Unlocking Value

2001 Annual Report and Form 10-K

ALLETE

Dear Shareholders —

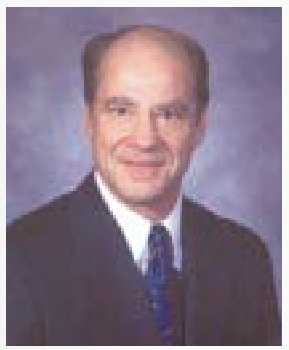
I have been fortunate to be a part of the growth and continuous change of ALLETE for the last 26 years. By far the greatest strength of the company has been its employees — their energy, focus and commitment to excellence. The result of their hard work is best illustrated by ALLETE's total shareholder return. Our annual TSR has averaged 17% since 1980 and 19% and 28% the past five-year and two-year periods, respectively. We're proud of our record, and we will never be complacent.

We resolve to continue this record of TSR growth. In order to do so, we will focus on earnings performance, strong cash flow discipline and sticking to the things we do best. Energy services and automotive remarketing — ALLETE's core competencies — will command our strategic thinking and define what we do as a corporation. Another example of our commitment to TSR growth was evident when our board of directors raised the dividend on our common stock by nearly 3% per share in January 2002.

ALLETE's top management decided to exit the water business from a position of strength. Over two decades, we built our water businesses — Florida Water Services and Heater Utilities — into the largest investor owned water utilities in Florida and North Carolina, respectively. We concluded that the growth of these businesses would never be significant to ALLETE and to value creation.

Our exit from the water business will result in a substantial flow of cash to ALLETE. We will use the proceeds from the sale of our water businesses to build a stronger corporation. The long-term development of our water utilities in Florida and North Carolina is a credit to the foresight and astute management our people employed to consolidate an assortment of small utilities into very valuable properties. The value we unlock with the sale of these assets is a great example of how our employees can make the most of an opportunity.

Just as we changed two decades ago to diversify into the water business, we will change again to create new opportunities. We've identified two major areas where we intend to invest: energy generation and the remarketing of "total loss" vehicles. As you will see in the pages that follow, our management team has laid the groundwork for a major expansion in these two promising areas.



David G. Gartzke

Energy production has been at the core of our business for almost a century. We've won major regulatory approvals, teamed with our partners at Wisconsin Public Service Corporation, to construct a 345-kilovolt transmission line across northwest Wisconsin. The time is right to expand our electric power base. The Mid-Continent Area Power Pool projects deficits in electric reserve capacity beginning in 2006 that will grow to nearly 3,000 megawatts by 2009. Such a shortfall would pose a serious threat to the reliability of the power grid in the Upper Midwest.

Already we are generating power at Taconite Harbor, where we acquired a 225-megawatt steam generating station from LTV Steel Mining Co. last year. We have a major co-generation facility on the drawing board at the Blandin Paper plant in Grand Rapids after we successfully started up a smaller co-gen plant at the Potlatch Paper facility in Cloquet. A gas-fired peaking plant is planned for Superior, WI with a projected start-up date of late 2003.

The Board is committed to the vision of creating a world class automotive remarketing company. During the past two years, we've invested more than $500 million to double our number of wholesale vehicle auctions and become the third largest provider of "total loss" vehicle services in North America. We have built our ADESA franchise to be the second largest vehicle remarketing network on the continent. We believe the auction market for "total loss" vehicles also has excellent growth potential. We plan to leverage our existing 23 "total loss" vehicle auctions into a strong network of services that will appeal to insurers who regularly take possession of thousands of "totaled" vehicles. And, of course, we plan to advance our industry leadership position in auto dealer financing through our wholesale and "total loss" vehicle auctions.

One of our challenges at ALLETE is to help investors understand our businesses. By consolidating into two basic endeavors, automotive remarketing and energy services, we sharpen the focus for both management and investors.

In summary, ALLETE is making a concerted effort to unlock the value in this corporation:

- By selling our water/wastewater businesses and using the cash proceeds to strengthen the energy and automotive components of our corporation.
- By exiting businesses that don't fit with our core competencies, are not strategic or significant, or have under-performed financially.
- By clarifying investor understanding of ALLETE's long-term value as an investment.

I am excited about the opportunities and challenges in front of us. As the cover of this report suggests, ALLETE common stock is not fully valued in the market despite our outstanding long-term TSR growth. We are committed to unlocking the value and closing this gap.

