

ALLETE INC

Form 10-Q

November 01, 2018

00.040.670.04false--12-31Q320180000066756Yesfalsefalse410418150210000026000000The following acquisition is consistent with ALLETE's stated strategy of investing in energy infrastructure and related services businesses to complement its regulated businesses, balance exposure to business cycles and changing demand, and provide potential long-term earnings growth.

19000000.000.0080000000800000005110000051400000511000005140000000.28328000002800000280000028000001400000000066756 2018-01-01 2018-09-30 0000066756 ale:TonkaWaterMember 2018-01-01 2018-09-30 0000066756 2018-09-30 0000066756 2017-12-31 0000066756 2017-01-01 2017-09-30 0000066756 2017-07-01 2017-09-30 0000066756 2018-07-01 2018-09-30 0000066756 2016-12-31 0000066756 2017-09-30 0000066756 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-09-30 0000066756 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-12-31 0000066756 us-gaap:RetainedEarningsMember 2017-12-31 0000066756 us-gaap:CommonStockMember 2018-01-01 2018-09-30 0000066756 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-09-30 0000066756 us-gaap:RetainedEarningsMember 2018-01-01 2018-09-30 0000066756 us-gaap:CommonStockMember 2018-09-30 0000066756 us-gaap:CommonStockMember 2017-12-31 0000066756 us-gaap:RetainedEarningsMember 2018-09-30 0000066756 ale:AlternativeProgramsMember ale:RegulatedOperationsMember 2018-01-01 2018-09-30 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:OperatingandMaintenanceMember 2017-01-01 2017-09-30 0000066756 ale:IndustrialCustomersMember us-gaap:LongTermContractWithCustomerMember ale:IndustrialMember 2022-01-01 ale:RegulatedOperationsMember 2018-09-30 0000066756 ale:OtherPowerSupplierCustomersMember ale:SaleofEnergyunderPSAMember us-gaap:LongTermContractWithCustomerMember ale:OtherPowerSuppliersMember ale:RegulatedOperationsMember 2018-09-30 0000066756 ale:RetailCustomersMember ale:ElectricRatesMember ale:MinnesotaPowerMember ale:EnergyIntensiveTradeExposedCustomerRatesMember ale:MPUCMember 2017-12-31 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:OperatingandMaintenanceMember 2017-07-01 2017-09-30 0000066756 ale:MunicipalCustomersMember ale:WholesaleElectricServiceMember us-gaap:LongTermContractWithCustomerMember ale:MunicipalMember ale:RegulatedOperationsMember 2018-01-01 2018-09-30 0000066756 ale:IndustrialCustomersMember us-gaap:LongTermContractWithCustomerMember ale:IndustrialMember 2023-01-01 ale:RegulatedOperationsMember 2018-09-30 0000066756 ale:IndustrialCustomersMember ale:RetailElectricServiceMember us-gaap:LongTermContractWithCustomerMember ale:IndustrialMember ale:RegulatedOperationsMember 2018-09-30 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:CostofSalesNonutilityMember 2017-01-01 2017-09-30 0000066756 ale:IndustrialCustomersMember ale:RetailElectricServiceMember us-gaap:LongTermContractWithCustomerMember ale:IndustrialMember ale:RegulatedOperationsMember 2018-01-01 2018-09-30 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:CostofSalesNonutilityMember 2017-07-01 2017-09-30 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:OtherIncomeExpenseMember 2017-01-01 2017-09-30 0000066756 ale:IncomeTaxExpenseMember 2018-01-01 2018-09-30 0000066756 us-gaap:AccountingStandardsUpdate201601Member 2017-12-31 0000066756 ale:AccountingStandardsUpdate201802Member 2017-12-31 0000066756 us-gaap:AccountingStandardsUpdate201409Member 2017-12-31 0000066756 ale:IndustrialCustomersMember us-gaap:LongTermContractWithCustomerMember ale:IndustrialMember 2020-01-01 ale:RegulatedOperationsMember 2018-09-30 0000066756 us-gaap:AccountingStandardsUpdate201707Member ale:OtherIncomeExpenseMember 2017-07-01 2017-09-30 0000066756 us-gaap:AccountingStandardsUpdate201618Member 2017-01-01 2017-09-30 0000066756 ale:OtherPowerSupplierCustomersMember us-gaap:LongTermContractWithCustomerMember ale:OtherPowerSuppliersMember 2018-01-01 ale:RegulatedOperationsMember 2018-09-30 0000066756 ale:OutOfPeriodAdjustmentforMISORatesDomain 2018-01-01 2018-09-30 0000066756 ale:RetailCustomersMember ale:ElectricRatesMember ale:MinnesotaPowerMember ale:EnergyIntensiveTradeExposedCustomerRatesMember 2018-09-30 0000066756 ale:MunicipalCustomersMember ale:WholesaleElectricServiceMember

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2018-09-30 0000066756 ale:TonkaWaterMember 2017-09-01 0000066756 ale:TonkaWaterMember 2017-09-01
2017-09-01 0000066756 srt:MaximumMember us-gaap:OtherIntangibleAssetsMember 2018-01-01 2018-09-30
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ale:MPUCMember 2018-09-30 0000066756 ale:RetailCustomersMember ale:ElectricRatesMember
ale:MinnesotaPowerMember ale:CurrentCostRecoveryRiderMember ale:MPUCMember 2017-07-01 2017-09-30
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ale:A2018WisconsinGeneralRateCaseMember ale:PSCWMember 2018-05-25 2018-05-25 0000066756
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2018-05-25 2018-05-25 0000066756 ale:RetailCustomersMember ale:ElectricRatesMember
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2016-11-30 0000066756 ale:GreatNorthernTransmissionLineMember srt:MaximumMember 2018-09-30 0000066756
ale:MunicipalCustomersMember ale:ElectricRatesMember ale:MinnesotaPowerMember

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ale:FercApprovedWholesaleRatesMember ale:FERCMember 2018-09-30 0000066756
ale:SolarEnergyGenerationMember ale:MinnesotaPowerMember ale:SolarEnergyPPAMember
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ale:MPUCMember 2018-04-02 2018-04-02 0000066756 ale:GreatNorthernTransmissionLineMember
ale:MinnesotaPowerMember srt:MinimumMember 2018-09-30 0000066756 ale:MinnesotaPowerMember
ale:CIPConsolidatedFilingMember ale:MPUCMember 2017-04-01 2017-06-30 0000066756
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ale:MPUCMember 2017-07-28 2017-07-28 0000066756 ale:MunicipalCustomersMember
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ale:MinnesotaSolarEnergyStandardCommunitySolarGardenProjectOwnedandOperatedMember ale:MPUCMember
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ale:ManitobaHydroMember ale:ManitobaHydroPpaExpires2035Member 2018-09-30 0000066756

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ale:NOVConsentDecreeMember 2018-09-30 0000066756 ale:NO2NAAQSMember 2018-01-01 2018-09-30
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2018-01-01 2018-09-30 0000066756 ale:MinnesotaPowerMember ale:CoalCombustionResidualsMember 2018-01-01
2018-09-30 0000066756 ale:MinnesotaPowerMember srt:MinimumMember ale:CoalCombustionResidualsMember
2018-01-01 2018-09-30 0000066756 ale:OzoneNAAQSMember 2018-01-01 2018-09-30 0000066756
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utreg:MW ale:Customers xbrli:pure ale:Years ale:Miles utreg:acre ale:Segments

UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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 September 30, 2018

or

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

For the transition period from _____ to _____

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Common Stock, without par value,
51,424,535 shares outstanding

as of September 30, 2018

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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.

<u>Abbreviation or Acronym</u>	<u>Term</u>
AFUDC	Allowance for Funds Used During Construction – the cost of both debt and equity funds used to finance regulated utility plant additions during construction periods
ALLETE	ALLETE, Inc.
ALLETE Clean Energy	ALLETE Clean Energy, Inc. and its subsidiaries
ALLETE Properties	ALLETE Properties, LLC and its subsidiaries
ALLETE Transmission Holdings	ALLETE Transmission Holdings, Inc.
ATC	American Transmission Company LLC
Bison	Bison Wind Energy Center
Blanchard	Blanchard Solar Energy Facility
BNI Energy	BNI Energy, Inc. and its subsidiary
Boswell	Boswell Energy Center
Camp Ripley	Camp Ripley Solar Array
CO ₂	Carbon Dioxide
Company	ALLETE, Inc. and its subsidiaries
CIP	Conservation Improvement Program
Cliffs	Cleveland-Cliffs Inc.
CSAPR	Cross-State Air Pollution Rule
DC	Direct Current
EIS	Environmental Impact Statement
EITE	Energy-Intensive Trade-Exposed
EPA	United States Environmental Protection Agency
ERP Iron Ore	ERP Iron Ore, LLC
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Form 10-K	ALLETE Annual Report on Form 10-K
Form 10-Q	ALLETE Quarterly Report on Form 10-Q
GAAP	Generally Accepted Accounting Principles in the United States of America
GHG	Greenhouse Gases
GNTL	Great Northern Transmission Line
Hibbard	Hibbard Renewable Energy Center
Husky Energy	Husky Energy Inc.
Invest Direct	ALLETE’s Direct Stock Purchase and Dividend Reinvestment Plan
IRP	Integrated Resource Plan
Item ____	Item ____ of this Form 10-Q
kV	Kilovolt(s)
kW / kWh	Kilowatt(s) / Kilowatt-hour(s)
Laskin	Laskin Energy Center
Magnetation	Magnetation, LLC
Manitoba Hydro	Manitoba Hydro-Electric Board

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MATS

Mercury and Air Toxics Standards

Mesabi Metallica

Mesabi Metallica Company, LLC (formerly Essar Steel Minnesota, LLC)

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Abbreviation or Acronym Term

Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midcontinent Independent System Operator, Inc.
MMTP	Manitoba-Minnesota Transmission Project
Montana-Dakota Utilities	Montana-Dakota Utilities Co., a division of MDU Resources Group, Inc.
MPCA	Minnesota Pollution Control Agency
MPUC	Minnesota Public Utilities Commission
MW / MWh	Megawatt(s) / Megawatt-hour(s)
NAAQS	National Ambient Air Quality Standards
NDPSC	North Dakota Public Service Commission
NOL	Net Operating Loss
NO ₂	Nitrogen Dioxide
NO _x	Nitrogen Oxides
Northern States Power	Northern States Power Company, a subsidiary of Xcel Energy Inc.
Northshore Mining	Northshore Mining Company, a wholly-owned subsidiary of Cleveland-Cliffs Inc.
Note ____	Note ____ to the Consolidated Financial Statements in this Form 10-Q
NPDES	National Pollutant Discharge Elimination System
NTEC	Nemadji Trail Energy Center
Oliver Wind I	Oliver Wind I Energy Center
Oliver Wind II	Oliver Wind II Energy Center
Palm Coast Park District	Palm Coast Park Community Development District in Florida
PolyMet	PolyMet Mining Corp.
PPA / PSA	Power Purchase Agreement / Power Sales Agreement
PPACA	Patient Protection and Affordable Care Act of 2010
PSCW	Public Service Commission of Wisconsin
SEC	Securities and Exchange Commission
Silver Bay Power	Silver Bay Power Company, a wholly-owned subsidiary of Cleveland-Cliffs Inc.
SO ₂	Sulfur Dioxide
Square Butte	Square Butte Electric Cooperative, a North Dakota cooperative corporation
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
TCJA	Tax Cuts and Job Act of 2017 (Public Law 115-97)
Tenaska	Tenaska Energy, Inc. and Tenaska Energy Holdings, LLC
Tonka Water	Tonka Equipment Company
Town Center District	Town Center at Palm Coast Community Development District in Florida
UPM Blandin	UPM, Blandin Paper Mill owned by UPM-Kymmene Corporation
U.S.	United States of America
U.S. Water Services	U.S. Water Services Holding Company and its subsidiaries
USS Corporation	United States Steel Corporation
WTG	Wind Turbine Generator

Forward-Looking Statements

Statements in this report that are not statements of historical facts are considered “forward-looking” and, accordingly, involve risks and uncertainties that could cause actual results to differ materially from those discussed. Although such forward-looking statements have been made in good faith and are based on reasonable assumptions, there can be no assurance that the expected results will be achieved. Any statements that express, or involve discussions as to, future expectations, risks, beliefs, plans, objectives, assumptions, events, uncertainties, financial performance, or growth strategies (often, but not always, through the use of words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “likely,” “will continue,” “could,” “may,” “potential,” “target,” “outlook” or words of similar meaning) are not statements of historical facts and may be forward-looking.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are providing this cautionary statement to identify important factors that could cause our actual results to differ materially from those indicated in forward-looking statements made by or on behalf of ALLETE in this Form 10-Q, in presentations, on our website, in response to questions or otherwise. These statements 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 that could cause our actual results to differ materially from those indicated in the forward-looking statements:

- our ability to successfully implement our strategic objectives;
- global and domestic economic conditions affecting us or our customers;
- changes in and compliance with laws and regulations;
- changes in tax rates or policies or in rates of inflation;
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements;
- weather conditions, natural disasters and pandemic diseases;
- our ability to access capital markets and bank financing;
- changes in interest rates and the performance of the financial markets;
- project delays or changes in project costs;
- changes in operating expenses and capital expenditures and our ability to raise revenues from our customers in regulated rates or sales price increases at our Energy Infrastructure and Related Services businesses;
- the impacts of commodity prices on ALLETE and our customers;
- our ability to attract and retain qualified, skilled and experienced personnel;
- effects of emerging technology;
- war, acts of terrorism and cybersecurity attacks;
- our ability to manage expansion and integrate acquisitions;
- population growth rates and demographic patterns;
- wholesale power market conditions;
- federal and state regulatory and legislative actions that impact regulated utility economics, including our allowed rates of return, capital structure, ability to secure financing, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities and utility infrastructure, recovery of purchased power, capital investments and other expenses, including present or prospective environmental matters;
- effects of competition, including competition for retail and wholesale customers;
- effects of restructuring initiatives in the electric industry;
- the impacts on our Regulated Operations segment of climate change and future regulation to restrict the emissions of GHG;
 - effects of increased deployment of distributed low-carbon electricity generation resources;

the impacts of laws and regulations related to renewable and distributed generation; pricing, availability and transportation of fuel and other commodities and the ability to recover the costs of such commodities; our current and potential industrial and municipal customers' ability to execute announced expansion plans; real estate market conditions where our legacy Florida real estate investment is located may not improve; the success of efforts to realize value from, invest in, and develop new opportunities in, our Energy Infrastructure and Related Services businesses; and factors affecting our Energy Infrastructure and Related Services businesses, including fluctuations in the volume of customer orders, unanticipated cost increases, changes in legislation and regulations impacting the industries in which the customers served operate, the effects of weather, creditworthiness of customers, ability to obtain materials required to perform services, and changing market conditions.

