative purposes, it is useful to present earnings excluding the impact of this charge. The table below reflects actual results adjusted for the exclusion of the Kendall County Charge.

	Quarter Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Millions Except Per Share Amounts				
Income (Loss) from Continuing Operations Before Change in Accounting Principle	$(39.6)	$ 2.4	$(21.6)	$23.8
Add Back: Kendall County Charge	50.4	–	50.4	–
Income from Continuing Operations Before Change in Accounting Principle Excluding the Kendall County Charge	10.8	2.4	28.8	23.8
Income (Loss) from Discontinued Operations	(0.7)	34.3	(1.3)	65.6
Change in Accounting Principle	–	–	–	(7.8)
	$ 10.1	$36.7	$ 27.5	$81.6
Diluted Earnings (Loss) Per Share of Common Stock				
Continuing Operations Before Change in Accounting Principle	$(1.45)	$0.08	$(0.79)	$0.84
Add Back: Kendall County Charge	1.84	–	1.84	–
Continuing Operations Before Change in Accounting Principle Excluding the Kendall County Charge	0.39	0.08	1.05	0.84
Discontinued Operations	(0.03)	1.21	(0.05)	2.31
Change in Accounting Principle	–	–	–	(0.27)
	$ 0.36	$1.29	$ 1.00	$2.88

Since the Kendall County Charge and discontinued operations significantly impacted cash flow from continuing operations for the six months ended June 30, 2005 and 2004, respectively, we maintain that for comparative purposes, it is useful to present cash flow activity excluding the impact of these items. The table below reflects actual results adjusted for the exclusion of the Kendall County Charge and discontinued operations.

Consolidated Cash Flow **Six Months Ended June 30,**	**2005**	**2004**
Millions		
Cash from (for) Operating Activities	$(20.0)	$87.0
Add Back: Kendall County Charge	77.9	–
Less: Discontinued Operations	(5.9)	54.5
	$ 63.8	$32.5
Cash from (for) Investing Activities	$58.4	$ 39.7
Less: Discontinued Operations	–	64.9
	$58.4	$(25.2)
Cash from (for) Financing Activities	$(4.3)	$265.0
Less: Discontinued Operations	(0.1)	328.9
	$(4.2)	$ (63.9)

Excluding the Kendall County Charge, income from continuing operations was $10.8 million, or $0.39 per diluted share, for the quarter ended June 30, 2005 ($2.4 million, or $0.08 per diluted share, for the quarter ended June 30, 2004). Strong electric sales and continued strong demand for real estate contributed to higher earnings during the second quarter of 2005, as did lower interest expense due to reduced debt balances and expense reductions following the spin-off of Automotive Services and exit from the Water Services businesses in 2004. In addition, second quarter 2004 included $3.2 million of impairment charges related to our emerging technology investments.

Excluding the Kendall County Charge, income from continuing operations was $28.8 million, or $1.05 per diluted share, for the six months ended June 30, 2005 ($23.8 million, or $0.84 per diluted share, for the six months ended June 30, 2004). In 2005, continued strong electric sales and the benefits of lower interest expense due to reduced debt balances and expense reductions following the spin-off of Automotive Services and exit from the Water Services businesses in 2004, were partially offset by the timing of closing real estate transactions.

Earnings per share for 2005 were favorably impacted by ALLETE common stock purchased pursuant to the Company's Retirement Savings and Stock Ownership Plan. (See Note 12.)

Excluding the Kendall County Charge, income in total was $10.1 million, or $0.36 per diluted share, for the quarter ended June 30, 2005 ($36.7 million, or $1.29 per diluted share, for the quarter ended June 30, 2004) and $27.5 million, or $1.00 per diluted share, for the six months ended June 30, 2005 ($81.6 million, or $2.88 per diluted share, for the six months ended June 30, 2004). The decrease in net income in total reflected reduced earnings from discontinued operations following the spin-off of Automotive Services and the exit from the Water Services businesses.

	Quarter Ended June 30, 2005	2004	Six Months Ended June 30, 2005	2004
Millions Except Per Share Amounts				
Operating Revenue				
Regulated Utility	$137.8	$136.8	$285.4	$278.2
Nonregulated Energy Operations	26.5	26.6	54.4	55.6
Real Estate	10.0	6.8	27.7	34.4
Other	12.5	16.0	26.2	27.0
	$186.8	$186.2	$393.7	$395.2
Operating Expenses				
Regulated Utility	$120.9	$120.7	$243.3	$237.4
Nonregulated Energy Operations	103.3 *(a)*	27.0	128.0 *(a)*	55.1
Real Estate	5.0	2.5	9.5	10.2
Other	13.3	16.7	26.5	29.1
	$242.5	$166.9	$407.3	$331.8
Interest Expense				
Regulated Utility	$4.4	$4.6	$ 8.7	$ 9.3
Nonregulated Energy Operations	1.6	1.2	2.9	2.4
Real Estate	0.2	–	0.2	0.1
Other	0.5	3.3	1.7	6.4
	$6.7	$9.1	$13.5	$18.2
Other Income (Expense)				
Regulated Utility	$0.4	$ 0.1	$ 0.4	$ 0.1
Nonregulated Energy Operations	–	1.4	0.2	0.9
Other	1.1	(5.0)	(3.3)	(4.1)
	$1.5	$(3.5)	$(2.7)	$(3.1)
Net Income (Loss)				
Regulated Utility	$ 7.8	$ 7.4	$ 20.7	$19.9
Nonregulated Energy Operations	(50.5) *(a)*	0.1	(48.9) *(a)*	(0.1)
Real Estate	2.8	2.1	9.7	13.0
Other	0.3	(7.2)	(3.1)	(9.0)
Income (Loss) from Continuing Operations	(39.6)	2.4	(21.6)	23.8
Income (Loss) from Discontinued Operations	(0.7)	34.3	(1.3)	65.6
Change in Accounting Principle	–	–	–	(7.8)
Net Income (Loss)	$(40.3)	$36.7	$(22.9)	$81.6
Diluted Average Shares of Common Stock	27.2	28.5	27.2	28.4
Diluted Earnings (Loss) Per Share of Common Stock				
Continuing Operations	$(1.45) *(a)*	$0.08	$(0.79) *(a)*	$0.84
Discontinued Operations	(0.03)	1.21	(0.05)	2.31
Change in Accounting Principle	–	–	–	(0.27)
	$(1.48)	$1.29	$(0.84)	$2.88

(a) Included operating expenses totaling $77.9 million ($50.4 million after tax, or $1.84 per diluted share) related to the assignment of the Kendall County power purchase agreement. (See Note 5.)

In 2005, we began allocating corporate charges and interest expense to our business segments. For comparative purposes, segment information for 2004 has been restated to reflect the new allocation method used in 2005 for corporate charges and interest expense. This restatement had no impact on consolidated net income or earnings per share.