On behalf of our 14,000 employees and our customers across the continent, thank you for your investment in ALLETE.

David G. Gartzke
Chairman, President and Chief Executive Officer

Financial Highlights

Millions except per share amounts

	2001	2000	1999
Operating Revenue	$1,527.7	$1,189.5	$995.5
Net Income	$138.7	$148.6	$ 68.0
Pro Forma Adjustments	4.4 *(a)*	(30.4) *(b)*	36.2 *(b)*
	$143.1	$118.2	$104.2
Diluted Earnings Per Share of Common Stock	$1.81	$2.11	$0.97
Pro Forma Adjustments	0.06 *(a)*	(0.44) *(b)*	0.52 *(b)*
	$1.87	$1.67	$1.49
Diluted Average Shares Outstanding	76.5	70.1	68.7
Dividends Per Share of Common Stock	$1.07	$1.07	$1.07
Total Assets	$3,282.5	$2,914.0	$2,312.6
Capital Expenditures	$153.0	$168.7	$99.7

(a) In December 2001 ALLETE recorded a $4.4 million, or $0.06 per share, charge to exit the auto transport company.

(b) In May 2000 ALLETE sold its investment in ACE Limited common stock, which resulted in an after-tax gain of $30.4 million, or $0.44 per share. The ACE shares were received in December 1999 upon completion of ACE's merger with Capital Re Corporation. During 1999 ALLETE recorded an aggregate $36.2 million, or $0.52 per share, after-tax charge in connection with the valuation and exchange of its investment in Capital Re stock for the ACE shares.

This annual report contains "forward-looking" statements as defined in the Private Securities Litigation Reform Act of 1995. Such statements should be read with the cautionary language and important factors included in the Annual Report and Form 10-K on page 10.

Growth

Minnesota Power, a division of ALLETE, strengthened its generation supply, won major approvals for a transmission project and moved forward with new initiatives during a landmark year for our energy business. The accomplishments of 2001 are expected to position Minnesota Power to generate more electricity, move it more readily, manage more transactions with less risk and benefit system reliability.

Against an uncertain backdrop of electric industry restructuring that featured bankruptcies at California utilities and at Enron, the nation's dominant energy trading firm, Minnesota Power took deliberate steps to enhance its competitive position in the Upper Midwest. While some regions suffered through power outages, Minnesota Power expanded its generation portfolio. While some power traders overextended themselves, Minnesota Power focused on partnership and profitability.

A partial rundown of recent Minnesota Power achievements:

Duluth-to-Wausau transmission line wins approval

The Public Service Commission of Wisconsin unanimously approved the construction of a 220-mile electric transmission line from Duluth, MN to Wausau, WI, saying it was necessary to insure the reliability of the regional electric grid. A joint project of Minnesota Power and Wisconsin Public Service Corporation, the proposal to "Power Up Wisconsin" with a much-needed new transmission line was announced in April 1999. Expected to cost $200 million, it is the largest transmission line approved in the U.S. in 2001.

The finalized route begins at the Arrowhead substation near Duluth and runs across northwest Wisconsin to just south of Wausau. Engineering and geographical surveys are underway. We see the project as an example of how communities, utilities and private landowners can work to ensure reliable electric supplies to the region.

The line is intended to provide economic stability and long-term energy security. It represents the first step in improving the reliability of the transmission system in the Upper Midwest. The selected route minimizes environmental impact and conflict with landowners.

Minnesota Power buys generating plant from LTV Steel Mining

Minnesota Power purchased a 225-megawatt coal-fired electric generating plant formerly operated by LTV Steel Mining Company in Taconite Harbor, MN. A 60-mile transmission line, railroad trackage rights and approximately 30,000 acres of forest and recreation land in northeast Minnesota were also acquired. As a part of the transaction, Minnesota Power will donate public use properties in Hoyt Lakes to enhance recreation.

Located about 75 miles northeast of Duluth, the Taconite Harbor facility consists of three 75-megawatt electric generating units fueled by sub-bituminous coal. Following cleanup and maintenance, all three units are projected to be generating electricity for Minnesota Power by May 2002, returning dozens of jobs lost with the closure of LTV. Electricity will be generated for system capacity and regional energy needs. A small portion of the power will be reserved for future economic development at the former LTV site.