Forward-Looking Statements (Continued)

Additional disclosures regarding factors that could cause our results or performance to differ from those anticipated by this report are discussed in Part I, Item 1A. Risk Factors of ALLETE's 2017 Form 10-K, and in Part II, Item 1A. Risk Factors in this Form 10-Q. 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 ALLETE in this Form 10-Q and in other reports filed with the SEC that attempt to identify the risks and uncertainties that may affect ALLETE's business.

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PART I. FINANCIAL INFORMATION**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****ALLETE
CONSOLIDATED BALANCE SHEET
Unaudited**

	September 30, December 31,	
	2018	2017
Millions		
Assets		
Current Assets		
Cash and Cash Equivalents	\$128.0	\$98.9
Accounts Receivable (Less Allowance of \$2.6 and \$2.1)	129.4	135.1
Inventories – Net	154.8	95.9
Prepayments and Other	27.2	37.6
Total Current Assets	439.4	367.5
Property, Plant and Equipment – Net	3,846.5	3,822.4
Regulatory Assets	370.6	384.7
Investment in ATC	126.0	118.7
Other Investments	51.7	53.1
Goodwill and Intangible Assets – Net	224.7	225.9
Other Non-Current Assets	104.4	107.7
Total Assets	\$5,163.3	\$5,080.0
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	\$131.8	\$136.3
Accrued Taxes	53.9	50.0
Accrued Interest	15.5	17.6
Long-Term Debt Due Within One Year	56.6	64.1
Other	144.9	83.2
Total Current Liabilities	402.7	351.2
Long-Term Debt	1,461.7	1,439.2
Deferred Income Taxes	231.3	230.5
Regulatory Liabilities	512.3	532.0
Defined Benefit Pension and Other Postretirement Benefit Plans	173.6	191.8
Other Non-Current Liabilities	265.6	267.1
Total Liabilities	3,047.2	3,011.8
Commitments, Guarantees and Contingencies (Note 13)		
Shareholders' Equity		
Common Stock Without Par Value, 80.0 Shares Authorized, 51.4 and 51.1 Shares Issued and Outstanding	1,421.1	1,401.4
Accumulated Other Comprehensive Loss	(27.3) (22.6
Retained Earnings	722.3	689.4
Total Shareholders' Equity	2,116.1	2,068.2
Total Liabilities and Shareholders' Equity	\$5,163.3	\$5,080.0

The accompanying notes are an integral part of these statements.

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ALLETE
CONSOLIDATED STATEMENT OF INCOME
Unaudited

	Quarter Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Millions Except Per Share Amounts				
Operating Revenue				
Contracts with Customers – Utility	\$261.3	\$277.6	\$789.3	\$824.1
Contracts with Customers – Non-utility	80.7	79.0	243.1	239.6
Other – Non-utility	6.0	5.9	17.9	17.7
Total Operating Revenue	348.0	362.5	1,050.3	1,081.4
Operating Expenses				
Fuel, Purchased Power and Gas – Utility	103.2	93.5	300.6	283.2
Transmission Services – Utility	17.9	18.9	53.1	53.1
Cost of Sales – Non-utility	38.7	36.0	108.6	105.9
Operating and Maintenance	80.3	81.1	253.6	251.4
Depreciation and Amortization	51.5	50.9	153.4	151.5
Taxes Other than Income Taxes	13.1	14.1	43.8	42.7
Total Operating Expenses	304.7	294.5	913.1	887.8
Operating Income	43.3	68.0	137.2	193.6
Other Income (Expense)				
Interest Expense	(17.6)	(16.6)	(51.6)	(50.5)
Equity Earnings in ATC	4.0	5.9	13.0	17.3
Other	1.4	1.8	5.7	5.0
Total Other Expense	(12.2)	(8.9)	(32.9)	(28.2)
Income Before Income Taxes	31.1	59.1	104.3	165.4
Income Tax Expense (Benefit)	0.4	14.2	(8.7)	34.6
Net Income	\$30.7	\$44.9	\$113.0	\$130.8
Average Shares of Common Stock				
Basic	51.4	51.0	51.3	50.7
Diluted	51.6	51.2	51.5	50.9
Basic Earnings Per Share of Common Stock	\$0.59	\$0.88	\$2.20	\$2.58
Diluted Earnings Per Share of Common Stock	\$0.59	\$0.88	\$2.19	\$2.57
Dividends Per Share of Common Stock	\$0.56	\$0.535	\$1.68	\$1.605

The accompanying notes are an integral part of these statements.

ALLETE
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Unaudited

	Quarter Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Millions				
Net Income	\$30.7	\$44.9	\$113.0	\$130.8
Other Comprehensive Income (Loss)				
Currency Translation Adjustments	—	0.1	—	(0.1)
Unrealized Gain (Loss) on Securities				
Net of Income Tax Expense of \$—, \$0.1, \$— and \$0.6	—	0.1	(0.1)	0.8
Defined Benefit Pension and Other Postretirement Benefit Plans				
Net of Income Tax Expense of \$0.1, \$0.1, \$0.3 and \$0.4	0.3	0.2	1.0	0.6
Total Other Comprehensive Income	0.3	0.4	0.9	1.3
Total Comprehensive Income	\$31.0	\$45.3	\$113.9	\$132.1

The accompanying notes are an integral part of these statements.

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ALLETE
CONSOLIDATED STATEMENT OF CASH FLOWS
Unaudited

	Nine Months Ended September 30, 2018 2017	
Millions		
Operating Activities		
Net Income	\$113.0	\$130.8
AFUDC – Equity	(0.9)	(0.7)
Income from Equity Investments – Net of Dividends	(1.3)	(3.8)
Depreciation Expense	149.3	147.4
Amortization of PSAs	(17.9)	(17.7)
Amortization of Other Intangible Assets and Other Assets	7.8	7.6
Deferred Income Tax Expense	(9.1)	34.3
Share-Based and ESOP Compensation Expense	5.1	5.0
Defined Benefit Pension and Postretirement Benefit Expense	6.4	7.6
Provision for Interim Rate Refund	13.0	—
Provision for Tax Reform Refund	9.2	—
Bad Debt Expense	1.5	0.5
Changes in Operating Assets and Liabilities		
Accounts Receivable	3.9	(9.6)
Inventories	(12.6)	5.3
Prepayments and Other	5.7	2.1
Accounts Payable	9.9	(2.6)
Other Current Liabilities	21.2	2.7
Cash Contributions to Defined Benefit Pension Plans	(15.0)	(1.7)
Changes in Regulatory and Other Non-Current Assets	7.2	23.9
Changes in Regulatory and Other Non-Current Liabilities	1.7	(23.9)
Cash from Operating Activities	298.1	307.2
Investing Activities		
Proceeds from Sale of Available-for-sale Securities	9.3	5.2
Payments for Purchase of Available-for-sale Securities	(12.5)	(5.9)
Acquisitions of Subsidiaries – Net of Cash and Restricted Cash Acquired	—	(17.4)
Investment in ATC	(5.0)	(6.6)
Additions to Property, Plant and Equipment	(201.0)	(130.3)
Other Investing Activities	1.4	3.3
Cash for Investing Activities	(207.8)	(151.7)
Financing Activities		
Proceeds from Issuance of Common Stock	14.6	80.5
Proceeds from Issuance of Long-Term Debt	72.7	131.5
Repayments of Long-Term Debt	(59.5)	(183.6)
Acquisition-Related Contingent Consideration Payments	—	(19.7)
Dividends on Common Stock	(86.2)	(81.4)
Other Financing Activities	(0.5)	(1.6)
Cash for Financing Activities	(58.9)	(74.3)

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Change in Cash, Cash Equivalents and Restricted Cash	31.4	81.2
Cash, Cash Equivalents and Restricted Cash at Beginning of Period	110.1	38.3
Cash, Cash Equivalents and Restricted Cash at End of Period	\$141.5	\$119.5

The accompanying notes are an integral part of these statements.

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ALLETE
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
Unaudited

	Total Shareholders' Equity	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock
Millions				
Balance as of December 31, 2017	\$2,068.2	\$689.4	\$(22.6)	\$1,401.4
Adjustments to Opening Balance – Net of Income Taxes <i>(a)</i>	0.5	6.1	(5.6))
Balance as of January 1, 2018	2,068.7	695.5	(28.2)) 1,401.4
Comprehensive Income				
Net Income	113.0	113.0	—	—
Other Comprehensive Income – Net of Income Taxes				
Unrealized Loss on Debt Securities	(0.1)—	(0.1)
Defined Benefit Pension and Other Postretirement Plans	1.0	—	1.0	—
Total Comprehensive Income	113.9			
Common Stock Issued	19.7	—	—	19.7
Dividends Declared	(86.2)(86.2)—	—
Balance as of September 30, 2018	\$2,116.1	\$722.3	\$(27.3)	\$1,421.1

Reflects the impacts associated with the adoption of accounting standards concerning Financial Instruments, Revenue from Contracts with (a) Customers and the Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. (See Note 1. Operations and Significant Accounting Policies.)

The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – UNAUDITED

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and do not include all of the information and notes required by GAAP for complete financial statements. Similarly, the December 31, 2017, Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. In management's opinion, these unaudited financial statements include all adjustments necessary for a fair statement of financial results. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Operating results for the nine months ended September 30, 2018, are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2018. For further information, refer to the Consolidated Financial Statements and notes included in our 2017 Form 10-K.

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Cash, Cash Equivalents and Restricted Cash. We consider all investments purchased with original maturities of three months or less to be cash equivalents. Restricted cash amounts included in Prepayments and Other on the Consolidated Balance Sheet include collateral deposits required under an ALLETE Clean Energy loan agreement and U.S. Water Service's standby letters of credit. The restricted cash amounts included in Other Non-Current Assets represent collateral deposits required under an ALLETE Clean Energy loan agreement and PSAs, and deposits from a SWL&P customer in aid of future capital expenditures. The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the Consolidated Balance Sheet that aggregate to the amount presented in the Consolidated Statement of Cash Flows. During the first quarter of 2018, the Company updated the presentation of its Consolidated Statement of Cash Flows to include restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the Consolidated Statement of Cash Flows. (See *Recently Adopted Pronouncements - Statement of Cash Flows: Restricted Cash.*)

Cash, Cash Equivalents and Restricted Cash	September 30, 2018	December 31, 2017	September 30, 2017	December 31, 2016
Millions				
Cash and Cash Equivalents	\$128.0	\$98.9	\$104.4	\$27.5
Restricted Cash included in Prepayments and Other	4.8	2.6	6.5	2.2
Restricted Cash included in Other Non-Current Assets	8.7	8.6	8.6	8.6
Cash, Cash Equivalents and Restricted Cash on the Consolidated Statement of Cash Flows	\$141.5	\$110.1	\$119.5	\$38.3

Inventories – Net. Inventories are stated at the lower of cost or net realizable value. Inventories in our Regulated Operations segment are carried at an average cost or first-in, first-out basis. Inventories in our U.S. Water Services and ALLETE Clean Energy segments, and Corporate and Other businesses are carried at an average cost, first-in, first-out or specific identification basis.

Inventories – Net	September 30, 2018	December 31, 2017
Millions		
Fuel (a)	\$27.3	\$34.8
Materials and Supplies	44.0	46.5
Construction of Wind Energy Facility (b)	66.7	—
Raw Materials	3.1	2.8
Work in Progress	5.5	4.2

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Finished Goods	9.0	8.3	
Reserve for Obsolescence	(0.8) (0.7)
Total Inventories – Net	\$154.8	\$95.9	

(a) Fuel consists primarily of coal inventory at Minnesota Power.

On February 28, 2018, Montana-Dakota Utilities exercised its option to purchase the Thunder Spirit II wind energy facility upon completion, (b) resulting in a reclassification of the project costs from Property, Plant and Equipment – Net to Inventories – Net as ALLETE Clean Energy will not own the facility upon completion.

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NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**Other Non-Current Assets** **September 30, December 31,**
2018 **2017****Millions**

Contract Assets (a)	\$31.1	\$31.6
Finance Receivable	10.4	11.0
Other	62.9	65.1
Total Other Non-Current Assets	\$104.4	\$107.7

(a) Contract Assets include payments made to customers as an incentive to execute or extend service agreements. The contract payments are being amortized over the term of the respective agreements as a reduction to revenue.

Other Current Liabilities **September 30, December 31,**
2018 **2017****Millions**

Provision for Interim Rate Refund (a)	\$36.7	—
Contract Liabilities (b)	22.7	\$8.7
PSAs	15.4	24.5
Provision for Tax Reform Refund (c)	9.2	—
Contingent Consideration (d)	5.7	—
Other	55.2	50.0
Total Other Current Liabilities	\$144.9	\$83.2

Provision for Interim Rate Refund is expected to be refunded to Minnesota Power's regulated retail customers in the first quarter of 2019 (a) and includes \$20.8 million of discounts provided to EITE customers that will be offset against interim rate refunds as of September 30, 2018 (\$8.6 million as of December 31, 2017). (See Note 6. Regulatory Matters.)