	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Kilowatthours Sold				
Millions				
Regulated Utility				
Retail and Municipals				
Residential	229.9	228.8	549.7	539.1
Commercial	300.5	294.3	640.3	626.2
Industrial	1,746.9	1,770.0	3,524.0	3,536.8
Municipals	199.3	189.0	421.3	402.8
Other	18.1	17.8	38.5	38.0
	2,494.7	2,499.9	5,173.8	5,142.9
Other Power Suppliers	366.9	168.4	603.6	385.6
	2,861.6	2,668.3	5,777.4	5,528.5
Nonregulated Energy Operations	399.9	414.6	753.8	848.6
	3,261.5	3,082.9	6,531.2	6,377.1
Real Estate				
Acres Sold	96	159	579	1,427
Lots Sold	0	12	7	211

NET INCOME

The following net income discussion summarizes a comparison of the six months ended June 30, 2005, to the six months ended June 30, 2004.

Regulated Utility contributed net income of $20.7 million in 2005 ($19.9 million in 2004). In 2005, a 57 percent increase in kilowatthour sales to other power suppliers, higher off-peak prices and continued strong retail electric sales offset $1.1 million of additional planned maintenance expense at Company generating facilities.

Nonregulated Energy Operations reported a net loss of $48.9 million in 2005 ($0.1 million net loss in 2004). In April 2005, we completed the assignment of our Kendall County power purchase agreement to Constellation Energy Commodities. As a result of this transaction, we incurred a charge to operating expenses totaling $50.4 million after tax in the second quarter of 2005. Excluding the Kendall County Charge, net income from nonregulated operations was up $1.5 million from last year, primarily due to power sales contracts that began in May 2004 and May 2005 at Taconite Harbor.

Real Estate contributed net income of $9.7 million in 2005 ($13.0 million in 2004). Lower net income in 2005 was primarily attributed to the timing of the closing of real estate transactions, which varies from period to period and impacts comparisons between years.

During the second quarter of 2005, ALLETE Properties recorded its first sales from the Town Center at Palm Coast development project in northeast Florida. Since the project is currently under construction, revenue and expenses are recorded using a percentage-of-completion method. (See Note 1.) As of June 30, 2005, we have $7.7 million of deferred profit on sales of real estate, before taxes and minority interest, on our balance sheet. We expect most of this deferred profit will be reflected in income during the next 18 months.

At June 30, 2005, total land sales under contract were $90.7 million, of which $53.5 million were for properties in the Town Center at Palm Coast development project. Pricing on these contracts range from $45,000 to $685,000 per acre for the Town Center at Palm Coast development project, and $2,000 to $524,000 per acre for all other properties. Prices per acre are stated on a gross acreage basis and are dependent on the type and location of the properties sold. The majority of the properties under contract are zoned commercial and mixed use.

NET INCOME (Continued)

Other reflected a net loss of $3.1 million in 2005 ($9.0 million net loss in 2004). In 2005, the Company benefited from the positive impact of lower interest expense due to reduced debt balances and expense reductions following the spin-off of Automotive Services and exit from the Water Services businesses in 2004, and a $1.2 million increase in earnings on cash, cash equivalents and short-term investments. Losses from our emerging technology investments were similar to last year. In 2005, we recorded $3.3 million of impairment losses related to our emerging technology investments ($3.2 million in 2004).

Discontinued Operations reflected a net loss of $1.3 million in 2005 ($65.6 million of net income in 2004). The absence of operations from Automotive Services, spun off in September 2004, accounted for $60.4 million of the decrease in income from discontinued operations. Income from Water Services was down $6.5 million, primarily due to gains recognized in June 2004 on the sale of Heater and the remaining 72 Florida Water systems. Water Services in 2005 reflected $1.3 million of administrative expenses incurred by Florida Water in connection with the FPSC's transfer proceedings.

COMPARISON OF THE QUARTERS ENDED JUNE 30, 2005 AND 2004

Regulated Utility

Operating revenue was up $1.0 million, or less than 1 percent, from 2004. Revenue from other power suppliers (power marketing) was up $8.1 million from 2004, due to a 118 percent increase in kilowatthour sales. Transmission revenue was up $1.4 million from 2004, reflecting increased MISO-related revenue. The Company is currently recovering other MISO expenses, subject to refund with interest, through the fuel clause. Revenue from sales to retail and municipal customers was down $8.4 million, primarily due to lower fuel clause recoveries in 2005. Kilowatthour sales to retail and municipal customers were similar to last year. As in 2004, the Company's industrial customers are operating at high production levels, with taconite and paper production at or near capacity, resulting in kilowatthour sales to industrial customers similar to last year. Overall, regulated utility kilowatthour sales were up 7 percent from 2004.

Revenue from electric sales to taconite customers accounted for 23 percent of consolidated operating revenue in 2005 (26 percent in 2004). Electric sales to paper and pulp mills accounted for 9 percent of consolidated operating revenue in both 2005 and 2004.

Operating expenses were up $0.2 million, or less than 1 percent, from 2004. Fuel and purchased power expense was down $1.3 million from 2004, due to lower purchased power expense in 2005. In 2004, an outage at Boswell Unit 4 required the Company to purchase additional power. The decrease in purchased power expense was mostly offset by increased fuel expense, due to a 53 percent increase in Company generation, and a $0.9 million increase in MISO transmission expense. Other operating expenses were also higher in 2005 and included a $0.5 million increase in conservation improvement program expenses, which are recovered through a billing adjustment clause. In 2004, operating expenses included $0.3 million of expenses related to Split Rock Energy, a joint venture, which we exited in March 2004.

Interest expense was down $0.2 million from 2004, due to lower effective interest rates.

Other income (expense) reflected $0.3 million more income in 2005, primarily due to higher EPA auction proceeds received for sulfur dioxide emission allowances.

COMPARISON OF THE QUARTERS ENDED JUNE 30, 2005 AND 2004 (Continued)

Nonregulated Energy Operations

Operating revenue was down $0.1 million, or less than 1 percent, from 2004. Revenue from nonregulated generation was down $1.9 million from 2004, reflecting the absence of Kendall County operations following the assignment of the Kendall County power purchase agreement partially offset by increased revenue from Taconite Harbor. Overall, nonregulated kilowatthour sales were down 4 percent from 2004. Revenue from Taconite Harbor was up $2.6 million due to a 76-MW one-year capacity contract that began in May 2004 and two 5-year contracts (175 MW in total) that began in May 2005. Coal revenue, realized under a cost-plus contract, was up $1.9 million from 2004 because of higher coal production expenses (see operating expense below).

Operating expenses were up $76.3 million, from 2004, primarily due to a $77.9 million charge related to the assignment of the Kendall County power purchase agreement to Constellation Energy Commodities on April 1, 2005.

Fuel and purchased power expense was down $5.6 million from 2004, reflecting the absence of operations at Kendall County partially offset by increased fuel and purchased power expense at Taconite Harbor due to a 15 percent increase in kilowatthour sales. Other operating expenses at Taconite Harbor were higher in 2005—sulfur dioxide emission allowance expenses were up $1.0 million and depreciation expense was up $0.2 million as a result of capitalized projects being completed and placed into operation. Expenses related to our coal operations were up $1.8 million, in part due to higher expenses associated with equipment repairs and a $0.7 million increase in lease expense related to the new dragline. In 2004, fewer equipment repairs reduced operating expenses.