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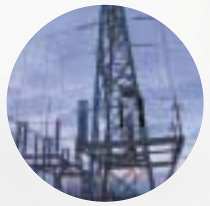

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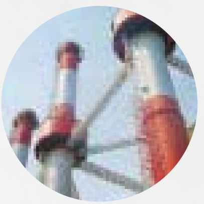

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1 The northern end of the Duluth-Wausau 345-kilovolt transmission line will connect to Minnesota Power's Arrowhead substation.
2 The Taconite Harbor generating station acquired from LTV will be operational in 2002.
3 Minnesota Power and Potlatch Corporation launched a new co-generation facility in Cloquet, MN in 2001.

4 A 225-megawatt co-generation facility is planned for construction at the Blandin Paper facility in Grand Rapids, MN in partnership with UPM-Kymmene of Finland.
5 The acquisition of Enventis strengthens the telecommunications component of Energy Services.

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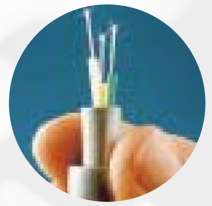

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In the same transaction, Cleveland-Cliffs Inc. bought the taconite processing plant and related mining lands in Hoyt Lakes, MN formerly owned by LTV, which filed for bankruptcy protection and shut down its processing plant early in 2001.

Customer-based generation projects:

New generator serves Potlatch Paper facility

Minnesota Power and Potlatch Corporation successfully started up Minnesota Power's new generating unit at Potlatch's pulp and paper facility in Cloquet, MN. Fueled by natural gas and wood waste, the 23-megawatt unit furnishes steam to Potlatch paper-making operations and provides electricity for other electric customers in the region. Under terms of a partnership agreement, Potlatch operates and maintains the plant.

Larger plant planned in partnership with UPM-Kymmene

A similar but much larger project is on the drawing board in Grand Rapids, MN. Minnesota Power and UPM-Kymmene of Helsinki, Finland are working on a proposal to build a 225-megawatt energy facility adjacent to the Blandin Paper Company facility. The combined heat and power plant will utilize state-of-the-art technologies in efficiency and environmental controls. The low-sulfur sub-bituminous coal-fired generating facility will be designed to satisfy up to 40% of its fuel requirements by burning renewable biomass, such as wood waste.

The generator's efficient design will replicate a project recently completed in Pietarsaari, Finland that is the world's largest bio-fuel circulating fluidized bed boiler.

The plant, as proposed, would replace existing energy production facilities at the Blandin Paper mill and would produce significant employment opportunities during construction.

A new company, Rapids Power LLC, was created to own the facility. Minnesota Power subsidiary Rainy River Energy Corporation owns 71.5% and Blandin Paper, a subsidiary of UPM-Kymmene, owns 28.5%. The project is proposed to produce steam for paper processing and electricity for the wholesale power market.

Details of Superior "peaking" plant announced

Minnesota Power released detailed plans to build a natural gas-fired electric generating plant near Superior, WI to help meet the region's energy needs during times of peak demand. The single-cycle "peaking" plant will be capable of producing approximately 160 megawatts of electric power. Construction of the plant, consistent with Minnesota Power's strategy to increase its presence in the merchant generation business, is slated for completion in late 2003.

ALLETE acquires data network provider, Enventis, Inc.

The telecommunications component of Energy Services was strengthened by the acquisition in 2001 of Enventis, Inc., a Twin Cities, MN-based data network systems provider. Enventis designs, deploys and supports networks that combine voice, video and data traffic into a single infrastructure. The transaction helps position ALLETE's telecommunications business as one of the leading integrated data service providers in the Upper Midwest. Enventis enhances the value of Energy Services' fiber optic system. All telecommunications operations are being merged under the name Enventis Telecom, Inc.

An alliance forged to smooth out volatility

Through its Split Rock Energy alliance with Great River Energy, Minnesota Power has taken a major step toward reducing risks due to fluctuations in wholesale power prices. This partnership, which pools both organizations' generation resources and electric loads, allows joint economic dispatch and provides its members with trading, marketing, transmission, risk management and accounting services.

Networks

It's not just an auction company anymore. It's an automotive remarketing company with the used vehicle industry's most comprehensive array of services.

By offering an expanding circle of customers new levels of service, ALLETE Automotive Services has become a key player in the North American auto industry.