(b) Contract Liabilities include deposits received as a result of entering into contracts with our customers prior to completing our performance obligations.

(c) Provision for Tax Reform Refund is expected to be refunded to Minnesota Power customers in the first quarter of 2019 and SWL&P customers in 2019 pending the outcome of SWL&P's rate filing with the PSCW. (See Note 6. Regulatory Matters.)

(d) Contingent Consideration relates to the estimated fair value of the earnings-based payment resulting from the U.S. Water Services acquisition. (See Note 5. Fair Value.)

Other Non-Current Liabilities **September 30, December 31,**
2018 **2017****Millions**

Asset Retirement Obligation	\$138.3	\$122.7
PSAs	80.0	89.5
Contingent Consideration (a)	—	5.4
Other	47.3	49.5
Total Other Non-Current Liabilities	\$265.6	\$267.1

(a) Contingent Consideration relates to the estimated fair value of the earnings-based payment resulting from the U.S. Water Services acquisition. (See Note 5. Fair Value.)

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**Supplemental Statement of Cash Flows Information.**

Nine Months Ended September 30,	2018	2017
Millions		
Cash Paid for Interest – Net of Amounts Capitalized	\$52.9	\$51.4
Noncash Investing and Financing Activities		
Increase (Decrease) in Accounts Payable for Capital Additions to Property, Plant and Equipment	\$(14.4)	\$1.2
Reclassification of Property, Plant and Equipment to Inventory <i>(a)</i>	\$46.3	—
Capitalized Asset Retirement Costs	\$15.4	\$19.7
AFUDC–Equity	\$0.9	\$0.7
ALLETE Common Stock Contributed to the Pension Plans	—	\$13.5

On February 28, 2018, Montana-Dakota Utilities exercised its option to purchase the Thunder Spirit II wind energy facility upon completion, (a) resulting in a reclassification of the project costs from Property, Plant and Equipment – Net to Inventories – Net as ALLETE Clean Energy will not own the facility upon completion.

Subsequent Events. The Company performed an evaluation of subsequent events for potential recognition and disclosure through the date of the financial statements issuance.

Revenue.

Contracts with Customers – Utility includes sales from our regulated operations for generation, transmission and distribution of electric service, and distribution of water and gas services to our customers. Also included is an immaterial amount of regulated steam generation that is used by customers in the production of paper and pulp.

Contracts with Customers – Non-utility includes sales of goods and services to customers from ALLETE Clean Energy, U.S. Water Services and our Corporate and Other businesses.

Other – Non-utility is the non-cash adjustments to revenue recognized by ALLETE Clean Energy for the amortization of differences between contract prices and estimated market prices for PSAs that were assumed during the acquisition of various wind energy facilities.

Revenue Recognition

Revenue is recognized upon transfer of control of promised goods or services to our customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. Revenue is recognized net of allowance for returns and any taxes collected from customers, which are subsequently remitted to the appropriate governmental authorities. We account for shipping and handling activities that occur after the customer obtains control of goods as a cost rather than an additional performance obligation thereby recognizing revenue at time of shipment and accruing shipping and handling costs when control transfers to our customers. We have a right to consideration from our customers in an amount that corresponds directly with the value to the customer for our performance completed to date; therefore, we may recognize revenue in the amount to which we have a right to invoice.

Nature of Revenue Streams

Utility

Residential and Commercial includes sales for electric, gas or water service to customers, who have implied contracts with the utility, under rates governed by the MPUC, PSCW or FERC. Customers are billed on a monthly cycle basis and revenue is recognized for electric, gas or water service delivered during the billing period. Revenue is accrued for service provided but not yet billed at period end. Performance obligations with these customers are satisfied at time of delivery to customer meters and simultaneously consumed.

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NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)
Revenue (Continued)

Municipal includes sales to 16 non-affiliated municipal customers in Minnesota under long-term wholesale electric contracts. All wholesale electric contracts include a termination clause requiring a three-year notice to terminate. These contracts have termination dates ranging from 2019 through at least 2032, with a majority of contracts effective through at least 2024. Performance obligations with these customers are satisfied at the time energy is delivered to an agreed upon municipal substation or meter.

Industrial includes sales recognized from contracts with customers in the taconite mining, iron concentrate, paper, pulp and secondary wood products, pipeline and other industries. Industrial sales accounted for approximately 50 percent of total regulated utility kWh sales for the nine months ended September 30, 2018. Within industrial revenue, Minnesota Power has 9 Large Power Customer contracts, each serving requirements of 10 MW or more of customer load. These contracts automatically renew past the contract term unless a four-year advanced written notice is given. Large Power Customer contracts have earliest termination dates ranging from 2022 through 2026. We satisfy our performance obligations for these customers at the time energy is delivered to an agreed upon customer substation. Revenue is accrued for energy provided but not yet billed at period end. Based on current contracts with industrial customers, we expect to recognize minimum revenue for the fixed contract components of approximately \$70 million per annum through 2019, \$50 million in 2020 and 2021, \$30 million in 2022 and \$40 million for aggregate years thereafter, which reflects the termination notice period in these contracts. When determining minimum revenue, we assume that customer contracts will continue under the contract renewal provision; however, if long-term contracts are renegotiated and subsequently approved by the MPUC or there are changes within our industrial customer class, these amounts may be impacted. Contracts with customers that contain variable pricing or quantity components are excluded from the expected minimum revenue amounts.

Other Power Suppliers includes the sale of energy under long-term PSAs with two customers as well as MISO market and liquidation sales. Expiration dates of these PSAs range from 2020 through 2026. Performance obligations with these customers are satisfied at the time energy is delivered to an agreed upon delivery point defined in the contract (generally the MISO pricing node). Based on current contracts with two customers, we expect to recognize minimum revenue for fixed contract components of approximately \$10 million per annum through 2019. Other power supplier contracts that extend beyond 2020 contain variable pricing components that prevent us from estimating future minimum revenue, and therefore are not included.

Other Revenue includes all remaining individually immaterial revenue streams for Minnesota Power and SWL&P, and is comprised of steam sales to paper and pulp mills, wheeling revenue and other sources. Revenue for steam sales to customers is recognized at the time steam is delivered and simultaneously consumed. Revenue is recognized at the time each performance obligation is satisfied.

Alternative Programs includes revenue that is driven by factors outside of our regulated entities' control or as a result of the achievement of certain objectives, such as CIP financial incentives. This revenue is accounted for in accordance with the accounting standards for alternative revenue programs which allow for the recognition of revenue under an alternative revenue program if the program is established by an order from the utility's regulatory commission, the order allows for automatic adjustment of future rates, the amount of revenue recognized is objectively determinable and probable of recovery, and the revenue will be collected within 24 months following the end of the annual period in which it is recognized. CIP financial incentives are recognized in the period in which the MPUC approves the filing, which is typically mid-year.

Non-utility

ALLETE Clean Energy

Long-term PSA revenue includes all sales recognized under long-term contracts for production, curtailment, capacity and associated renewable energy credits from ALLETE Clean Energy wind energy facilities. Expiration dates of these PSAs range from 2018 through 2032. Performance obligations for these contracts are satisfied at the time energy is delivered to an agreed upon point, or production is curtailed at the request of the customer, at specified prices.

Revenue from the sale of renewable energy credits is recognized at the same time the related energy is delivered to the customer when sold to the same party.

Other is the non-cash adjustments to revenue recognized by ALLETE Clean Energy for the amortization of differences between contract prices and estimated market prices on assumed PSAs. As part of wind energy facility acquisitions, ALLETE Clean Energy assumed various PSAs that were above or below estimated market prices at the time of acquisition; the resulting differences between contract prices and estimated market prices are amortized to revenue over the remaining PSA term.

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NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)
Revenue (Continued)

U.S. Water Services

Point-in-time revenue is recognized for purchases by customers for chemicals, consumable equipment (e.g., filters, pumps and valves) or related maintenance and repair services as the customer's usage and needs change over time. These goods and services are purchased on an as-needed basis by customers and therefore revenue can be variable. Products are shipped to the customer in accordance with the terms of the purchase order, and performance obligations are satisfied at the time of shipment of goods or when services are rendered to the customer.

Contract includes monthly revenue from contracts with customers to provide chemicals, consumable equipment and services to meet customer needs during the contract period. As agreed with the customer, a fixed amount is invoiced based on the goods and services to be provided under the contract. The duration of these contracts generally range in length from three months to five years and automatically renew. A 30-day notice is required to terminate such contracts without penalty after contract execution. Performance obligations are satisfied during the period as goods and service are delivered in accordance with the terms of the contract.

Capital Project includes the sale of equipment and other components assembled to create a water treatment system for a customer. These projects are provided under contracts at an agreed upon price to meet a customer's specifications and typically take less than one year to complete. In general, progress payments are received throughout the project period and are recorded as contract liabilities until performance obligations are satisfied at the time the equipment and other components are delivered to the customer's site.

Corporate and Other

Long-term Contract encompasses the sale and delivery of coal to customer generation facilities. Revenue is recognized on a monthly basis at the cost of production plus a specified profit per ton of coal delivered to the customer. Coal sales are secured under long-term coal supply agreements extending through 2037. Performance obligations are satisfied during the period as coal is delivered to customer generation facilities.

Other primarily includes revenue from BNI Energy unrelated to coal, the sale of real estate from ALLETE Properties, and non rate base steam generation that is sold for use during production of paper and pulp. Performance obligations are satisfied when control transfers to the customer.

Payment Terms

Payment terms and conditions vary across our businesses. Aside from taconite-producing Large Power Customers, payment terms generally require payment to be made within 15 to 30 days from the end of the period that the service has been rendered or goods provided. In the case of its taconite-producing Large Power Customers, as permitted by the MPUC, Minnesota Power requires weekly payments for electric usage based on monthly energy usage estimates. These customers receive estimated bills based on Minnesota Power's estimate of the customers' energy usage, forecasted energy prices and fuel adjustment clause estimates. Minnesota Power's taconite-producing Large Power Customers have generally predictable energy usage on a weekly basis and any differences that occur are trued-up the following month. Due to the timing difference of revenue recognition from the timing of invoicing and payment, the customer receives credit for the time value of money; however, we have determined that our contracts do not include a significant financing component as the period between when we transfer the service to the customer and when they

pay for such service is minimal.

Assets Recognized From the Costs to Obtain a Contract with a Customer

We recognize as an asset the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We expense incremental costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. As of September 30, 2018, we have \$31.1 million of assets recognized for costs incurred to obtain contracts with our customers (\$31.6 million as of December 31, 2017). Management determined the amount of costs to be recognized as assets based on actual costs incurred and paid to obtain and fulfill these contracts to provide goods and services to our customers. Assets recognized to obtain contracts are amortized on a straight-line basis over the contract term as a non-cash reduction to revenue. For the nine months ended September 30, 2018, and 2017, we recognized \$1.9 million of non-cash amortization.

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NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**New Accounting Pronouncements.*****Recently Adopted Pronouncements***

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. In February 2018, the FASB issued an update allowing for a one-time reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the enactment of the TCJA. With the enactment of the new federal tax rates in 2017, entities were required to adjust deferred tax assets and liabilities to reflect the lower federal rate with the effect of this reduction impacting income from continuing operations in the period of enactment, even in instances where the related income tax effects of items were originally recognized in other comprehensive income. As such, companies were left with stranded tax effects in accumulated other comprehensive income that did not reflect the appropriate tax rate. This guidance is effective in the first quarter of 2019 with early adoption permitted. The Company elected to early adopt this guidance in the first quarter of 2018 which resulted in a reduction of \$5.7 million to Accumulated Other Comprehensive Loss and a corresponding increase to Retained Earnings for the reclassification of the stranded income tax effects.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. In March 2017, the FASB issued an accounting standard update to improve the presentation of net periodic pension and postretirement benefit costs. Under the guidance, an entity is required to present the service cost component of the net periodic benefit cost in the same income statement line as other employee compensation costs arising from services rendered during the period. The guidance also allows only the service cost component of the periodic cost to be eligible for capitalization on a prospective basis. The other components of net periodic expense must be presented separately from the line item that includes the service cost and must be excluded from the operating income subtotal. The Company adopted the guidance in the first quarter of 2018 and retrospectively adjusted the presentation of the service cost component and the other components of net periodic costs in the Consolidated Statement of Income. The retrospective adjustments for the quarter and nine months ended September 30, 2017, were as follows: Operating and Maintenance increased \$1.1 million and \$3.2 million, respectively, Cost of Sales – Non-utility decreased \$0.1 million and \$0.2 million, respectively, resulting in an increase of \$1.0 million and \$3.0 million, respectively to Other Income (Expense) – Other. There was no impact to net income as a result of adoption.

Financial Instruments. In 2016, the FASB issued an accounting standard update which requires entities to measure equity investments at fair value and recognize any changes in fair value in net income unless the investments qualify for the practicability exception. The practicability exception will be available for equity investments that do not have readily determinable fair values. The update was adopted by the Company in the first quarter of 2018 which resulted in a cumulative-effect transition adjustment reducing Retained Earnings by \$0.1 million, including the tax effect, for the previously unrealized loss on available-for-sale equity securities in Accumulated Other Comprehensive Loss as of December 31, 2017.

Classification of Certain Cash Receipts and Cash Payments. In 2016, the FASB issued an accounting standard update which addressed the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of

the predominance principle. The amendments of this update were adopted by the Company in the first quarter of 2018. There was no impact to the Consolidated Statement of Cash Flows as a result of adoption.