Other income (expense) reflected $1.4 million less income in 2005—$0.7 million primarily due to the timing of contract services related to the Duluth-to-Wausau transmission and $0.7 million due to fewer Minnesota land sales.

Real Estate

Operating revenue was up $3.2 million, or 47 percent, from 2004, primarily because of the type and location of real estate sold. In 2005, 96 acres and 0 lots were sold for $8.6 million, excluding deferred revenue of $7.5 million. Town Center accounted for 42 of the 96 acres sold in 2005 ($1.7 million of revenue, excluding $7.5 million of deferred revenue). In 2004, 159 acres and 12 lots were sold for $5.2 million in 2004, excluding deferred revenue of $0.

Operating expenses were up $2.5 million from 2004. Cost of sales was $3.2 million in 2005, excluding deferred cost of sales of $1.7 million ($0.7 million, in 2004, excluding no deferred cost of sales).

Other

Operating revenue was down $3.5 million, or 22 percent, from 2004, due to less revenue from our telecommunications business because of fewer equipment sales.

Operating expenses were down $3.4 million, or 20 percent, from 2004, reflecting a $3.1 million decrease in expenses at our telecommunication business, primarily due to lower cost of goods sold associated with fewer equipment sales.

Interest expense was down $2.8 million from 2004, primarily due to lower debt balances. The Company repaid a $53 million balance on a credit agreement in April 2004 and $125 million of 7.80% Senior Notes in July 2004. A combination of internally-generated funds, proceeds from the sale of our Water Services assets and proceeds received from ADESA were used to repay debt.

Other income (expense) reflected $6.1 million less expense in 2005 because in 2004 we recorded $5.5 million of impairment losses related to our privately-held emerging technology investments. Other income also reflected a $0.7 million increase in earnings on cash, cash equivalents and short-term investments in 2005.

COMPARISON OF THE QUARTERS ENDED JUNE 30, 2005 AND 2004 (Continued)

Income Taxes

The effective rate for income taxes in 2005 deviated from the statutory rate, primarily as a result of the Kendall County capital loss recorded in April 2005. The current benefit for the loss was limited to a federal benefit for income tax purposes. The state tax benefit for this item is not expected to be realized currently or in future periods. This state capital loss carry forward was entirely reserved. Current taxes were higher in 2005, due to the expiration of the accelerated depreciation deduction allowed by the Jobs and Growth Tax Relief Act of 2003, which expired December 31, 2004. The effective rate for income taxes in 2004 increased, due to nondeductible spin-off costs related to the ADESA transaction.

COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

Regulated Utility

Operating revenue was up $7.2 million, or 3 percent, from 2004. Revenue from other power suppliers (power marketing) was up $10.1 million from 2004, due to a 57 percent increase in kilowatthour sales and higher off-peak market prices. Transmission revenue was up $2.9 million from 2004, reflecting increased MISO-related revenue. The Company is currently recovering other MISO expenses, subject to refund with interest, through the fuel clause. Revenue from sales to retail and municipal customers was down $6.4 million, primarily due to lower fuel clause recoveries in 2005. Kilowatthour sales to retail and municipal customers remained strong—up 1 percent from 2004. Sales to industrial customers were similar to last year because, as in 2004, the Company's industrial customers are operating at high production levels, with taconite and paper production at or near capacity. Overall, regulated utility kilowatthour sales were up 5 percent from 2004.

Revenue from electric sales to taconite customers accounted for 22 percent of consolidated operating revenue in 2005 (23 percent in 2004). Electric sales to paper and pulp mills accounted for 8 percent of consolidated operating revenue in both 2005 and 2004.

Operating expenses were up $5.9 million, or 2 percent, from 2004. Fuel and purchased power expense was up $3.1 million from 2004, reflecting increased fuel expense, due to a 32 percent increase in Company generation, and a $2.3 million increase in MISO transmission expenses. These increases were partially offset by lower purchased power expense in 2005. In 2004, an outage at Boswell Unit 4 required additional power to be purchased. Maintenance expenses were up $1.9 million from 2004, primarily due to more planned maintenance in 2005. Other operating expenses were also higher in 2005 and included a $1.1 million increase in conservation improvement program expenses, which are recovered through a billing adjustment clause. In 2004, operating expenses included $2.0 million of expenses related to Split Rock Energy, a joint venture, which we exited in March 2004.

Interest expense was down $0.6 million from 2004, due to lower effective interest rates.

Other income (expense) reflected $0.3 million more income in 2005, primarily due to higher EPA auction proceeds received for sulfur dioxide emission allowances.

Nonregulated Energy Operations

Operating revenue was down $1.2 million, or 2 percent, from 2004. Revenue from nonregulated generation was down $4.3 million from 2004, reflecting the absence of Kendall County operations partially offset by increased revenue from Taconite Harbor. Overall, nonregulated kilowatthour sales were down 11 percent from 2004. Revenue from Taconite Harbor was up $2.0 million due to a 76-MW one-year capacity contract that began in May 2004 and two 5-year contracts (175 MW in total) that began in May 2005. Coal revenue, realized under a cost-plus contract, was up $3.6 million from 2004 because of higher coal production expenses (see operating expense below).

COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (Continued)

Nonregulated Energy Operations (Continued)

Operating expenses were up $72.9 million from 2004, primarily due to the $77.9 million charge related to the assignment of the Kendall County power purchase agreement to Constellation Energy Commodities on April 1, 2005. Nonregulated generation fuel and purchased power expense was down $9.8 million from 2004, reflecting the absence of Kendall County operations. Operating expenses at Taconite Harbor were higher in 2005—sulfur dioxide emission allowance expenses were up $1.5 million and depreciation expense was up $0.3 million as a result of capitalized projects being completed and placed into operation. Expenses related to our coal operations were up $3.5 million, in part due to higher expenses associated with equipment repairs and a $1.4 million increase in lease expense related to the new dragline. In 2004, fewer equipment repairs reduced operating expenses.

Other income (expense) reflected $0.7 million less income in 2005, primarily due to fewer Minnesota land sales.

Real Estate

Operating revenue was down $6.7 million, or 19 percent, from 2004, primarily due to lower sales volume. In 2005, 579 acres and 7 lots were sold for $25.6 million, excluding deferred revenue of $8.5 million. Town Center accounted for 42 of the 96 acres sold in 2005 ($1.7 million of revenue, excluding $7.5 million of deferred revenue). In 2004, 1,427 acres and 211 lots were sold for $31.3 million in 2004, excluding deferred revenue of $0. Revenue from land sales was lower in 2005, primarily due to timing of transactions closing. Revenue from lot sales was also lower in 2005 because in January 2004 we sold the remaining 184 lots at Sugarmill Woods for $3.9 million, essentially exiting the lot sales business.

Operating expenses were down $0.7 million, or 7 percent, from 2004, primarily due to a $0.6 million decrease in selling expenses as a result of lower sales volume in 2005. Cost of sales, however, was higher in 2005—$5.8 million, excluding deferred cost of sales of $1.8 million ($5.5 million in 2004, excluding deferred cost of sales of $0).

Other

Operating revenue was down $0.8 million, or 3 percent, from 2004, due to decreased revenue from our telecommunications business because of fewer equipment sales.