ADESA and AFC drive 50% net income growth

Automotive Services' net income exceeded our expectations in 2001, growing to $74.8 million, a 50% increase over 2000. Despite a sluggish economy and the events of September 11, same-store earnings at ADESA wholesale auctions increased 13% over 2000 levels as measured by earnings before interest, taxes, depreciation, amortization and lease expense. AFC financed 904,000 vehicles, an increase of 14% over 2000.

We expect 20% earnings per share growth at Automotive Services in 2002, excluding newly mandated changes in accounting standards.

Network refinements, ADESA Tulsa, reconstruction update

ADESA took a major step toward improving the profitability of recently acquired auctions by fully integrating the Auction Management System, a computerized database tool, into all auction locations. New standardized accounting software is also being installed throughout the network. New facilities were constructed in Des Moines, IA and Kitchener, Ontario to better serve larger volumes at existing ADESA auctions.

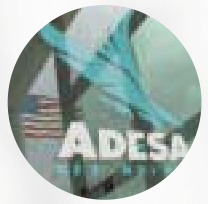
In May 2001, ADESA acquired the I-44 Auto Auction in Tulsa, OK and renamed it ADESA Tulsa. Located on 75 acres, the new site gives ADESA six more auction lanes, storage for more than 3,000 vehicles and an enhanced presence in the Southern Plains region.

Work is progressing on a new ADESA Golden Gate, located on a 218-acre site in suburban San Francisco. Completion of this new facility in mid-2002 will improve ADESA's market presence in California.

AFC provides steady earnings growth

AFC continues to grow its business outside the ADESA auction network as well as within the network. About three-quarters of AFC's business comes from independent auctions and offices outside ADESA's network. Receivables managed by AFC grew to $489 million by the end of 2001. AFC provides secured financing to licensed independent used car dealers across North America.

In spite of a sluggish economy that slipped into recession in 2001, AFC continued to expand its customer base and contribute solid corporate earnings. AFC remains the largest provider of floorplanning for independent car dealers in North America. Floorplanning is the provision of short-term inventory loans for approved dealers. There are now about 8,800 used vehicle dealers who have a floorplan loan through AFC, and a total of about 18,000 auto and truck dealers are registered to do business with us.



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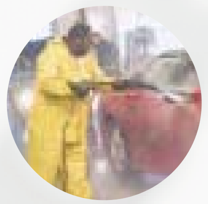

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1 Complete reconditioning is just one of the remarketing services provided at ADESA auctions in the U.S. and Canada.
2 With 53 wholesale auctions in the U.S. and Canada, ADESA is the second largest wholesale vehicle auction network in North America.
3 Old Glory reflects off the new plate glass at ADESA Des Moines, which opened in 2001.

Seeking gains in "total loss" vehicles

With ADESA firmly established as the second largest wholesale vehicle auction network in North America, ALLETE's leadership turned to another key segment in the automotive value chain: the "total loss" vehicle market. Each year an estimated 3 million cars and trucks in the U.S. and Canada are sold through "total loss" vehicle auctions, generating approximately $900 million in revenue. It made a lot of sense for ALLETE to enter the "total loss" vehicle market in a big way.

Early in 2001, ADESA acquired Rhode Island-based Auto Placement Center (APC), which at the time owned and operated eight "total loss" vehicle auctions in New York, New Hampshire, Rhode Island, Maine, Massachusetts and Vermont. At the same time, ALLETE also acquired ComSearch, an Internet-based auto parts location and insurance adjustment business.

By the end of 2001, ADESA was operating 23 "total loss" vehicle auctions under the banner of ADESA Impact. Combined with Impact Auto Auctions, already the premier "total loss" vehicle auction firm in Canada, the addition of APC means that ALLETE Automotive Services is the third largest provider of "total loss" vehicle services in North America.

There are many synergies in combining a network of salvage auctions with ADESA's roster of 53 wholesale vehicle auction facilities. From a purely competitive standpoint, ADESA Impact has room to grow. It's much less expensive for ALLETE Automotive Services to launch a "total loss" vehicle sale at an

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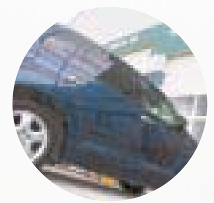

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4 Automotive Finance Corporation financed 904,000 vehicles in 2001, 14% more than in 2000.
5 Earnings at ALLETE Automotive Services jumped 50% from 2000 to 2001.

existing ADESA location than for a competitor to acquire land, hire employees and install business systems at a new start-up site. Several ADESA locations have already become "combination sites" — where a wholesale auction is held on one day of the week and a "total loss" vehicle sale is held on another day. More ADESA auction sites will add "total loss" vehicle sales in 2002.