Statement of Cash Flows: Restricted Cash. In 2016, the FASB issued an accounting standard update related to the presentation of restricted cash in the Company's Consolidated Statement of Cash Flows. The update requires that the Consolidated Statement of Cash Flows explain the change during the period in cash, cash equivalents and restricted cash. Restricted cash should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the Consolidated Statement of Cash Flows. This guidance update was adopted by the Company in the first quarter of 2018 and was applied retrospectively to the periods presented in the Consolidated Statement of Cash Flows which resulted in a net increase in cash from financing activities of \$4.3 million for the nine months ended September 30, 2017. Additional disclosure, including a reconciliation of the beginning-of-period and end-of-period cash on hand to the statement of cash flows, is included in this note. (See *Cash, Cash Equivalents and Restricted Cash.*)

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)
New Accounting Pronouncements (Continued)

Revenue from Contracts with Customers. In 2014, the FASB issued amended revenue recognition guidance that clarifies the principles for recognizing revenue from contracts with customers by providing a single comprehensive model to determine the measurement of revenue and timing of recognition. The guidance requires an entity to recognize revenue in a manner that depicts the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled to in exchange for those goods or services. The guidance requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures regarding customer contracts, significant judgments and changes in those judgments, and the assets recognized from the costs to obtain or fulfill a contract are required. The Company adopted this accounting guidance in the first quarter of 2018 and elected to apply the modified retrospective method of adoption to all contracts as of the date of initial application. The financial impact to the consolidated financial statements as a result of adoption of the new standard is immaterial. Based on the nature of the contracts with our customers and our related performance obligations which transfer control, a \$0.5 million after-tax cumulative effect transition adjustment was made to increase the opening balance of Retained Earnings. We have included additional disclosures in the notes to the consolidated financial statements including additional information on the Company's revenue streams and related performance obligations required to be satisfied in order to recognize revenue. (See *Revenue Recognition*.)

Practical Expedients

The following practical expedients were used by the Company as part of the adoption of the new revenue recognition guidance:

We have a right to consideration from our customers in an amount that corresponds directly with the value to such customer for performance completed to date; therefore, we may recognize revenue in the amount to which we have a right to invoice.

We do not adjust the promised amount of consideration for the effects of a significant financing component as at contract inception we expect that the period between when we transfer a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Where applicable, we adopted this guidance using the portfolio approach in which contracts that have similar characteristics were reviewed as a portfolio. The effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying the guidance to each individual contract.

We recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that would otherwise have been recognized is one year or less.

Recently Issued Pronouncements

Simplifying the Test for Goodwill Impairment. In January 2017, the FASB issued updated guidance which simplifies the measurement of goodwill impairment by removing step two of the goodwill impairment test that requires the determination of the fair value of individual assets and liabilities of a reporting unit. The updated guidance requires goodwill impairment to be measured as the amount by which a reporting unit's carrying value exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This guidance is effective for the Company beginning in the first quarter of 2020, with early adoption permitted on a prospective basis.

Leases. In 2016, the FASB issued an accounting standard update which revises the existing guidance for leases. Under the revised guidance, lessees will be required to recognize a “right-of-use” asset and a lease liability for all leases with a term greater than 12 months. The new standard also requires additional quantitative and qualitative disclosures by lessees and lessors to enable users of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The accounting for leases by lessors and the recognition, measurement, and presentation of expenses and cash flows from leases are not expected to significantly change as a result of the new guidance. As of September 30, 2018, the Company has reviewed substantially all of its leases for its regulated businesses, completing the preliminary evaluations of the impact of this guidance. Our review and analysis of the Company’s energy infrastructure and related services and corporate and other businesses is nearly complete as well. Based on our preliminary assessment, we expect to recognize right-of-use assets and lease liabilities of approximately \$65 million at adoption, which represents the discounted future minimum operating lease payments. The Company plans to adopt and implement the new guidance, utilizing the additional optional transition method and package of practical expedients, by recognizing a cumulative effect adjustment to retained earnings on the Consolidated Balance Sheet, if necessary, in the period of adoption. Management continues to evaluate the need for additional qualitative and quantitative disclosures to meet the requirements of the new standard following adoption. The revised guidance is effective for the Company beginning in the first quarter of 2019.

NOTE 1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes. Under SEC Staff Accounting Bulletin 118 (SAB 118), which was issued in December 2017, companies are allowed up to one year to complete the required analyses and accounting for the TCJA. SAB 118 requires companies to disclose which tax positions are considered complete, which tax positions are considered provisional and which tax provisions reflect prior law. At December 31, 2017, we were reasonably able to estimate the effects of the TCJA, and therefore recorded provisional amounts associated with the changes under the TCJA. The provisional amounts incorporated assumptions made based upon the Company's interpretation of the TCJA. On August 21, 2018, the Internal Revenue Service provided initial guidance for handling changes surrounding the executive compensation deduction, which resulted in recording additional income tax expense of \$0.9 million in the third quarter of 2018. The full-year additional income tax expense related to this guidance is expected to be \$1.1 million. As the Company receives additional clarification and implementation guidance, any additional adjustments would be included in income from operations as an adjustment to income tax expense. The accounting for the TCJA is still considered provisional while we complete our analysis.

Consolidated Statement of Income. In the third quarter of 2018, we recognized a \$4.4 million reduction in revenue for MISO rates that were billed in 2017 and are expected to be credited to customers in 2019. We have evaluated the effect of this out-of-period adjustment on the quarter and nine months ended September 30, 2018, as well as on the previous interim and annual periods in which they should have been recognized, and concluded that this adjustment is not material to any of the periods affected.

NOTE 2. INVESTMENTS

Investments. As of September 30, 2018, the investment portfolio included the legacy real estate assets of ALLETE Properties, debt and equity securities consisting primarily of securities held in other postretirement plans to fund employee benefits, the cash equivalents within these plans and other assets consisting primarily of land in Minnesota.

Other Investments	September 30, December 31,	
	2018	2017
Millions		
ALLETE Properties	\$25.4	\$26.4
Available-for-sale Securities (a)	21.0	19.1
Cash Equivalents	1.5	3.8
Other	3.8	3.8
Total Other Investments	\$51.7	\$53.1

As of September 30, 2018, the aggregate amount of available-for-sale corporate and governmental debt securities maturing in one year or (a) less was \$1.8 million, in one year to less than three years was \$3.5 million, in three years to less than five years was \$1.9 million and in five or more years was \$1.1 million.

Available-for-Sale Securities. We account for our available-for-sale securities portfolio in accordance with the guidance for certain investments in debt and equity securities. Our available-for-sale securities portfolio consisted primarily of securities held in other postretirement plans to fund employee benefits. Gross realized and unrealized gains and losses on our available-for-sale securities were immaterial for the quarter and nine months ended September 30, 2018, and 2017.

NOTE 3. ACQUISITIONS

The following acquisition is consistent with ALLETE's stated strategy of investing in energy infrastructure and related services businesses to complement its regulated businesses, balance exposure to business cycles and changing demand, and provide potential long-term earnings growth. The pro forma impact of the following acquisition was not significant to the results of the Company for the nine months ended September 30, 2018, and 2017.

2017 Activity.

Tonka Water. In September 2017, U.S. Water Services acquired 100 percent of Tonka Water. Total consideration for the transaction was \$19.2 million, including a working capital adjustment. Consideration of \$19.0 million was paid in cash on the acquisition date and a working capital adjustment of \$0.2 million was paid in the fourth quarter of 2017. Tonka Water is a supplier of municipal and industrial water treatment systems that expands U.S. Water Services' geographic and customer markets.

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NOTE 3. ACQUISITIONS (Continued)

The acquisition was accounted for as a business combination and the purchase price was allocated based on the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition. The purchase price accounting, which was finalized in 2018, is reflected in the following table. Fair value measurements were valued primarily using the discounted cash flow method and replacement cost basis.

Millions

Assets Acquired	
Accounts Receivable	\$5.1
Other Current Assets	5.1
Trade Names (a)	0.9
Goodwill (a)(b)	16.9
Other Non-Current Assets	0.2
Total Assets Acquired	\$28.2
Liabilities Assumed	
Current Liabilities	\$9.0
Total Liabilities Assumed	\$9.0
Net Identifiable Assets Acquired	\$19.2

(a) Presented within Goodwill and Intangible Assets – Net on the Consolidated Balance Sheet. (See Note 4. Goodwill and Intangible Assets.)

(b) Recognized goodwill is attributable to the assembled workforce and anticipated synergies. For tax purposes, the purchase price allocation resulted in \$4.1 million of deductible goodwill.

Acquisition-related costs were immaterial, expensed as incurred during 2017 and recorded in Operating and Maintenance on the Consolidated Statement of Income.

NOTE 4. GOODWILL AND INTANGIBLE ASSETS

The aggregate carrying amount of goodwill was \$148.5 million as of September 30, 2018, and \$148.3 million as of December 31, 2017.

Balances of intangible assets, net, excluding goodwill as of September 30, 2018, are as follows:

	December 31, 2017	Additions	Amortization	September 30, 2018
Millions				
Intangible Assets				
Definite-Lived Intangible Assets				
Customer Relationships	\$54.7	\$0.2	\$(3.2)	\$51.7
Developed Technology and Other (a)	6.3	2.5	(0.9)	7.9
Total Definite-Lived Intangible Assets	61.0	2.7	(4.1)	59.6
Indefinite-Lived Intangible Assets				
Trademarks and Trade Names	16.6	—	n/a	16.6
Total Intangible Assets	\$77.6	\$2.7	\$(4.1)	\$76.2

(a) Developed Technology and Other includes patents, non-compete agreements, land easements and trade names with finite lives.

Customer relationships have a remaining useful life of approximately 19 years, and developed technology and other

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have remaining useful lives ranging from less than 1 year to approximately 10 years (weighted average of approximately 6 years). The weighted average remaining useful life of all definite-lived intangible assets as of September 30, 2018, is approximately 18 years.

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NOTE 4. GOODWILL AND INTANGIBLE ASSETS (Continued)

Amortization expense for intangible assets was \$1.4 million and \$4.1 million for the quarter and nine months ended September 30, 2018, respectively (\$1.3 million and \$4.1 million for the quarter and nine months ended September 30, 2017, respectively). Accumulated amortization was \$18.9 million as of September 30, 2018 (\$14.8 million as of December 31, 2017). The estimated amortization expense for definite-lived intangible assets for the remainder of 2018 is \$1.5 million. Estimated annual amortization expense for definite lived intangible assets is \$5.3 million in 2019, \$4.9 million in 2020, \$4.9 million in 2021, \$4.6 million in 2022 and \$38.4 million thereafter.

NOTE 5. FAIR VALUE

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. We primarily apply the market approach for recurring fair value measurements and endeavor to utilize the best available information. Accordingly, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs, which are used to measure fair value, are prioritized through the fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Descriptions of the three levels of the fair value hierarchy are discussed in Note 9. Fair Value to the Consolidated Financial Statements in our 2017 Form 10-K.

The following tables set forth by level within the fair value hierarchy our assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2018, and December 31, 2017. Each asset and liability is classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of these assets and liabilities and their placement within the fair value hierarchy levels. The estimated fair value of Cash and Cash Equivalents listed on the Consolidated Balance Sheet approximates the carrying amount and therefore is excluded from the recurring fair value measures in the following tables.

Recurring Fair Value Measures	Fair Value as of September 30, 2018			
	Level 1	Level 2	Level 3	Total
Millions				
Assets				
Investments (a)				
Available-for-sale – Equity Securities	\$12.7	—	—	\$12.7
Available-for-sale – Corporate and Governmental Debt Securities	—	\$8.3	—	8.3
Cash Equivalents	1.5	—	—	1.5
Total Fair Value of Assets	\$14.2	\$8.3	—	\$22.5
Liabilities				
Deferred Compensation (b)	—	\$20.5	—	\$20.5
U.S. Water Services Contingent Consideration (c)	—	—	\$5.7	5.7
Total Fair Value of Liabilities	—	\$20.5	\$5.7	\$26.2

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Total Net Fair Value of Assets (Liabilities) \$14.2 \$(12.2) \$(5.7) \$(3.7)

(a) Included in Other Investments on the Consolidated Balance Sheet.

(b) Included in Other Non-Current Liabilities on the Consolidated Balance Sheet.

(c) Included in Other Current Liabilities on the Consolidated Balance Sheet.

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NOTE 5. FAIR VALUE (Continued)

Recurring Fair Value Measures	Fair Value as of December 31, 2017			Total
	Level 1	Level 2	Level 3	
Millions				
Assets				
Investments (a)				
Available-for-sale – Equity Securities	\$10.2	—	—	\$10.2
Available-for-sale – Corporate and Governmental Debt Securities	—	\$8.9	—	8.9
Cash Equivalents	3.8	—	—	3.8
Total Fair Value of Assets	\$14.0	\$8.9	—	\$22.9
Liabilities (b)				
Deferred Compensation	—	\$18.2	—	\$18.2
U.S. Water Services Contingent Consideration	—	—	\$5.4	5.4
Total Fair Value of Liabilities	—	\$18.2	\$5.4	\$23.6
Total Net Fair Value of Assets (Liabilities)				
Purchase of fixed assets	(1,501)	(564)	(22,919)	(22,139)
Net cash used by investing activities	(1,501)	(564)	(22,919)	(22,139)
Cash flows from financing activities:				
Settlement of intercompany balances	(327,557)	(598,963)	(815,761)	(1,100,923)
Proceeds from factoring line	764,636	614,694	2,590,867	403,025
Repayment of factoring line	(700,617)	(548,639)	(2,484,630)	(270,296)
Net cash used by financing activities	(263,538)	(532,908)	(709,524)	(968,194)
Net decrease in cash and cash equivalents	(10,090)	(17,364)	(10,454)	(152,909)
Cash and cash equivalents at beginning of period	11,065	21,519	21,519	174,428
Cash and cash equivalents at end of period	\$ 975	\$ 4,155	\$ 11,065	\$ 21,519
Supplemental disclosure of cash flow information:				
Cash paid during the year for:				
Interest	\$ 46,333	\$ 24,490	\$ 111,217	\$ -

The accompanying notes are an integral part of the TPV Business Unaudited Financial Statements

TPV BUSINESS
NOTES TO UNAUDITED FINANCIAL STATEMENTS

Note 1

Summary of Significant Accounting Policies, Nature of Operations and Use of Estimates

Operations

Customer Contact Support Services

Calibrus, Inc. ("Calibrus" or the "Parent") was incorporated on October 22, 1999, in the State of Nevada. Calibrus' principal business purpose is to operate a customer contact center for a variety of clients who are located throughout the United States (the "TPV Business" or the "Company"). The Company provides customer contact support services for various companies wishing to outsource these functions. (See Note 2 – Concentrations of Risk).