Operating expenses were down $2.6 million, or 9 percent, from 2004, reflecting a $1.7 million decrease in expenses at our telecommunication business, primarily due to lower cost of goods sold associated with fewer equipment sales, and a reduction in other expenses following the spin-off of Automotive Services and exit from the Water Services businesses in 2004.

Interest expense was down $4.7 million from 2004, primarily due to lower debt balances. The Company repaid a $53 million balance on a credit agreement in April 2004 and $125 million of 7.80% Senior Notes in July 2004. A combination of internally-generated funds, proceeds from the sale of our Water Services assets and proceeds received from ADESA were used to repay debt.

Other income (expense) reflected $0.8 million more income in 2005, primarily due to a $1.8 million increase in earnings on cash and short-term investments. In 2005, we recorded $5.1 million of impairment losses related to our emerging technology investments ($5.5 million in 2004). In 2004, $1.3 million of income from a rabbi trust, established to secure certain deferred executive compensation, was recorded.

Income Taxes

The effective rate for income taxes in 2005 deviated from the statutory rate, primarily as a result of the emerging technology investment impairment losses recorded in March 2005 and the Kendall County capital loss recorded in April 2005. The current benefit for these items was limited to a federal benefit for income tax purposes. The state tax benefit from these items is not expected to be realized currently or in future periods. These state net capital loss carry forwards are entirely reserved. Current taxes also increased in 2005, due to the expiration of the accelerated depreciation deduction allowed by the Jobs and Growth Tax Relief Act of 2003, which expired December 31, 2004. The effective rate for income taxes for 2004 increased, due to nondeductible spin-off costs related to the ADESA transaction.

CRITICAL ACCOUNTING POLICIES

Certain accounting measurements under applicable GAAP involve management's judgment about subjective factors and estimates, the effects of which are inherently uncertain. Accounting measurements that we believe are most critical to our reported results of operations and financial condition include: impairment of long-lived assets, pension and postretirement health and life actuarial assumptions, valuation of investments and provisions for environmental remediation. These policies are reviewed with the Audit Committee of our Board of Directors on a regular basis and summarized in our 2004 Form 10-K.

OUTLOOK

The April 2005 assignment of the Kendall County power purchase agreement to Constellation Energy Commodities was a key strategic accomplishment for the Company. As a result of this assignment, we recorded expenses totaling $50.4 million after tax, or $1.84 per diluted share, in the second quarter of 2005, and eliminated anticipated annual losses of approximately $8 million after tax.

We continue to expect ALLETE's earnings per share from continuing operations to grow by 45 percent to 50 percent in 2005. The growth is expected to come from continued strong real estate sales, lower interest expense and the transfer of the Kendall County purchased power agreement. Our earnings expectation excludes the one-time charge related to the Kendall County assignment and any earnings from investments we may make in growth initiatives.

In 2005, we have fewer shares outstanding for earnings per share calculation purposes. The ESOP used proceeds from the sale of ADESA stock to purchase ALLETE common stock on the open market. Pursuant to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans," unallocated ALLETE common stock currently held by the ESOP is treated as unearned ESOP shares and not considered outstanding for earnings per share computations. ESOP shares are included in earnings per share computations after they are allocated to participants.

Regulated Utility and Nonregulated Energy Operations

As a result of MISO Day 2 implementation on April 1, 2005, energy transactions to serve retail customers are sourced by wholesale transactions with MISO as the counterparty. Minnesota Power filed a petition with the MPUC in February 2005 to amend the fuel clause to accommodate costs and revenue related to MISO Day 2 market implementation. On March 24, 2005, the MPUC approved interim accounting treatment of MISO Day 2 costs to be recovered through the fuel clause. This interim treatment will continue until the MPUC addresses the cost recovery petitions from Xcel Energy Inc., Otter Tail Power Company, Alliant Energy Corporation and Minnesota Power. The MPUC action regarding MISO Day 2 will include an analysis of how the fuel clause is affected, and whether it should be modified as a result of MISO Day 2.

On April 14, 2005, the PSCW approved an 11.7 percent return on common equity and a 3.9 percent average increase in retail utility rates for SWL&P customers. New rates became effective May 19, 2005.

In June 2005, we reached a long-term, all requirements agreement with United States Steel Corporation (USS) to provide electric service through October 2013 to its Minntac and Keewatin Taconite production facilities. Extending our electric supply contract is an important achievement for both USS and Minnesota Power. Electric power is a key component in the production of taconite and the taconite industry consumes a sizable portion of the electricity we produce. This agreement helps to provide planning certainty for both companies. The contract is subject to MPUC approval. Minntac and Keewatin Taconite, combined, use 275 megawatts of electricity. USS is our largest customer and represents approximately 12 percent of our consolidated annual revenue. We expect to be successful with additional industrial customer contract extensions going forward.

Also in June 2005, we added a significant resource to our Regulated Utility generation portfolio when we entered into a 25-year agreement to purchase approximately 50 megawatts of wind power from a new wind generation project to be built in North Dakota by an affiliate of FPL Energy, LLC. FPL Energy expects the facility to be operational by the end of 2006. The wind farm will include 33 new wind turbines linked to the Square Butte substation in Center, North Dakota. The project is subject to certain conditions, including regulatory approvals, as well as the extension of the federal production tax credit. We are actively pursuing proposals for a second new wind farm to be located in northeastern Minnesota.

OUTLOOK (Continued)

The U.S. Congress has completed debate on comprehensive energy legislation and is expected to pass and send the legislation to the President. The bill could be signed into law in early August 2005. Key provisions in the bill include: mandatory electric reliability standards; FERC backstop siting authority for transmission corridors of national interest, as well as, giving the Department of Energy (DOE) "lead agency" authority to coordinate federal agencies involved in siting transmission lines; and the repeal of the Public Utility Holding Company Act of 1935 (PUHCA) giving the FERC additional authority over merger reviews and allowing the states expanded books and records authority. The law also reforms the hydro licensing process and supports the DOE's clean coal/FutureGen program. We believe the overall impact on the electric utility industry will be positive, but we are currently evaluating the effects of this pending legislation and are unable to predict the impact on the Company's results of operations and our operations in general.

Real Estate

In March 2005, Florida Landmark signed an agreement with Developers Realty Corporation (DRC) to develop the first phase of the urban core area of Town Center at Palm Coast. The agreement also includes the development of a 51-acre commercial retail site. The agreement provides that DRC has an inspection period through July 31, 2005, which allows DRC to terminate the agreement with no penalty. Revenue associated with this agreement is anticipated to be $21.8 million over the life of the contract, which extends to September 2012. DRC is a regional commercial developer with strong ties to national retailers and has experience developing "lifestyle center" projects. ALLETE Properties recorded its first sales from Town Center at Palm Coast in the second quarter of 2005.

ALLETE Properties occasionally provides seller financing, and outstanding finance receivables were $12.5 million at June 30, 2005, with maturities ranging up to seven years. Outstanding finance receivables accrue interest at market-based rates. These finance receivables are collateralized by the financed properties.