For our customers, it's another example of finding a full array of remarketing services at one location. At a "total loss" vehicle auction, the purchasers might be used vehicle dealers or licensed dismantlers or rebuilders. The sellers are primarily insurance companies, which paid out $13 billion in total loss claims in 1999. ADESA Impact offers vehicle suppliers a range of services that simplify and streamline the "total loss" vehicle disposal process. For buyers of the salvaged parts, ADESA Impact will offer an expanding network of locations to replenish inventory.

We believe further consolidation of the "total loss" vehicle auction industry will occur, not unlike what has happened in the wholesale vehicle auction business. We'll continue to look for accretive acquisitions not only in the wholesale auction business but also in the "total loss" vehicle market.

Other components of Automotive Services enhance "full service" remarketing

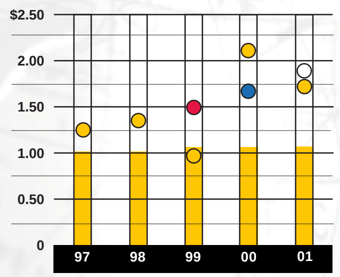
AutoVIN, acquired in 1999, provides technology-enabled vehicle inspection services and inventory auditing to the wholesale automotive industry, utilizing hand-held computing and web-enabled delivery systems.

PAR North America built its client list through its expertise in remarketing, recovery and lease-end services used by manufacturers, banks, finance companies, leasing companies, fleet operators and dealers. Employee growth at PAR prompted the company to upsize its office space in Carmel, IN.

ADESA Importation Services expects growth opportunities due to a growing number of vehicles being imported into the U.S. from Canada. Headquartered in Holly, MI, it operates facilities in Buffalo, NY, Grand Forks, ND, Sweetgrass, MT and Blaine, WA.

Excluding a 6 cents per share exit charge recorded by ALLETE's auto transport company in 2001 and a 44 cent gain relating to the company's past investment in ACE Limited in 2000, ALLETE earned $1.87 per share, compared with $1.67 in 2000, an increase of 12%. Reported earnings per share in 2001 were $1.81, compared to $2.11 in 2000.

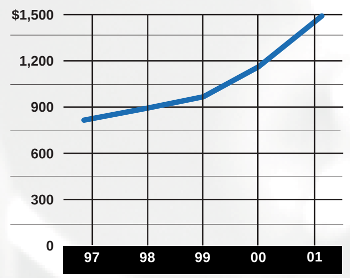
Diluted Earnings and Dividends Per Share



- Diluted Earnings
- Dividends
- Excluding Capital Re Transaction
- Excluding ACE Transaction
- Excluding Auto Transport Exit Charge