The TPV Business provides Third Party Verification (TPV) Services, Hosted Call Recording Services and Interactive Voice Response/Voice Recognition Unit (IVR/VRU) Services to certain telecom, cable and insurance companies.

The Company has also in the past conducted outbound sales and customer service campaigns. Although the Company does not have any current outbound calling campaign contracts it may again in the future.

Third Party Verification is the confirmation of a customer's order by an independent third party. This process protects both the customer, and the company selling their service, from fraud and slamming and/or cramming of products onto their lines. Once a sale has been made the customer is transferred to an independent third party verification source such as the TPV Business that will read a pre-determined script to which the customer will answer yes or no to verify their acceptance of the service. This service has typically been performed for telecommunications providers.

The TPV Business' Hosted Call Recording service offers a number of features necessary for a superior call recording solution. The TPV Business' Hosted Call Recording solutions are an alternative for companies that do not wish to invest in expensive hardware, maintenance, personnel and support of a technology based call recording system.

IVR or Interactive Voice Response allows customers to offer customer service or verification services without the need of a live agent. The TPV Business' automated IVR/VRU verification method provides customers with a pre-determined script to comply with each client's unique verification requirements.

Our technology provides us with the ability to provide fully-integrated live voice, data, and automated services and combinations of services out of a unified platform. Our system's processes and functionality allow our IT staff to easily design and build systems that satisfy client's process requirements. Using our technology has allowed us to develop and build customized web-based solutions incorporating call recording, "click to call" and voice message broadcast functionality.

Basis of presentation

These financial statements represent the activity of the Company's TPV Business. Management has used significant estimates in the allocations of assets, liabilities and expenses between corporate activity and the TPV business in the preparation of these unaudited financial statements for all periods presented. Management believes these estimates are reasonable given the facts and circumstances.

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Note 1

Summary of Significant Accounting Policies, Nature of Operations and Use of Estimates (Continued)

Presentation of Interim Information

The condensed financial statements included herein have been prepared by the TPV Business without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”) and should be read in conjunction with the audited financial statements of Calibus, Inc. as of December 31, 2011. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, as permitted by the SEC, although we believe the disclosures, which are made, are adequate to make the information presented not misleading. Further, the condensed financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly our financial position at March 31, 2012, and the results of our operations and cash flows for the periods presented. The December 31, 2011 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Interim results are subject to significant seasonal variations and the results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include, but are not limited to, allocation of expenses to the TPV Business, the estimate of the allowance for doubtful accounts, income taxes, and depreciable lives of long lived assets.

Cash and Cash Equivalents

For financial accounting purposes, cash and cash equivalents are considered to be all highly liquid investments purchased with an initial maturity of three (3) months or less.

Accounts Receivable

The Company provides for potentially uncollectible accounts receivable by use of the allowance method. The allowance is provided based upon a review of the individual accounts outstanding, and the Company's prior history of uncollectible accounts receivable. As of March 31, 2012 and December 31, 2011 and 2010, a provision for uncollectible trade accounts receivable has been established in the amount of \$50,000. The Company does not accrue interest charges or fees on delinquent accounts receivable. The accounts are generally unsecured.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided for on the straight-line method over the estimated useful lives of the assets. The average lives range from three (3) to five (5) years. Leasehold improvements are amortized on the straight-line method over the lesser of the lease term or the useful life. Maintenance and repairs

that neither materially add to the value of the property nor appreciably prolong its life are charged to expense as incurred. Betterments or renewals are capitalized when incurred. For the three months ended March 31, 2012 and 2011, depreciation expense was \$5,333 and \$6,872, respectively. For the years ended December 31, 2011 and 2010, depreciation expense was \$29,211 and \$54,791, respectively.

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Note 1

Summary of Significant Accounting Policies, Nature of Operations and Use of Estimates (Continued)

Intangible Assets

The intangible assets are comprised of branding costs and the Company's website. The intangible assets are being amortized using the straight-line method over its economic life, which is estimated to be seven (7) years. As of December 31, 2010 the amount related to the Company's branding cost and company website have been fully amortized. Amortization expense for the year ended December 31, 2010 was \$1,167.

Revenue Recognition

Revenue for inbound calls is recorded on a per-call or per-minute basis in accordance with the rates established in the respective contracts. Revenue for outbound calls is on a commission basis, with revenue being recognized as the commission is earned. As the Company's customers are primarily well established, creditworthy institutions, Management believes collectability is reasonably assured at the time of performance. The Company, from time to time, executes outbound sales campaigns for customers, primarily for the sale of telecommunications services. Although this revenue source has been immaterial, the Company recognizes the commissions earned on these campaigns on a net basis in accordance with FASB ASC 605-45 Reporting Revenue Gross as a Principal versus Net as an Agent.

Impairment of Long-Lived Assets

The Company reviews the carrying value of its long-lived assets at least annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Income Taxes

Calibus files income tax returns in the U.S. federal jurisdiction, and the State of Arizona, which include the operating activity of the TPV Business. Calibus is subject to federal, state and local income tax examinations by tax authorities for approximately the past three years, or in some instances longer periods.

Deferred income taxes are provided using the asset and liability method, whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Net deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the net deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of the changes in tax laws and rates at the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the

position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured, if any, is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interests and penalties associated with unrecognized tax benefits, if any, are classified as additional income taxes in the statement of operations. During the three months ended March 31, 2012 and 2011 and the years ended December 31, 2011 and 2010 there were no interest or penalties incurred related to income taxes.

Note 1
Summary of Significant Accounting Policies, Nature of Operations and Use of Estimates (Continued)

Fair Value of Financial Instruments

The estimated fair values for financial instruments are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The carrying amounts of accounts receivable, notes payable, accounts payable, accrued liabilities approximate fair value given their short term nature or effective interest rates.

Pending Accounting Pronouncements

There have been no accounting pronouncements or changes in accounting principles during the quarter ended March 31, 2012 or the year ended December 31, 2011 that are of significance, or potential significance, to us.

Note 2
Concentrations of Risk

During the three months ended March 31, 2012, the Company rendered a substantial portion of its services to its three largest customers representing 45%, 20% and 14% of total revenues. As of March 31, 2012, the amounts due from these customers were \$238,936, \$133,569 and \$77,977, respectively.

During the year ended December 31, 2011, the Company rendered a substantial portion of its services to its three largest customers representing 50%, 17% and 15% of total revenues. As of December 31, 2011, the amounts due from these customers were \$199,535, \$78,813 and \$202,967, respectively.

During the three months ended March 31, 2011, the Company rendered a substantial portion of its services to its three largest customers representing 60%, 20% and 10% of total revenues. As of March 31, 2011, the amounts due from these customers were \$317,811, \$115,875 and \$58,966, respectively.

During the year ended December 31, 2010, the Company rendered a substantial portion of its services to its two largest customers representing 68% and 17% of total revenues. As of December 31, 2010, the amounts due from these customers were \$266,261 and \$72,680, respectively.

The Company maintains cash and cash equivalents at various financial institutions. Deposits not to exceed \$250,000 at each financial institution are insured by the Federal Deposit Insurance Corporation. At March 31, 2012 and December 31, 2011 and 2010, the Company had no uninsured cash and cash equivalents.

Note 3

Property and Equipment

Property and equipment as of March 31, 2012 and December 31, 2011 and 2010 consist of the following:

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	March 31, 2012	December 31, 2011	December 31, 2010
Computer hardware	\$ 2,143,956	\$ 2,142,455	\$ 2,120,537
Furniture and fixtures	244,785	244,785	243,785
Leasehold improvements	156,144	156,144	156,144
Software costs	1,195,761	1,195,761	1,195,761
	3,740,646	3,739,145	3,716,227
Less: accumulated depreciation	(3,703,413)	(3,698,080)	(3,668,870)
	\$ 37,233	\$ 41,065	\$ 47,357

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Note 4
Due to Factor

During the year ended December 31, 2010 the Company entered into a Factoring and Security Agreement with Factors Southwest, LLC (FSW). The agreement states that FSW will advance to the Company 80% of eligible accounts receivable upon submission to FSW for funding. Factoring fees related to advances will equal 2.25% for the first 30-day period, .56% for the next 15-day period and .75% for each additional 30-day period following. Advances are made with full-recourse after a 90-day period. The maximum credit under the factoring line is \$600,000 and is secured by all assets of the Company and a first priority lien filing on accounts receivable and proceeds. All payments made by customers of the Company on factored invoices are sent directly to FSW. For the three months ended March 31, 2012, FSW advanced a total of \$764,636 of which \$700,617 was repaid. For the three months ended March 31, 2011, FSW advanced a total of \$614,694 of which \$548,639 had been repaid. For the year ended December 31, 2011, FSW advanced a total of \$2,590,867 of which \$2,484,630 was repaid. For the year ended December 31, 2010, FSW advanced a total of \$403,025 of which \$270,296 had been repaid. The total amount due to FSW at March 31, 2012 was \$302,985. During the quarter ended March 31, 2012 the Company received an over-advance on its factoring line from Factors Southwest, LLC in the amount of \$115,000. Interest on the over-advance is 5% per 30-day period. As of March 31, 2012 the balance of the over-advance is \$105,000 and is included in the due to factor balance. Total amounts due to FSW at December 31, 2011 and 2010 was \$238,966 and \$132,729, respectively. Factoring expense for the three months ended March 31, 2012 and 2011 was \$46,333 and \$24,490, respectively, and was included in interest expense. Factoring expense for the years ended December 31, 2011 and 2010 was \$111,217 and \$11,680, respectively, and was included in interest expense. All factored invoices are full-recourse after 90 days.

Note 5
Accrued Liabilities

	March 31, 2012	December 31, 2011	December 31, 2010
Payroll and related taxes	\$69,914	\$62,889	\$65,618
Deferred rent	4,403	3,947	607
Accrued vacation	93,477	86,900	72,475
Accrued interest	34,460	24,296	96,600
Other accrued expenses	46,611	38,838	30,806
	\$248,865	\$216,870	\$266,106

Note 6

Commitments and Contingencies

Operating Leases

The Company leased office space in Tempe, Arizona, under a five (5) year operating lease agreement which expired in 2010, at a rate of approximately \$30,000 per month. During the year ended December 31, 2010 the Company signed a five year extension on its leased facility and reduced the rentable square feet from 13,295 to 7,767. As a result of this extension the Company decreased the monthly rent from approximately \$30,000 per month to \$12,000 per month.

The Company leased office equipment under an operating lease agreement expiring through June 2011, at the rate of approximately \$754 per month. In August 2011, the Company signed another operating lease agreement for office equipment at the rate of approximately \$415 per month, expiring in July of 2016.

Total rent expense under the aforementioned operation leases was approximately \$38,895 and \$39,782 for the three months ended March 31, 2012 and 2011, respectively.

Total rent expense under the aforementioned operating leases was approximately \$155,061 and \$304,000 for the years ended December 31, 2011 and 2010, respectively.

A schedule of future minimum lease payments is as follows:

Twelve-Month Period Ending March 31,	Amount
2013	\$ 145,971
2014	147,793
2015	149,614
2016	89,952
2017	1,646
	\$534,976

Employment Agreements

Calibus has agreements with all officers and those employees identified herein as key employees. All of our agreements contain language assigning all inventions over to Calibus, and also contain non-compete agreements.

Additionally, on termination, if not for cause and Calibus is cash flow and earnings positive, our officers and key employees will receive up to three months salary as severance. On a change of control of Calibus, which results in termination of the officer or key employee and Calibus is cash flow positive and has positive earnings per share at the time of the change of control, the officer or key employee will receive a three months salary as severance based on the officers or employees' current salary. Employment contracts are entered into for two, three or four year periods with automatic two, three or four one year extensions depending on the officer or key employee. Except for terms and salary, all of our employment contracts contain the same material terms. A summary of the officers' employment contracts are below:

Employee	Beginning Date	Annual Salary
Jeff W. Holmes	1/1/2005	\$ 220,000
Greg W. Holmes	1/1/2005	\$ 150,000
Kevin J. Asher	2/5/2008	\$ 130,000
Tom Harker	1/10/2007	\$ 140,000
Michael Brande	1/10/2007	\$ 105,000
Michael Rae	1/10/2007	\$ 90,000
Kelly Robinson	6/28/2004	\$ 90,000

During the years ended December 31, 2011 and 2010, each of the employees listed above took salary decreases due to limited cash flow in the Company. Each of the employees has agreed to waive the unpaid amounts per their respective employment agreements.

Indemnification Agreements

The Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. As a result of no current or expected litigation, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of March 31, 2012, December 31, 2011 and 2010.

Note 7 Litigation

On September 13, 2010, a former employee filed a lawsuit in the Superior Court of the State of Arizona, in and for the County of Maricopa (Case No. CV2010-027027) against the Company. The complaint was hand-written and did not itemize the specific legal claims, but could include (1) discrimination (no statute identified), (2) failure to pay minimum wage or overtime (no statute identified), (3) retaliation, (4) assault, and (5) intentional infliction of emotional distress. On May 22, 2011 the suit was dismissed with prejudice.

Note 8

Subsequent Events

Subsequent to March 31, 2012 the Company paid down the over-advance from Factors Southwest, LLC by \$10,000. The remaining balance of the over-advance is \$95,000.

Calibrus, Inc.