Summary of Development Projects At June 30, 2005	**Ownership**	**Total Acres *(a)***	**Residential Units *(b)***	**Commercial Sq. Ft. *(b)***	**Office Sq. Ft. *(b)***	**Industrial Sq. Ft. *(b)***
Town Center at Palm Coast	80%	1,508	2,950	2,010,000	1,118,000	–
Palm Coast Park	100%	4,705	3,600	1,600,000	800,000	800,000
Ormond Crossings *(c)*	100%	5,773	–	–	–	–
		11,986	6,550	3,610,000	1,918,000	800,000

(a) Acreage amounts are approximate and shown on a gross basis, including wetlands and minority interest. Acreage amounts may vary due to platting or surveying activity. Wetland amounts vary by property and are often not formally determined prior to sale.
(b) Estimated and includes minority interest. The actual property breakdown at full build-out may be different than these estimates.
(c) Units and square footage have not been determined.

Summary of Other Land Inventories At June 30, 2005	**Ownership**	**Total**	**Mixed Use**	**Residential**	**Commercial**	**Agricultural**
Acres *(a)*						
Palm Coast Holdings	80%	2,888	1,848	513	281	246
Lehigh	80%	827	600	134	84	9
Cape Coral	100%	71	–	1	70	–
Other	100%	908	–	–	–	908
		4,694	2,448	648	435	1,163

(a) Acreage amounts are approximate and shown on a gross basis, including wetlands and minority interest. Acreage amounts may vary due to platting or surveying activity. Wetland amounts vary by property and are often not formally determined prior to sale. The actual property breakdown at full build-out may be different than these estimates.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Activities

A primary goal of our strategic plan is to improve cash flow from operations. Our strategy includes growing our businesses both internally by expanding facilities, services and operations (see Capital Requirements), and externally through acquisitions.

We believe our financial condition is strong, as evidenced by cash and cash equivalents of $79.1 million, $63.0 million of short-term investments and a debt to total capital ratio of 40 percent at June 30, 2005.

Excluding the Kendall County Charge and discontinued operations, we continued to generate strong cash flow from operating activities, which amounted to $63.8 million for the first six months of 2005 ($32.5 million for the first six months of 2004). Cash from operating activities, excluding the Kendall County Charge and discontinued operations, was higher in 2005, due to increased income from continuing operations, the collection of an outstanding receivable at December 31, 2004, from American Transmission Company LLC for work on the Duluth-to-Wausau transmission line and other receivables, and additional deferred profit on real estate activities.

Cash from investing activities, excluding discontinued operations, was higher in 2005, primarily due to $87.6 million in net proceeds received from the sale of short-term investments ($271.1 million in gross proceeds; $183.5 million for purchases) and lower additions to property, plant and equipment in 2005, which vary from period to period depending on projects. These increases were partially offset by $12 million received from Split Rock Energy in 2004 upon termination of the joint venture.

Cash for financing activities, excluding discontinued operations, was lower in 2005, primarily due to the repayment of a $53.0 million note payable in 2004.

ALLETE Properties' Town Center at Palm Coast development project in Florida (Town Center) is being financed with a revolving development loan and tax-exempt bonds. In March 2005, Florida Landmark entered into an $8.5 million revolving development loan with CypressCoquina Bank to fund approximately $26 million of Town Center development costs. The loan has an interest rate equal to the prime rate with an initial term of 36 months. The term of the loan may be extended 24 months, if certain conditions are met. Also in March 2005, the Town Center at Palm Coast Community Development District (Town Center CDD) issued $26.4 million of tax-exempt, 6% Capital Improvement Revenue Bonds, Series 2005, due May 1, 2036 (Bonds). Approximately $21 million of the Bond proceeds will be used for construction of infrastructure improvements at Town Center, with the remaining funds to be used for capitalized interest, a debt service reserve fund and costs of issuance. The Bonds are payable from and secured by the revenue derived from assessments to be imposed, levied and collected by the Town Center CDD. The assessments represent an allocation of the costs of the improvements, including bond financing costs, to the lands within the Town Center CDD benefiting from the improvements. The assessments will be included in the annual property tax bills of land owners in the development project beginning in November 2006. Town Center CDD is an independent unit of local government, created and established in accordance with Florida's Uniform Community Development District Act of 1980 (Act). The Act provides legal authority for a community development district to finance the construction of major infrastructure for community development with general obligation, revenue and special assessment revenue debt obligations.

Working Capital. Additional working capital, if and when needed, generally is provided by the sale of commercial paper. Approximately 1 million original issue shares of our common stock are available for issuance through *Invest Direct*, our direct stock purchase and dividend reinvestment plan.

Securities

In March 2001, ALLETE, ALLETE Capital II and ALLETE Capital III, jointly filed a registration statement with the SEC, pursuant to Rule 415 under the Securities Act of 1933. The registration statement, which has been declared effective by the SEC, relates to the possible issuance of a remaining aggregate amount of $387 million of securities, which may include ALLETE common stock, first mortgage bonds and other debt securities, and ALLETE Capital II and ALLETE Capital III preferred trust securities. ALLETE also previously filed a registration statement, which has been declared effective by the SEC, relating to the possible issuance of $25 million of first mortgage bonds and other debt securities. We may sell all or a portion of the remaining registered securities if warranted by market conditions and our capital requirements. Any offer and sale of the above-mentioned securities will be made only by means of a prospectus meeting the requirements of the Securities Act of 1933 and the rules and regulations thereunder.

In March 2005, ALLETE executed a bond purchase agreement with certain institutional buyers in the private placement market to sell $35 million of ALLETE's first mortgage bonds. When issued, on or about August 1, 2005, the bonds will carry an interest rate of 5.28% and will have a term of 15 years. In June 2005, ALLETE called for redemption on August 1, 2005, $35 million in principal amount of First Mortgage Bonds, 7 1/2% Series due 2007.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements are summarized in our 2004 Form 10-K, with additional disclosure discussed in Note 13 of this Form 10-Q.

Capital Requirements

For the six months ended June 30, 2005, capital expenditures for continuing operations totaled $24.2 million ($34.7 million in 2004). Expenditures for the six months ended June 30, 2005, included $20.7 million for Regulated Utility, $1.9 million for Nonregulated Energy Operations and $1.6 million for Other, which related to our telecommunications business. Internally-generated funds were the source of funding for these expenditures.

Capital expenditures are expected to be $61 million in total for 2005 ($48 million for system component replacement and upgrades within Regulated Utility; $11 million for system component replacement and upgrades, and coal handling equipment within Nonregulated Energy Operations; and $2 million for telecommunication fiber within Other). We expect to use internally-generated funds to fund all capital expenditures.

Due to the passage of two new EPA rules in 2005 that reduce and permanently cap emissions of mercury, sulfur dioxide, nitrogen oxides and particulates from the electric utility industry, capital expenditures are expected to total about $675 million for 2006 through 2009, an increase of $175 million from the previously anticipated $500 million. This estimated increase reflects additional technological investment in our existing facilities. We are considering, however, a combination of solutions that include both technology and emission allowance purchases. We have commenced litigation in the U.S. Court of Appeals for the District of Columbia Circuit and intend to file a Petition for Reconsideration to have the EPA revisit flaws in the application and methodology of the CAIR rule. If successful, we expect our compliance costs to be approximately $175 million lower than our current expected capital expenditures, which reflect application of the current rules to Minnesota Power's facilities. (See Note 13.)