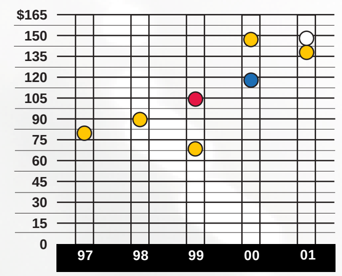
Operating Revenue

Millions



Net Income

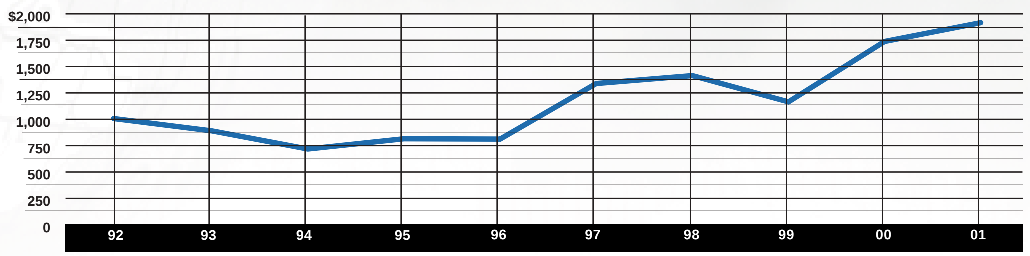
Millions



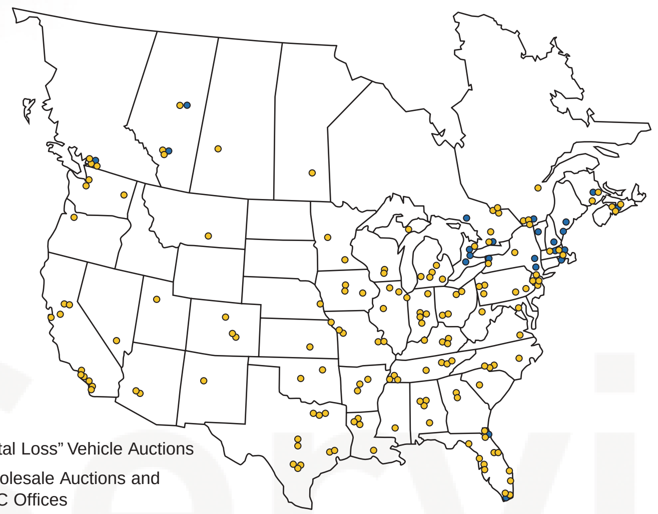
- Net Income
- Excluding Capital Re Transaction
- Excluding ACE Transaction
- Excluding Auto Transport Exit Charge

ALLETE Market Capitalization

Millions

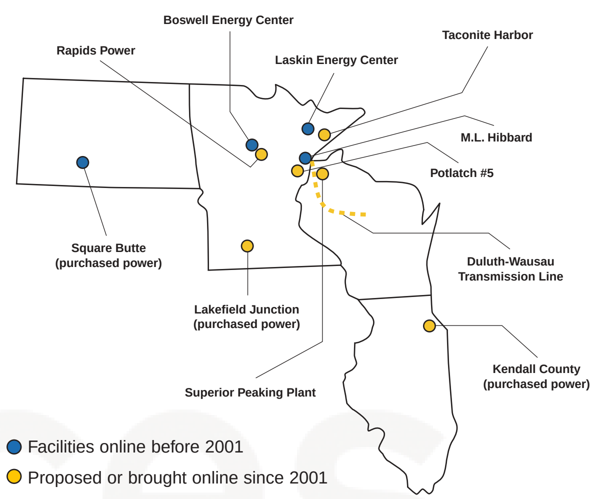


Automotive Services



- "Total Loss" Vehicle Auctions
- Wholesale Auctions and AFC Offices

Energy Services



- Facilities online before 2001
- Proposed or brought online since 2001

❶ **JACK I. RAJALA,** 62, is Chairman and CEO of Rajala Companies, lumber manufacturing and trading firms, Grand Rapids, Minnesota.

❷ **DENNIS E. EVANS,** 63, is President and CEO of Hanrow Financial Group, Ltd., a merchant banking firm, Minneapolis.

❸ **AREND J. SANDBULTE,** 68, is the retired Chairman, President and CEO of ALLETE, Duluth, Minnesota.

❹ **GEORGE L. MAYER,** 57, is President of Manhattan Realty Group, which manages real estate properties, Larchmont, New York.

❺ **BRUCE W. STENDER,** 59, is President and CEO of Labovitz Enterprises, which owns and manages hotels and commercial real estate, Duluth, Minnesota.

❻ **DAVID G. GARTZKE,** 58, is Chairman, President and CEO of ALLETE, Duluth, Minnesota.

❼ **GLENDA E. HOOD,** 51, is Mayor of Orlando, Florida, Chairman of the City Council, and board member of the Orlando Utilities Commission.

❽ **KATHLEEN A. BREKKEN,** 52, is President and CEO of Midwest of Cannon Falls, Inc., a Minnesota-based designer, wholesaler and distributor of giftware.

❾ **NICK SMITH,** 65, is Chairman and CEO of Northeast Ventures, a venture capital firm, Duluth, Minnesota.

❿ **PETER J. JOHNSON,** 65, is Chairman and CEO of Hoover Construction Co., a highway and heavy construction contractor, Virginia, Minnesota.

⓫ **DONALD C. WEGMILLER,** 63, is President and CEO of Clark/Bardes Consulting — HealthCare Group, Minneapolis, a national benefits consulting firm.

ALLETE is proud to use the products and services of its customers in this Annual Report and Form 10K. It is printed on Northwest, a fine paper manufactured by the Minnesota Pulp and Paper Division of Potlatch Corporation. Banta Direct Marketing printed the report and shipped it from its plant in Chanhassen, MN. Minnesota Power, an ALLETE company, provides electricity to Potlatch's papermaking facilities in Brainerd and Cloquet, MN and to the Banta facility at Long Prairie, MN.

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