Proxy

2012 Special Meeting of Stockholders

This Proxy is solicited on behalf of the Board of Directors

The undersigned hereby appoints Greg Holmes and Kevin Asher, and each or either of them, as proxies, with full power of substitution, to represent and to vote, as designated below, all shares of common stock which the undersigned is entitled to vote at the Special Meeting of the Stockholders of Calibrus, Inc. to be held on August 22, 2012 at 10:00 a.m. local time at our offices at 1225 West Washington, Suite 213, Tempe, Arizona 85281, or any adjournment thereof, hereby revoking any proxy previously given.

1. Proposal No. 1: To approve the sale of substantially all of the assets of the third party verification business of Calibrus, Inc., which may be deemed a sale of substantially all our assets for purposes of Nevada law:

For [] Against [] Abstain []

2. Proposal No. 2: To approve the change of the name of the Company from "Calibrus, Inc." to "Fanatic Fans, Inc.":

For [] Against [] Abstain []

3. Proposal No. 3: To approve the adoption of the 2012 Stock Option and Restricted Stock Plan of the Company:

For [] Against [] Abstain []

4. Proposal No. 4: In their discretion, the proxies are authorized to vote upon such other business as may properly come before the Special Meeting or any adjournment thereof as set forth in the Notice and Proxy Statement relating to this Special Meeting, receipt of which is hereby acknowledged.

Please sign, date and mail this proxy card promptly
Using the enclosed postage-paid envelope
(Please sign and date this card on the reverse side)

This proxy when properly executed will be voted in the manner directed herein by the undersigned stockholder. If no direction is made, this proxy will be voted FOR the adoption and approval of Proposals No. 1, No. 2 and No. 3. and on any other business, in the disposition of the proxies.

I authorize my proxy to vote as his discretion may dictate on the transaction of such other business as may properly come before the Special Meeting or any adjournments thereof.

Dated: _____, 2012

Signature

[Votes must be indicated in black or blue ink.]

Important: Please sign exactly
as name appears below

Where shares are held by more than one owner, all should sign. When signing as an attorney, executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in corporate name by the president or other authorized officer. If a partnership, please sign in partnership name by authorized person.

Exhibit A

ASSET PURCHASE AGREEMENT

This Asset Purchase Agreement (the “Agreement”) dated June 15, 2012 (the “Effective Date”), is between CALIBRUS, INC., a Nevada corporation (“Seller”), and CALIBRUS HOSTED BUSINESS SOLUTIONS, LLC, an Arizona limited liability company (“Buyer”).

RECITALS

- A. Seller operates a third party verification business located in Tempe, Arizona (the “Business”).
- B. Buyer desires to purchase substantially all assets of Seller used to operate the Business, and Seller desires to sell such assets, in exchange for the consideration described herein.
- C. The parties hereto desire to provide for the acquisition of substantially all assets of Seller used to operate the Business by Buyer on the terms and conditions set forth in this Agreement.

AGREEMENT

The parties agree as follows:

SECTION 1. ACQUISITION OF ASSETS; ASSUMPTION OF LIABILITIES.

1.1 Purchase and Sale of Assets. Subject to the terms and conditions of this Agreement, at the Closing (defined below), Seller will sell, assign, transfer and convey to Buyer, free and clear of any liens, security interests, encumbrances, mortgages, pledges or other defects of title other than permitted encumbrances, if any, and Buyer will purchase from Seller, all of Seller’s right, title and interest in and to the assets listed below, all of which are used exclusively by Seller to operate the Business and constitute all of the assets required to operate the Business as of the Effective Date (collectively, the “Purchased Assets”):

- (a) the assets listed on Schedule 1.1(a) attached hereto;
- (b) any and all customer lists related to the Business;
- (c) the service provider contracts and agreements listed on Schedule 1.1(c) (“Assumed Contracts”); and
- (d) all intellectual property related to the Business, including, without limitation, the “Calibus” trade name and trademarks used in the Business and certain software upgrades and add-ons made by Seller to certain of its software used in connection with the Business. Seller will take any and all action necessary to transfer the foregoing trade name, trademarks and software upgrades and add-ons to Buyer at Closing, including, but not limited to, filing Articles of Amendment (or a similar instrument) with the Nevada Secretary of State and Arizona Corporation Commission, thereby changing the name of Seller.

1.2 Excluded Assets. Other than the Purchased Assets subject to Section 1.1, Buyer expressly understands and agrees that it is not purchasing or acquiring, and Seller is not selling or assigning, any other assets or properties of Seller, and all such other assets and properties shall be excluded from the Purchased Assets (the "Excluded Assets"). Excluded Assets include, but are not limited to, the following assets and properties of Seller:

- (a) cash, cash equivalents, investments, bank accounts, security deposits and safe deposit boxes of Seller, except for any of the foregoing that are derived from the Purchased Assets after the Closing;
- (b) accounts receivable of Seller, except for accounts receivable derived from the Purchased Assets after the Closing. With respect to accounts receivable of Seller derived from the Purchased Assets prior to the Closing (the "Pre-Closing A/R"), on or prior to the Closing Date, Seller will prepare invoices and a schedule listing all Pre-Closing A/R and deliver such invoices to both the customers and to Buyer. After Closing, Buyer will collect all Pre-Closing A/R and remit such amounts to Seller as Buyer receives such amounts. Seller agrees that the provisions of Section 10.2 will apply with respect to Seller contacting any customer listed on the Pre-Closing A/R schedule prepared under this Section 1.2(b);
- (c) claims relating to Seller prior to Closing, including without limitation, those for income tax refunds and insurance payments; and
- (d) any and all assets not constituting a Purchased Asset.

For avoidance of doubt, the Excluded Assets are listed on Schedule 1.2 attached hereto. With respect to any cash, cash equivalents, or accounts receivables derived from the Purchased Assets after Closing, any such amounts received by Seller will be immediately payable to Buyer without demand, deduction, or setoff.

1.3 Assumed Liabilities. Subject to the terms and conditions set forth herein, Buyer shall assume and agree to pay, perform and discharge when due any and all liabilities and obligations of Seller arising out of or relating to the Business or the Purchased Assets on or after the Closing, other than the Excluded Liabilities (collectively, the "Assumed Liabilities"), including, without limitation, the following:

- (a) all the liabilities and obligations related to or arising out of the operation of the Purchased Assets on and after the Closing Date; and
- (b) all liabilities and obligations to be performed or discharged after the Closing pursuant and related to the Purchased Assets.

1.4 Excluded Liabilities. Buyer assumes only the Assumed Liabilities and no other liabilities associated with Seller or the operation of the Business. Notwithstanding any other provision of this Agreement, except for the Assumed Liabilities, Buyer will not assume, or otherwise be responsible for, any of Seller's liabilities or obligations, whether actual or contingent, matured or unmatured, liquidated or unliquidated, known or unknown, or related or unrelated to the Business or the Assets, whether arising out of occurrences prior to, at, or after the Closing Date (collectively, "Excluded Liabilities").

1.5 Taxes. All sales, use, transfer, documentary, stamp, excise, privilege, income, or other similar taxes payable as a result of the consummation of the transactions contemplated hereby will be paid by Seller. Seller will indemnify, defend, protect, and hold Buyer and its managers, members, directors, officers, and employees harmless for, from, and against any liabilities that may be assessed against Buyer for taxes, interest, or penalties payable as a result of the consummation of the transactions contemplated herein.

SECTION 2. CONSIDERATION; INVESTIGATION PERIOD; CLOSING.

2.1 Consideration. The consideration for the Purchased Assets (the "Purchase Price") is the payment of Three Million Dollars (\$3,000,000), subject to the adjustments set forth below, payable as follows:

(a) On the Closing Date, Buyer will pay Seller the amount of Two Million Dollars (\$2,000,000) in cash, cashier's check, or immediately available funds, subject to adjustment for any amounts unpaid by Seller to Buyer under that certain Senior Multiple Advance Promissory Note, dated April 26, 2012, executed by Seller, as Maker, in favor of Buyer, as Holder, subsequently replaced by that certain Amended and Restated Senior Multiple Advance Promissory Note dated June 15, 2012 executed by Seller, as Maker, in favor of Buyer, as Holder (the "Buyer Note"), and that certain Senior Multiple Advance Promissory Note, dated June 15, 2012, executed by Seller, as Maker, in favor of Marcus Shotey, as Holder (the "Shotey Note") (the Buyer Note and the Shotey Note are collectively referred to herein as the "Pre-Closing Note"). The initial payment described in this Section 2.1(a) will be reduced by the amount, if any, outstanding and payable to Buyer under the Pre-Closing Note and the Pre-Closing Note will then be cancelled and treated as paid in full.

(b) Within thirty (30) days after the end of the twelve (12) month period immediately following the Closing Date, Buyer will pay Seller the amount of Five Hundred Thousand Dollars (\$500,000) in cash, cashier's check, or immediately available funds (the "Twelve Month Payment"), subject to the adjustment provided for in this Section 2.1(b). Within thirty (30) days after the end of the twelve (12) month period immediately following the Closing Date, Buyer will calculate the gross revenues received from all of the existing customers of the Business as of the Closing Date and from six prospective customers of the Business that Seller has actively engaged or can demonstrate proof of active engagement for new business as listed on Schedule 2.1 hereto (collectively, the "Business Customers") for the twelve (12) month period beginning on the Closing Date and ending on the last day of the twelfth month following the Closing Date (the "Twelve Month Revenue"). If the Twelve Month Revenue is equal to \$3,500,000, then there will be no adjustment to the Twelve Month Payment. If the Twelve Month Revenue is less than \$3,500,000, the Twelve Month Payment will be reduced by the amount of \$1.25 for every \$1.00 the Twelve Month Revenue is less than \$3,500,000. If the Twelve Month Revenue is equal to or less than \$3,100,000, Buyer will not owe the Twelve Month Payment to Seller. If the Twelve Month Revenue is greater than \$3,500,000, the Twelve Month Payment will be increased by the amount of \$0.20 for every \$1.00 the Twelve Month Revenue is greater than \$3,500,000 until the Twelve Month Revenue equals or exceeds \$5,000,000, at which time no further payments will be due Seller under this Section 2(b). With respect to the Business Customers listed on Schedule 2.1, if any of the prospective customers become customers of the Business prior to the Closing Date, the Seller shall have the right to substitute a new prospective customer for each customer listed below that became a customer of the Business.

(c) Within thirty (30) days after the end of the eighteen (18) month period immediately following the Closing Date, Buyer will pay Seller the amount of Five Hundred Thousand Dollars (\$500,000) in cash, cashier's check, or immediately available funds (the "Eighteen Month Payment"), subject to the adjustment provided for in this Section 2.1(c). Within thirty (30) days after the end of the eighteenth month following the Closing Date, Buyer will calculate the gross revenues received from the Business Customers for the twelve (12) month period beginning on the first day of the seventh month following the Closing Date and ending at the end of the eighteenth month following the Closing Date (the "Eighteen Month Revenue"). If the Eighteen Month Revenue is equal to \$3,500,000, then there will be no adjustment to the Eighteen Month Payment. If the Eighteen Month Revenue is less than \$3,500,000, the Eighteen Month Payment will be reduced by the amount of \$1.25 for every \$1.00 the Eighteen Month Revenue is less than \$3,500,000. If the Eighteen Month Revenue is equal to or less than \$3,100,000, Buyer will not owe the Eighteen Month Payment to Seller. If the Eighteen Month Revenue is greater than \$3,500,000, the Eighteen Month Payment will be increased by the amount of \$0.20 for every \$1.00 the Eighteen Month Revenue is greater than \$3,500,000 until the Eighteen Month Revenue equals or exceeds \$5,000,000, at which time no further payments will be due Seller under this Section 2(c).

(d) Notwithstanding anything herein to the contrary, Buyer will have the right to offset the Twelve Month Payment or the Eighteen Month Payment due Seller to the extent Seller breaches any representation or warranty of Seller contained in this Agreement, provided, that, Buyer shall first provide notice of such alleged breach and intent to offset ("Notice of Offset") to Seller. Upon receipt of the Notice of Offset, the parties shall have a fifteen (15) day period in which to resolve the potential offset, if any, provided however, that, Buyer shall pay the Twelve Month Payment and Eighteen Month Payment when due, less the disputed potential offset amount. If the parties are unable to resolve the potential offset, then the parties shall utilize the arbitration process set forth in Section 8.6 of this Agreement to resolve the amount of the offset, if any. The amount of offset shall not exceed the amount of damages caused to Buyer (including reasonable attorneys' fees and court costs) as a result of any such breach of a Seller representation or warranty contained in this Agreement and shall be determined by agreement of the parties or through the arbitration process, as set forth above.

2.2 Closing and Closing Date. The closing of the purchase and sale provided for in this Agreement (the "Closing") will be held on or before August 31, 2012 ("Closing Date") at the offices of Gallagher & Kennedy, P.A. in Phoenix, Arizona, or such other date or location that the parties agree to in writing, after the satisfaction or waiver of the conditions to Closing specified in Section 7 hereof (other than those conditions that are normally performed at the Closing, but subject to the satisfaction or waiver of such conditions); provided, however, that the Closing Date shall be automatically extended up to a maximum of forty-five (45) additional days if required in order to comply with any regulatory requirements of the United States Securities Exchange Commission. Seller shall provide written notice to Buyer of any such required extension.

2.3 Allocation of Consideration. The consideration for the Purchased Assets will be allocated to Seller and among the Purchased Assets as specified on Schedule 2.3. Within ninety (90) days following the Closing, Buyer will prepare and submit to Seller an Internal Revenue Form 8594 (relating to purchase price allocation), prepared in accordance with such allocation. Seller and Buyer will prepare their respective federal, state and local tax returns and reports employing the allocation made pursuant to this Section 2.3 and will not take a position in any tax proceeding or audit or otherwise that is inconsistent with such allocation. Seller and Buyer will give prompt notice to each other of the commencement of any tax audit or the assertion of any proposed deficiency or adjustment by any tax authority or agency that challenges such allocation.

SECTION 3. REPRESENTATIONS AND WARRANTIES OF SELLER.