ENVIRONMENTAL MATTERS AND OTHER

As previously mentioned in our Critical Accounting Policies section, our businesses are subject to regulation by various federal, state and local authorities concerning environmental matters. We anticipate that potential expenditures for environmental matters will be material in the future, due to stricter environmental requirements through legislation and/or rulemakings that are expected to require significant capital investments. We are unable to predict the outcome of the issues discussed in Note 13.

NEW ACCOUNTING STANDARDS

New accounting standards are discussed in Note 1.

Readers are cautioned that forward-looking statements including those contained above, should be read in conjunction with our disclosures under the heading: "SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995" located on page 3 of this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SECURITIES INVESTMENTS

Available-For-Sale Securities. Our securities investments include certain securities, which are accounted for as available-for-sale securities. Available-for-sale securities are recorded at fair value with unrealized gains and losses included in accumulated other comprehensive income (loss), net of tax. Unrealized losses that are other than temporary are recognized in earnings. At June 30, 2005, our available-for-sale securities portfolio consisted of securities in a grantor trust established to fund certain employee benefits included in Investments and various auction rate municipal bonds and variable rate municipal demand notes included as Short-Term Investments. Our available-for-sale securities portfolio had a fair value of $92.4 million at June 30, 2005 ($179.4 million at December 31, 2004) and a total unrealized after-tax gain of $1.5 million at June 30, 2005 ($1.5 million at December 31, 2004). We use the specific identification method as the basis for determining the cost of securities sold. Our policy is to review on a quarterly basis available-for-sale securities for other than temporary impairment by assessing such factors as the continued viability of products offered, cash flow, share price trends and the impact of overall market conditions. As a result of our periodic assessments, we did not record any impairment on available-for-sale securities for the six months ended June 30, 2005.

Emerging Technology Portfolio. As part of our emerging technology portfolio, we have several minority investments in venture capital funds and direct investments in privately-held, start-up companies. We account for our investment in venture capital funds under the equity method and account for our direct investment in privately-held companies under the cost method. The total carrying value of our emerging technology portfolio was $8.7 million at June 30, 2005, down $4.9 million from December 31, 2004. In March 2005, we recorded $5.1 million ($3.3 million after tax) of impairment losses, which included a reserve for future commitments, that related to direct investments in certain privately-held, start-up companies whose future business prospects have diminished significantly. Recent developments at these companies indicated that future commercial viability is unlikely, as is new financing necessary to continue development. Our basis in cost method investments included in the emerging technology portfolio was zero at June 30, 2005 ($4.5 million at December 31, 2004). Our policy is to review these investments quarterly for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment.

COMMODITY PRICE RISK

Our regulated utility operations in Minnesota and Wisconsin incur costs for fuel (primarily coal), power and natural gas purchased for resale in our regulated service territories, and related transportation. Our regulated utilities' exposure to price risk for these commodities is significantly mitigated by the current ratemaking process and regulatory environment which generally allows a fuel clause surcharge if costs are in excess of those in our last rate filing. Conversely, costs below those in our last rate filing result in a rate credit. We seek to prudently manage our customers' exposure to price risk by entering into contracts of various durations and terms for the purchase of coal and power (in Minnesota), power and natural gas (in Wisconsin), and related transportation costs.

POWER MARKETING

Our power marketing activities consist of (1) purchasing energy in the wholesale market for resale in our regulated service territories when retail energy requirements exceed generation output, and (2) selling excess available regulated utility generation and purchased power, as well as selling nonregulated generation.

From time to time, our regulated utility operations may have excess generation that is temporarily not required by retail and municipal customers in our regulated service territory. We actively sell this generation to the wholesale market to optimize the value of our generating facilities. This generation is generally sold in the MISO market or under short-term contracts at market prices.

We have approximately 200 MW of nonregulated generation available for sale to the wholesale markets at our Taconite Harbor facility in northern Minnesota, which has been sold through various short-term and long-term capacity and energy contracts. Approximately 116 MW of existing capacity and energy sales contracts expired on April 30, 2005. Long-term, we have entered into two capacity and energy sales contracts totaling 175 MW (201 MW including a 15 percent reserve), which were effective May 1, 2005, and expire on April 30, 2010. Both contracts contain fixed monthly capacity charges and fixed minimum energy charges. One contract provides for an annual escalator to the energy charge based on increases in our cost of coal, subject to a small minimum annual escalation. The other contract provides that the energy charge will be the greater of a fixed minimum charge or an amount based on the variable production cost of a combined-cycle, natural gas unit. Our exposure in the event of a full or partial outage at our Taconite Harbor facility is significantly limited under both contracts. When the buyer is notified at least two months prior to an outage, there is no exposure. Outages with less than two months' notice are subject to an annual duration limitation typical of this type of contract. We also have a 50 MW capacity and energy sales contract that extends through April 2008 and a 15 MW energy sales contract that extends through May 2007. The 50 MW capacity and energy sales contract has fixed pricing through January 2006 and market-based pricing thereafter.

In addition to generation, Taconite Harbor will meet its sales contract obligations with two contracts that began in May 2005. We have a 50 MW capacity and energy purchase contract that extends through April 2006, with fixed capacity payments and the right to purchase energy at market price. We also have a 25 MW fixed-priced energy purchase contract that extends through January 2006.

ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of management, including our chief executive officer and chief financial officer, as of the end of the period covered by this Form 10-Q. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings. While we continue to enhance our internal control over financial reporting, there has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION
ITEM 1. LEGAL PROCEEDINGS

Material legal and regulatory proceedings are included in the discussion of Other Information in Part II, Item 5 and/or Note 13, and are incorporated by reference herein.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) We held our Annual Meeting of Shareholders on May 10, 2005.

(b) Included in (c) below.

(c) The election of directors, the ratification of the appointment of PricewaterhouseCoopers LLP, as the Company's independent registered public accounting firm for 2005, and the continuation of the ALLETE Executive Long-Term Incentive Compensation Plan were voted on at the Annual Meeting of Shareholders.

The results were as follows:

	Votes For	Votes Withheld
Directors		
Heidi J. Eddins	25,575,868	587,372
Peter J. Johnson	25,438,790	724,450
Madeleine W. Ludlow	25,520,384	642,856
George L. Mayer	25,437,028	726,212
Roger D. Peirce	25,397,560	765,680
Jack I. Rajala	25,322,780	840,460
Donald J. Shippar	25,643,498	519,742
Nick Smith	25,422,674	740,566
Bruce W. Stender	25,605,356	557,884

	Votes For	Votes Against	Abstentions	Broker Nonvotes
Independent Registered Public Accounting Firm				
PricewaterhouseCoopers LLP	25,296,573	707,633	159,034	–
Continuation of the Executive Long-Term Incentive Compensation Plan	17,743,925	3,081,478	861,677	4,476,160

(d) Not applicable.

ITEM 5. OTHER INFORMATION

Reference is made to our 2004 Form 10-K for background information on the following updates. Unless otherwise indicated, cited references are to our 2004 Form 10-K.

Ref. Page 8 – New Footnote to Contract Status for Minnesota Power Large Power Customers Table

In June 2005, Minnesota Power reached a long-term agreement with United States Steel Corporation (USS) to provide electric service through October 2013 to its Minntac and Keewatin Taconite production facilities. USS is Minnesota Power's largest energy customer. The contract is subject to MPUC approval.

Ref. Page 11 – First Paragraph

On May 27, 2005, we entered into a 25-year agreement with an affiliate of FPL Energy, LLC to purchase all of the renewable energy from an approximately 50-megawatt wind facility to be built in North Dakota. FPL Energy, LLC expects the facility to be operational by the end of 2006. The wind farm will include 33 new wind turbines linked to the Square Butte substation in Center, North Dakota. The project is subject to certain conditions, including regulatory approvals, as well as the extension of the federal production tax credit (PTC). In addition, we are actively pursuing proposals for the purchase of renewable energy from a second new wind farm that would be located in northeastern Minnesota. This project, expected to be operational in 2006 or 2007, would be similar in size to the North Dakota project and would be subject to contract negotiation and execution, as well as regulatory approvals and extension of the PTC.

Ref. Page 11 -– Seventh Paragraph

The U.S. Congress has completed debate on comprehensive energy legislation and is expected to pass and send the legislation to the President. The bill could be signed into law in early August 2005. Key provisions in the bill include: mandatory electric reliability standards; FERC backstop siting authority for transmission corridors of national interest, as well as, giving the Department of Energy (DOE) "lead agency" authority to coordinate federal agencies involved in siting transmission lines; and the repeal of the Public Utility Holding Company Act of 1935 (PUHCA) giving the FERC additional authority over merger reviews and allowing the states expanded books and records authority. The law also reforms the hydro licensing process and supports the DOE's clean coal/FutureGen program. We believe the overall impact on the electric utility industry will be positive, but we are currently evaluating the effects of this pending legislation and are unable to predict the impact on the Company's results of operations and our operations in general.

Ref. Page 13 – New Paragraph after Second Paragraph

On June 24, 2005, a growth management bill was signed into law by the Governor of Florida that will significantly change Florida's land development regulations. Generally, the bill requires that sufficient roads, schools and water supply be in place before future development can be approved by local governments. Our Town Center and Palm Coast Park development projects were "grandfathered" under the former regulations and will not be impacted. Ormond Crossings and future Company projects will be regulated by the new legislation. However, due to the large scale of these projects, roads, schools and water supply were already being addressed in our development approvals. Smaller developments will see the greatest negative effect of the legislation, which could lead to a competitive advantage for us under our long-term strategy, but could negatively impact our short-term efforts to obtain development approvals for smaller projects.

ITEM 6. EXHIBITS

Exhibit Number

10	Director Compensation Summary.
31(a)	Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(b)	Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Section 1350 Certification of Periodic Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99	ALLETE News Release dated July 29, 2005, announcing 2005 second quarter earnings. **[This exhibit has been furnished and shall not be deemed “filed” for purposes of Section 18 of the Securities Act of 1934, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.]**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALLETE, Inc.

July 29, 2005

/s/ James K. Vizanko
James K. Vizanko
Senior Vice President and Chief Financial Officer

July 29, 2005

/s/ Mark A. Schober
Mark A. Schober
Senior Vice President and Controller

EXHIBIT INDEX

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Exhibit 10

ALLETE, INC.

Director Compensation

EFFECTIVE MAY 1, 2005

Board Retainers [1][2]	
Cash	$23,500
Stock	$47,500
Committee Cash Retainers [1][2]	
Audit	$9,000
Executive Compensation	$7,500
Corporate Governance & Nominating	$7,500
Chair Cash Retainers [1][2]	
Audit	$8,500
Executive Compensation	$5,500
Corporate Governance & Nominating	$4,500

Lead Director/Non-Employee Chairman Retainer [1][2][3]	
Cash	$73,000
Stock	$47,500

1 Cash retainers may be deferred under the Director Compensation Deferral Plan.
2 Cash retainers may be elected to be received in ALLETE stock.
3 Represents total compensation for Lead Director/Non-Employee Chairman. Not eligible for other committee or chair retainers.

Exhibit 31(a)

Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Donald J. Shippar, President and Chief Executive Officer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended June 30, 2005, of ALLETE;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2005

/s/ Donald J. Shippar

Donald J. Shippar
President and Chief Executive Officer

Exhibit 31(b)

Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, James K. Vizanko, Senior Vice President and Chief Financial Officer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended June 30, 2005, of ALLETE;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2005

/s/ James K. Vizanko

James K. Vizanko
Senior Vice President and Chief Financial Officer

Exhibit 32

Section 1350 Certification of Periodic Report
By the Chief Executive Officer and Chief Financial Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, each of the undersigned officers of ALLETE, Inc. (ALLETE), does hereby certify that:

1. The Quarterly Report on Form 10-Q of ALLETE for the quarterly period ended June 30, 2005 (Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of ALLETE.

Date: July 29, 2005

/s/ Donald J. Shippar
Donald J. Shippar
President and Chief Executive Officer

Date: July 29, 2005

/s/ James K. Vizanko
James K. Vizanko
Senior Vice President and Chief Financial Officer

This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability pursuant to that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that ALLETE specifically incorporates it by reference.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to ALLETE and will be retained by ALLETE and furnished to the Securities and Exchange Commission or its staff upon request.

For Release: July 29, 2005
Contact: Margaret Hodnik
218-723-3966
mhodnik@allete.com

Investor Contact: Tim Thorp
218-723-3953
tthorp@allete.com

NEWS

ALLETE reports second quarter results; reaffirms guidance for 2005 earnings growth

Kendall County charge impacts quarterly earnings

For the second quarter 2005, ALLETE, Inc. (NYSE: ALE) today reported a loss of $1.45 per share from continuing operations that included a previously-announced charge of $1.84 per share related to the assignment of the Kendall County, Ill. power purchase agreement.

Excluding the Kendall County charge, ALLETE's earnings from continuing operations were 39 cents per share compared with eight cents per share in the second quarter of 2004. The company's earnings in the second quarter of 2004 were adversely affected by an impairment charge.

"We're pleased that our core energy and real estate businesses continue to perform at a high level," said Donald J. Shippar, CEO of ALLETE. The company reaffirmed its guidance of 45 to 50 percent earnings growth in 2005 from continuing operations, excluding the Kendall transaction and any earnings from investments it may make in growth initiatives.

"Two significant events occurred during the quarter," Shippar said. "First, the Kendall County transaction was a key strategic accomplishment for our company. Second, site preparation began at our Town Center at Palm Coast project, which we expect will contribute substantial earnings over the next few years."

Quarterly net income from continuing operations at the company's **Regulated Utility** segment climbed five percent to $7.8 million compared to the second quarter of 2004, due to continued strong electricity sales to retail customers and other power suppliers.