Seller represents and warrants to Buyer that the following are true, accurate, and correct as of the Effective Date and as of the Closing Date:

3.1 Organization and Authorization. Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Nevada and all other states in which Seller conducts its business. Seller has the requisite power and authority to execute and deliver this Agreement and perform its obligations thereunder. This Agreement has been duly and validly authorized, executed, and delivered by Seller and constitutes the legal, valid, and binding obligations of Seller, enforceable in accordance with its terms subject to applicable bankruptcy, insolvency, reorganization, and other similar laws affecting the enforceability of creditors' rights generally, general equitable principles, and the discretion of courts in granting equitable remedies.

3.2 Ownership of the Assets. Except as disclosed on Schedule 3.2, Seller owns and has valid title to and ownership of the Purchased Assets, free and clear of any lien, security interest, encumbrance, mortgage, pledge, or other defect of title. On or prior to the Closing Date, Seller shall cause any liens, security interests, encumbrances, mortgages, pledges or other defects of title encumbering the Purchased Assets to be released.

3.3 No Violation or Conflict. Neither the execution and delivery of this Agreement, nor the performance of its obligations hereunder, by Seller is a violation of any provision of its articles of incorporation or bylaws, or any law, rule, regulation, order, writ, injunction, judgment, decree, contract, or other obligation to which it is a party or to which it or the Purchased Assets are subject.

3.4 Licenses and Permits. Schedule 3.4 sets forth all licenses, permits, authorizations, franchises, and certifications of governmental and non-governmental authorities held by Seller that are material to Seller or the Business. Seller is in compliance in all material respects with all such licenses, permits, authorizations, franchises, and certifications, all of which are in full force and effect. There are no other licenses, permits, authorizations, franchises, or certifications that are material to Seller or the Business that Seller is required to obtain. Seller does not know of any threatened suspension, revocation, or invalidation of any such licenses, permits, authorizations, franchises, or certifications, or any basis therefore.

3.5 Consents. Except as disclosed on Schedule 3.5, no consent or approval by, or filing with, any governmental authority or any other Person is required in connection with the execution and delivery by Seller of this Agreement or the consummation by Seller of the transactions contemplated hereby.

3.6 Adverse Proceedings. Except as disclosed on Schedule 3.6, there are no actions, suits, proceedings, or arbitrations pending or, to the Knowledge of Seller (defined below), threatened against Seller that would materially adversely affect the Purchased Assets or any portion thereof.

3.7 Condition of the Purchased Assets. All of the tangible Purchased Assets are free from material defects and are in good operating condition and repair, normal wear and tear excepted.

3.8 Taxes. All federal, state, county, and local tax and other returns and reports required and due to be filed with respect to Seller, the Purchased Assets, or both have been filed, and all taxes, levies, license and registration fees, charges or withholdings of any nature whatsoever, including, without limitation, ad valorem taxes (collectively, "Taxes") have been paid, or adequate provision for the payment thereof has been made. Buyer will not be responsible for, and Buyer specifically assumes no obligations to pay, any Taxes or any other similar liability or obligation of Seller. To the Knowledge of Seller, Seller is not in default of the payment of any Taxes due or payable or of any assessments received in respect thereof and Seller has not waived any statute of limitations in connection with, or granted any extension of a period for the assessment of, any Tax.

3.9 Environmental Matters. To the Knowledge of Seller, the conduct of Seller's operations and its operation of the Business, have at all times complied in all material respects with all applicable foreign, federal, state and local statutes, laws, ordinances, judgments, decrees, orders, rules, regulations, policies and guidelines relating to pollution, environmental protection, hazardous substances, human health and safety, and related matters (collectively, the "Environmental Legal Requirements"). Seller has not received any notice from any governmental authority or any other Person of any alleged violation or noncompliance by Seller or of any liabilities or potential liabilities of Seller arising under the Environmental Legal Requirements. For purposes of this Section 3.9, "hazardous substance" means oil or any other substance which is included within the definition of a "hazardous substance," "pollutant," "toxic substance," "toxic waste," "hazardous waste," "contaminant," or other words of similar import in any federal or state environmental law, statute, ordinance, rule or regulation.

3.10 No Finders or Brokers. Except as set forth on Schedule 3.10, Seller has not engaged any finder or broker in connection with the transactions contemplated hereunder.

3.11 Real Property.

(a) Owned Real Property. Seller does not own any real property.

(b) No Other Leases. Except as specifically disclosed on Schedule 3.11, there are no leases, subleases, licenses, occupancy agreements, options, rights, concessions or other agreements or arrangements, written or oral, granting to any Person the right to purchase, use or occupy real property in connection with the operation of the Business. Schedule 3.11 sets forth a true and complete list of each location of real property leased, subleased, or licensed to Seller with respect to the Business. Seller has delivered to Buyer true and complete copies of the leases, subleases, or other agreements relating to such leased real property, including all amendments, supplements, modifications, and guaranties associated therewith (each a "Real Property Lease"). After the Effective Date, no Real Property Lease will be modified or supplemented without Buyer's prior written consent. Except as specifically disclosed on Schedule 3.11, each Real Property Lease is in full force and effect and is valid and enforceable against the landlord of each such Real Property Lease in accordance with its terms, except as may be limited by applicable bankruptcy, insolvency, or creditor's rights laws. Except as set forth on Schedule 3.11, Seller is not in receipt of any notice of default pursuant to any Real Property Lease, no rentals are past due and to the Knowledge of Seller, no conditions exist which with the giving of notice or the lapse of time or both would constitute a default under a Real Property Lease by any party thereto.

3.12 Financial Statements. Attached hereto as Schedule 3.12(a) are the audited financial statements of Seller as of December 31, 2011 (the "Audited Financial Statements") and the unaudited financial statements of Seller for the quarter ended March 31, 2012 (the "Unaudited Financial Statements" and, together with the Audited Financial Statements, the "Financial Statements"). Attached hereto as Schedule 3.12(b) are the unaudited pro forma financial statements relating to the Business (the "Pro Forma Financials"). The Audited Financial Statements (a) are consistent with the underlying books and records of Seller, (b) have been prepared in accordance with generally accepted accounting principles consistently applied throughout the periods covered thereby, and (c) fairly and accurately present the assets, liabilities (including all reserves) and financial position of the Business as of the respective dates thereof and the results of operations and changes in cash flows for the periods then-ended. The Unaudited Financial Statements (a) are consistent with the underlying books and records of Seller, and (b) fairly and accurately present the assets, liabilities (including all reserves) and financial position of the Business as of the respective dates thereof and the results of operations and changes in cash flows for the periods then-ended. At the respective dates of the Financial Statements and except as set forth on Schedule 3.12, there were no liabilities of Seller (whether known or unknown, whether asserted or unasserted, whether absolute or contingent, whether accrued or unaccrued, whether liquidated or unliquidated, and whether due or to become due, including any liability for taxes) which, in accordance with generally accepted accounting principles, should have been shown or reflected in the Financial Statements or the notes thereto, which are not shown or reflected in the Financial Statements or the notes thereto.

3.13 Compliance with Law. To the Knowledge of Seller, Seller's conduct of the Business has not violated in any respect and is in compliance in all respects with any and all local, state, federal, and foreign laws, statutes, ordinances, regulations, rules, codes, decisions, decrees, and orders. Seller has not received any notice to the effect that, or otherwise been advised that, it is not in compliance with any such statutes, regulations, rules, judgments, decrees, orders, ordinances, or other laws.

3.14 Intellectual Property. Schedule 3.14 lists all of Seller's intellectual property (collectively, the "Intellectual Property"). Except as set forth on Schedule 3.14, (i) no Person has a right to receive a royalty or similar payment in respect of any of the Intellectual Property, (ii) Seller has no licenses granted, sold, or otherwise transferred by or to it or other similar agreements to which it is a party, restricting or limiting Seller's rights, in whole or in part, to any of the Intellectual Property, and (iii) Seller owns or controls and has the sole right to use the Intellectual Property. Seller has taken commercially reasonable steps to protect the Intellectual Property from infringement by any other Person. To the Knowledge of Seller, Seller's use of the Intellectual Property is not infringing upon or otherwise violating the rights of any third party.

3.15 Employees. Schedule 3.15 sets forth (i) a list of all employees of Seller, and their wage rates or salaries, as of the Effective Date, (ii) the dates of employment for such employees, and (iii) a list of each contract, plan, arrangement, policy, program or commitment, whether oral or written, providing for insurance coverage (including, without limitation, any self-insured arrangements), workers' compensation, disability benefits, supplemental unemployment benefits, vacation benefits, retirement benefits, life, health, dental, disability or accident benefits or for deferred compensation, pension, profit-sharing, bonuses, stock options, stock appreciation rights, stock purchases or other forms of incentive compensation or post-retirement insurance, compensation or benefits (collectively, "Employee Plans"). Seller has paid all benefits due to its employees at any time under its Employee Plans. Seller complies and has complied in all material respects with all applicable laws respecting employment, and, no administrative charges, claims, controversies, investigations, or suits are pending or threatened, with respect to such laws or regulations, either by private individuals or by any governmental authority.

3.16 Insurance. Schedule 3.16 sets forth and describes all policies of insurance which are maintained by Seller and which relate to the Purchased Assets, and all of such policies of insurance are in good standing, valid and subsisting, and in full force and effect in accordance with their terms and Seller is not in default with respect to its payment obligations under any such policies. Seller has not been refused any insurance with respect to the Purchased Assets or the Business, and its coverage has not been limited by any insurance carrier to which it has applied for any such insurance or with which it has carried.

3.17 Customers. Schedule 3.17 sets forth the top ten (10) customers of Seller (based on dollar amounts of services purchased from Seller) for the twelve (12) months ended March 31, 2012 (the "Material Customers") and the amounts for which such Seller invoiced such Material Customers during such period. Except as set forth on Schedule 3.17, (i) all Material Customers continue to be customers of Seller in connection with the Business, (ii) Seller has not received any notice, nor does Seller have knowledge, that any Material Customer will reduce materially its business with Seller in connection with the Business from the levels achieved during the twelve (12) months ended March 31, 2012, (iii) no Material Customer has terminated its relationship with Seller in connection with the Business or, threatened to do so, (iv) no Material Customer has modified or, indicated that it intends to modify its relationship with Seller in connection with the Business in a manner that is less favorable in any material respect to Seller, or, to the Knowledge of Seller, indicated it will not agree to do business on such terms and conditions at least as favorable as the terms and conditions provided to Seller on March 31, 2012, and (v) Seller is not involved in any material claim, dispute, or controversy with any Material Customer. Since March 31, 2012 and except as otherwise set forth on Schedule 3.17, there has been no other material adverse change in the relationship between Seller and any Material Customer.

3.18 Assumed Contracts. All of the Assumed Contracts which will be assigned by Seller and assumed by Buyer and listed on Schedule 3.18 are valid and in full force and effect. Seller has duly performed all of its obligations under the Assumed Contracts to the extent those obligations to perform have accrued and no violation of, or default or breach under any Assumed Contracts by Seller or, to the Knowledge of Seller, any other party has occurred and neither Seller nor any other party has repudiated any provisions thereof. No event or action has occurred, is pending, or, to the Knowledge of Seller, is threatened, which, after the giving of notice, the lapse of time, or otherwise, will result in a breach or default in any material respect by Seller, or, to the Knowledge of Seller, any other person, under any Assumed Contract.

3.19 Disclosure. Neither this Agreement nor any of the Schedules or Exhibits hereto contains or will contain when delivered at Closing any untrue statement by Seller of a material fact or will omit to state a material fact necessary to make the statements contained herein or therein, in light of the circumstances in which they were made, not misleading.

3.20 No Other Representations and Warranties. Except for the representations and warranties contained in this Section 3 (including the related portions of the relevant Schedules), neither Seller nor any other Person has made or makes any other express or implied representation or warranty, either written or oral, on behalf of Seller.

SECTION 4. REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer hereby represents and warrants to Seller as of the date of this Agreement and as of the Closing Date as follows:

4.1 Organization and Authorization. Buyer is a limited liability company duly organized, validly existing and in good standing under the laws of the State of Arizona, and has the requisite power and authority to execute and deliver this Agreement and perform its obligations hereunder. This Agreement has been duly and validly executed and delivered by Buyer and constitutes the legal, valid and binding obligation of Buyer enforceable in accordance with its terms, subject to applicable bankruptcy and other similar laws affecting the enforceability of creditors' rights generally, general equitable principles and the discretion of courts in granting equitable relief.

4.2 No Violation or Conflict. Neither the execution nor delivery of this Agreement, nor the performance of its obligations hereunder, by Buyer is a violation of any provision of any law, rule, regulation, order, writ, injunction, judgment or decree.

4.3 Consents. No consent or approval by, or filing with, any governmental authority or any other Person is required in connection with the execution and delivery by Buyer of this Agreement or for consummation by Buyer of the transactions contemplated hereby.

4.4 Brokers. Buyer has not engaged any finder or broker in connection with the transactions contemplated hereunder.

4.5 Sufficiency of Funds. Buyer has sufficient cash on hand or other sources of immediately available funds to enable it to make payment of the Purchase Price in accordance with the provisions of Section 2.1 and consummate the transactions contemplated by this Agreement.

4.6 Solvency. Immediately after giving effect to the transactions contemplated hereby, Buyer shall be solvent and shall: (a) own property that has a fair saleable value greater than the amounts required to pay its debts (including a reasonable estimate of the amount of all contingent liabilities); and (b) have adequate capital to carry on its business. No transfer of property is being made and no obligation is being incurred in connection with the transactions contemplated hereby with the intent to hinder, delay, defraud either present or future creditors of Buyer or Seller. In connection with the transactions contemplated hereby, Buyer has not incurred, nor plans to incur, debts beyond its ability to pay as they become absolute and matured.