Real Estate income from continuing operations was $2.8 million in the second quarter of 2005, compared with $2.1 million in the same period a year ago. During the quarter, ALLETE Properties recorded its first sales from Town Center at Palm Coast, a major development project now taking shape in the fast-growing northeast Florida community.

Results from **Nonregulated Energy Operations** reflected the Kendall County charge, which was announced by ALLETE in April of this year. The elimination of operating losses incurred at the Kendall County facility was partially offset by increased expenses at the Taconite Harbor generating facility and less income at other Nonregulated Energy Operations businesses.

In ALLETE's **Other** business segment, the second quarter produced income from continuing operations of $300,000 compared to a loss of $7.2 million a year ago. This quarter the company benefited from lower interest expense due to reduced debt balances and debt refinancing. In the second quarter of 2004, the company recorded a $3.2 million after-tax impairment in its emerging technology investment portfolio.

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ALLETE, headquartered in Duluth, Minn., provides energy services in the upper Midwest and has significant real estate holdings in Florida. More information about the company is available at www.allete.com.

The statements contained in this release and statements that ALLETE may make orally in connection with this release that are not historical facts are forward-looking statements. Actual results may differ materially from those projected in the forward-looking statements. These forward-looking statements involve risks and uncertainties, and investors are directed to the risks discussed in documents filed by ALLETE with the Securities and Exchange Commission.

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ALLETE, Inc.

Consolidated Statement of Income
For the Periods Ended June 30, 2005 and 2004
Millions Except Per Share Amounts

	Quarter Ended		Year to Date	
	2005	2004	2005	2004
Operating Revenue	$186.8	$186.2	$393.7	$395.2
Operating Expenses				
Fuel and Purchased Power	70.3	77.2	139.4	146.1
Operating and Maintenance	81.6	77.2	164.7	160.8
Kendall County Charge	77.9	–	77.9	–
Depreciation	12.7	12.5	25.3	24.9
Total Operating Expenses	242.5	166.9	407.3	331.8
Operating Income (Loss) from Continuing Operations	(55.7)	19.3	(13.6)	63.4
Other Income (Expense)				
Interest Expense	(6.7)	(9.1)	(13.5)	(18.2)
Other	1.5	(3.5)	(2.7)	(3.1)
Total Other Expense	(5.2)	(12.6)	(16.2)	(21.3)
Income (Loss) from Continuing Operations Before Minority Interest and Income Taxes	(60.9)	6.7	(29.8)	42.1
Minority Interest	0.2	0.5	1.4	1.9
Income (Loss) from Continuing Operations Before Income Taxes	(61.1)	6.2	(31.2)	40.2
Income Tax Expense (Benefit)	(21.5)	3.8	(9.6)	16.4
Income (Loss) from Continuing Operations Before Change in Accounting Principle	(39.6)	2.4	(21.6)	23.8
Income (Loss) from Discontinued Operations – Net of Tax	(0.7)	34.3	(1.3)	65.6
Change in Accounting Principle – Net of Tax	–	–	–	(7.8)
Net Income (Loss)	$ (40.3)	$ 36.7	$ (22.9)	$ 81.6
Average Shares of Common Stock				
Basic	27.2	28.4	27.2	28.2
Diluted	27.2	28.5	27.2	28.4
Basic Earnings (Loss) Per Share of Common Stock				
Continuing Operations	$(1.45)	$0.08	$(0.79)	$0.85
Discontinued Operations	(0.03)	1.21	(0.05)	2.32
Change in Accounting Principle	–	–	–	(0.28)
	$(1.48)	$1.29	$(0.84)	$2.89
Diluted Earnings (Loss) Per Share of Common Stock				
Continuing Operations	$(1.45)	$0.08	$(0.79)	$0.84
Discontinued Operations	(0.03)	1.21	(0.05)	2.31
Change in Accounting Principle	–	–	–	(0.27)
	$(1.48)	$1.29	$(0.84)	$2.88
Dividends Per Share of Common Stock	$0.3150	$0.8475	$0.6150	$1.6950

Consolidated Balance Sheet
Millions

	Jun. 30, 2005	Dec. 31, 2004		Jun. 30, 2005	Dec. 31, 2004
Assets			**Liabilities and Shareholders' Equity**		
Cash and Cash Equivalents	$ 79.1	$ 44.9	Current Liabilities	$ 85.7	$ 97.8
Restricted Cash	–	30.3	Long-Term Debt	389.3	390.2
Short-Term Investments	63.0	149.2	Other Liabilities	295.5	300.9
Other Current Assets	152.9	141.7	Discontinued Operations	6.5	12.0
Property, Plant and Equipment	883.0	883.1	Shareholders' Equity	576.4	630.5
Investments	123.3	124.5			
Discontinued Operations	4.0	4.9			
Other	48.1	52.8			
Total Assets	$1,353.4	$1,431.4	**Total Liabilities and Shareholders' Equity**	$1,353.4	$1,431.4

ALLETE, Inc.	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Year to Date June 30, 2005	Year to Date June 30, 2004
Net Income (Loss)				
Millions				
Regulated Utility	$ 7.8	$ 7.4	$ 20.7	$19.9
Nonregulated Energy Operations *(a)*	(50.5)	0.1	(48.9)	(0.1)
Real Estate	2.8	2.1	9.7	13.0
Other	0.3	(7.2)	(3.1)	(9.0)
Income (Loss) from Continuing Operations	(39.6)	2.4	(21.6)	23.8
Income (Loss) from Discontinued Operations	(0.7)	34.3	(1.3)	65.6
Change in Accounting Principle	–	–	–	(7.8)
Net Income	$(40.3)	$36.7	$(22.9)	$81.6
Diluted Earnings (Loss) Per Share				
Continuing Operations	$(1.45)	$0.08	$(0.79)	$0.84
Discontinued Operations	(0.03)	1.21	(0.05)	2.31
Change in Accounting Principle	–	–	–	(0.27)
	$(1.48)	$1.29	$(0.84)	$2.88

(a) *In April 2005, ALLETE recorded a $50.4 million, or $1.84 per diluted share, charge related to the assignment of the Kendall County power purchase agreement.*

Note: In 2005, we began allocating corporate charges and interest expense to our business segments. For comparative purposes, segment information for 2004 has been restated to reflect the new allocation method used in 2005 for corporate charges and interest expense. This restatement had no impact on consolidated net income or earnings per share.

	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004	Year to Date June 30, 2005	Year to Date June 30, 2004
Kilowatthours Sold				
Millions				
Regulated Utility				
Retail and Municipals				
Residential	229.9	228.8	549.7	539.1
Commercial	300.5	294.3	640.3	626.2
Industrial	1,746.9	1,770.0	3,524.0	3,536.8
Municipals	199.3	189.0	421.3	402.8
Other	18.1	17.8	38.5	38.0
	2,494.7	2,499.9	5,173.8	5,142.9
Other Power Suppliers	366.9	168.4	603.6	385.6
	2,861.6	2,668.3	5,777.4	5,528.5
Nonregulated Energy Operations	399.9	414.6	753.8	848.6
	3,261.5	3,082.9	6,531.2	6,377.1
Real Estate				
Acres Sold	96	159	579	1,427
Lots Sold	–	12	7	211