4.7 Independent Investigation. Buyer has conducted its own independent investigation, review and analysis of the Business and the Purchased Assets, and acknowledges that it has been provided adequate access to the personnel, properties, assets, premises, books and records, and other documents and data of Seller for such purpose. Buyer acknowledges and agrees that: (a) in making its decision to enter into this Agreement and to consummate the transactions contemplated hereby, Buyer has relied solely upon its own investigation and the express representations and warranties of Seller set forth in Section 3 of this Agreement (including related portions of the relevant Schedules); and (b) neither Seller nor any other Person has made any representation or warranty as to Seller, the Business, the Purchased Assets or this Agreement, except as expressly set forth in Section 3 of this Agreement (including the related portions of the relevant Schedules).

SECTION 5. COVENANTS OF SELLER; CERTAIN OTHER MATTERS.

5.1 Representations and Warranties. Until the Closing Date, Seller will not take any action that would cause any of the representations and warranties made by Seller in this Agreement not to be true and correct in all material respects on and as of the Closing Date with the same force and effect as if such representations and warranties had been made on and as of the Closing Date.

5.2 Confidential Information. Seller will not, and will cause all Affiliates (defined below) not to, directly or indirectly, use or disclose to any third Person, any confidential or proprietary information relating to Buyer, except as required by law.

5.3 Due Diligence Review. Seller will, at all reasonable times prior to the Closing Date, make all aspects of the Business reasonably available for examination by the Buyer's officers or agents, including, but not limited to, Persons having business relationships with Seller, including Material Customers and vendors of the Business, as Buyer will reasonably determine. Buyer will provide reasonable prior notice to Seller if it desires to meet with any Person having a business relationship with Seller. Any examination of the Business will be conducted, to the extent practicable, (i) after reasonable notice and during normal business hours, (ii) under the supervision of Seller's personnel, (iii) in such a manner as to maintain the confidentiality of the transactions contemplated hereby, and (iv) without unreasonably interfering with the operations of the Business. No such examination, inspection, or review by Buyer or its representatives will in any way affect, diminish, or terminate any of the representations, warranties, or covenants of Seller expressed in this Agreement. Without limiting the generality of the foregoing, Buyer and Seller acknowledge and agree that Buyer's examination will include confirming the business relationship of the customers of the Business.

5.4 Consents. To the extent consents are required under any Assumed Contract, Seller will use all commercially reasonable efforts (with the reasonable assistance of Buyer) to obtain the written consent, authorization, or approval to the assignment by Seller to Buyer of the Assumed Contracts prior to the Closing Date.

5.5 No Alternative Transactions. Seller will (i) not directly, or indirectly through any manager, officer, director, shareholder, partner, employee, agent or advisor of Seller, solicit, initiate, pursue, or encourage (by way of furnishing information or otherwise) any inquiries or proposals, or enter into any discussions, negotiations, or agreements (whether preliminary or definitive) with any Person, contemplating or providing for any merger, acquisition, purchase, or sale of the stock of Seller or any material part of the assets of Seller (any thereof, an "Alternative Proposal"); (ii) deal exclusively with Buyer with respect to the sale of the Business and the Assets; and (iii) notify Buyer within 24 hours upon receipt by Seller or its Affiliate, member, partner, manager, officer, director, shareholder, employee or agent of Seller of any Alternative Proposal.

5.6 Conduct of Business Pending the Closing. From the Effective Date until the Closing, except as otherwise provided in this Agreement or approved in writing by Buyer, Seller will comply with the following covenants:

(a) No Material Changes; Compliance with Laws. Seller will carry on the Business and maintain the Business in the ordinary course of business and in substantially the same manner as heretofore conducted. Seller will duly comply with all laws applicable to the Business or the Purchased Assets.

(b) Related Party Transactions. Seller will not enter into any transaction, including, without limitation, the leasing of property, the purchase or sale of goods or services, or the borrowing or lending of money with any Affiliate that relates to or is likely to effect the Purchase Assets.

(c) No Encumbrances. Seller will not suffer or permit the creation of any lien or encumbrance upon any of the Purchased Assets.

(d) Intellectual Property. Seller will duly maintain all the Intellectual Property, and with respect to each item of pending, issued, or registered Intellectual Property, will fully and diligently prosecute and not allow abandonment of such item of Intellectual Property.

(e) Maintenance of Assumed Contracts. Seller will not change, amend, terminate, or otherwise modify any material term of any Assumed Contract in connection with, or in any way relating to, the Business, to which Seller is a party.

(f) Maintenance of Insurance. Seller will maintain all of the insurance policies in effect as of the date hereof unless replaced by policies which are substantially comparable to such policies.

SECTION 6. COVENANTS OF BUYER.

6.1 Representations and Warranties. Until the Closing Date, Buyer will not take any action that would cause any of the representations and warranties made by Buyer in this Agreement not to be true and correct in all material respects on and as of the Closing Date with the same force and effect as if such representations and warranties had been made on and as of the Closing Date.

6.2 Confidential Information. Buyer will not, and will cause all Affiliates not to, directly or indirectly, use or disclose to any third Person, any confidential or proprietary information relating to Seller, except as required by law.

SECTION 7. CLOSING DELIVERIES; CONDITIONS TO CLOSING; CLOSING COSTS AND PRORATIONS

7.1 Closing Deliveries.

(a) At Closing, Buyer will deliver all of the following:

(i) the various certificates, instruments, and documents referred to in Section 7.3 below; and

(ii) such other documents or instruments of conveyance or transfer as may be reasonably requested by Seller, each in form or substance satisfactory to Seller and executed by Buyer.

(b) At Closing, Seller will deliver all of the following:

(i) the various certificates, instruments, and documents referred to in Section 7.2 below;

(ii) company resolutions from the board of directors and shareholders of Seller authorizing the transactions contemplated hereby;

(iii) a non-foreign affidavit properly executed and containing such information as is required by IRC Section 1445(b)(2) and its regulations; and

(iv) such other documents or instruments of conveyance or transfer as may be reasonably requested by Buyer, each in form or substance satisfactory to Buyer and executed by Seller.

7.2 Conditions to Obligations of Buyer. Unless waived in writing by Buyer, the obligation of Buyer hereunder to consummate the transactions contemplated by this Agreement is subject to the satisfaction at or prior to the Closing Date of the following conditions:

(a) Representations and Warranties True. The representations and warranties of Seller contained in this Agreement will be true and accurate in all material respects on and as of the Closing Date with the same effect as though made on and as of such date.

- (b) Covenants Performed. Seller will have performed and complied in all material respects with the covenants, agreements and conditions required to be performed or complied with by it hereunder on or prior to the Closing Date.
- (c) Compliance Certificate. Buyer will have received a certificate of Seller certifying as to the matters set forth in Sections 7.2(a) and (b) above.
- (d) Required Consents Received. Seller will have obtained and delivered to Buyer copies of all required consents listed on or required to be listed on Schedule 3.5, and no such required consents will have been withdrawn, suspended or conditioned.
- (e) Bill of Sale. Seller will have delivered to Buyer an executed Bill of Sale in substantially the form attached hereto as Schedule 7.2(e).
- (f) Assignment and Assumption of Contracts. Seller will have delivered to Buyer an executed Assignment and Assumption of Contracts in substantially the form attached hereto as Schedule 7.2(f).
- (g) Assignments of Intellectual Property. Seller will have delivered to Buyer assignments of intellectual property, in recordable form to the extent necessary to assign such rights, each in a form reasonably acceptable to Buyer.
- (h) Employment Agreements. Seller will have caused each of Tom Harker, Kelly M. Robinson, Michael Brande and Mike Rae (each individually a “Key Employee” and collectively, the “Key Employees”) to execute and deliver to Buyer an employment agreement in form and substance satisfactory to Buyer. At such time as the form of employment agreement is agreed upon, Schedule 7.2(h) to this Agreement will be updated to include such form of employment agreement.
- (i) Release of Factors Southwest Lien. Seller will cause the liens encumbering the Purchased Assets in favor of Factors Southwest, LLC, as secured party, to be released in full. Such release will include, without limitation, the filing of UCC-3 termination statements with the Nevada Secretary of State and Arizona Secretary of State along with terminations of any credit or factoring agreements between Seller and Factors Southwest, LLC.
- (j) Shareholder Approval. Seller will have received approval and consent of the required number of shareholders under Nevada law to consummate the transaction contemplated by this Agreement and such consent will not have been withdrawn, suspended or conditioned. Seller will certify such shareholder approval in writing to Buyer on or before the Closing Date.
- (k) Telephone and Internet. Seller will have delivered to Buyer an assignment of all telephone numbers, facsimile numbers and internet addresses currently used in the Business, including the execution of all documents and the performance of any steps reasonably required by the applicable telephone company or internet domain registrar to effect such an assignment.

(l) Required Contract Renewals Received. Seller will have obtained and delivered to Buyer copies of all required Business Customer contract renewals as listed Schedule 3.5.

7.3 Conditions to Obligations of Seller. Unless waived in writing by Seller, the obligation of Seller hereunder to consummate the transactions contemplated by this Agreement is subject to the satisfaction at or prior to the Closing of the following conditions:

(a) Representations and Warranties True. The representations and warranties of Buyer contained in this Agreement will be true and accurate in all material respects on and as of the Closing Date with the same effect as though made on and as of such date.

(b) Covenants Performed. Buyer will have performed and complied in all material respects with the covenants, agreements and conditions required to be performed or complied with by it hereunder on or prior to the Closing Date.

(c) Compliance Certificate. Seller will have received a certificate of Buyer certifying as to the matters set forth in Sections 7.3(a) and (b) above.

(d) Bill of Sale. Buyer will have delivered to Seller an executed Bill of Sale in substantially the form attached hereto as Schedule 7.2(e).

(e) Assignment and Assumption of Contracts. Buyer will have delivered to Seller an executed Assignment and Assumption of Contracts in substantially the form attached hereto as Schedule 7.2(f).

(f) Shareholder Approval. Seller will have received approval and consent of the required number of shareholders under Nevada law to consummate the transaction contemplated by this Agreement and such consent will not have been withdrawn, suspended or conditioned.

7.4 Cooperation. Seller and Buyer will use commercial reasonable efforts, and will cooperate fully with each other, to comply as soon as practicable with all governmental requirements applicable to, or necessary for the consummation of, the transactions contemplated hereby. Seller and Buyer will provide such information and communications to governmental authorities as such governmental authorities may request, including Seller cooperating with Buyer in the transfer or application for permits and licenses required to operate the Business and reasonably cooperating in the resolution of the administrative actions (if any) brought before such governmental authorities.

SECTION 8.

INDEMNIFICATION.

8.1 Indemnification by Seller. Seller will indemnify, defend, protect and hold harmless Buyer, its Affiliates and their respective shareholders, managers, directors, officers, employees, representatives and members (“Buyer Indemnitees”) for, from and against any and all losses, costs, expenses, claims, damages, actions, suits, proceedings, hearings, investigations, charges, complaints, demands, injunctions, judgments, orders, decrees, rulings, directions, dues, penalties, fines, amounts paid in settlement, liabilities, obligations, taxes, liens, losses, and fees, court costs, reasonable obligations and liabilities, including interest, penalties and reasonable

attorneys fees and disbursements (“Damages”), arising out of, based upon or otherwise in respect of:

- (a) any inaccuracy in or breach of any representation or warranty of Seller made in or pursuant to this Agreement;
- (b) any breach or nonfulfillment by Seller of any covenant or obligation contained in this Agreement;
- (c) any and all liabilities, claims, damages, costs or expenses arising under any Assumed Contract as a result of obligations and duties of Seller under any Assumed Contract arising or occurring prior to the Closing Date; and
- (d) other than the Assumed Liabilities, any liability relating to Seller’s operation of the Business or ownership of the Purchased Assets prior to the Closing Date.

8.2 Indemnification by Buyer. Buyer will indemnify, defend, protect and hold harmless Seller, its Affiliates and their officers, directors, employees, representatives and shareholders (“Seller Indemnitees”) for, from and against any and all Damages, arising out of, based upon or otherwise in respect of:

- (a) any inaccuracy in or breach of any representation or warranty of Buyer made in or pursuant to this Agreement;
- (b) any breach or nonfulfillment by Buyer of any covenant or obligation contained in this Agreement;
- (c) any and all liabilities, claims, damages, costs or expenses arising any Assumed Contract as a result of obligations and duties of Seller under any Assumed Contract arising or occurring after the Closing Date; and
- (d) the Assumed Liabilities and any liability relating to the operation of the Purchased Assets as of or after the Closing Date.

8.3 Defense of Claims. If a claim for damages (a “Claim”) is to be made by a party entitled to indemnification hereunder against the indemnifying party, the party claiming such indemnification shall give written notice (a “Claim Notice”) to the indemnifying party as soon as practicable after the party entitled to indemnification becomes aware of any fact, condition or event which may give rise to damages for which indemnification may be sought under this Section 8; provided, that the omission by any indemnified party to give notice as provided herein shall not relieve the indemnifying party of its indemnification obligation under this Section 8 except to the extent that such omission results in a failure of actual notice to the indemnifying party and such indemnifying party is damaged as a result of such failure to give notice. After such notice, if the indemnifying party shall acknowledge in writing to the indemnified party that the indemnifying party shall be obligated under the terms of its indemnity hereunder in connection with such lawsuit or action, then the indemnifying party shall be entitled, if it so elects, (i) to take control of the defense and investigation of such lawsuit or action, (ii) to employ and engage attorneys of its own choice (which shall be reasonably acceptable to the indemnified party) to handle and defend the same, at the indemnifying party’s cost, risk and expense unless

the named parties to such action or proceeding include both the indemnifying party and the indemnified party and the indemnified party has been advised in writing by counsel that there may be one or more legal defenses available to such indemnified party that are different from or additional to those available to the indemnifying party; provided, that the indemnified party may participate in such defense, but only at such indemnified party's expense pursuant to this Section 8.3, and (iii) to compromise or settle such claim, which compromise or settlement shall be made only with the written consent of the indemnified party, such consent not to be unreasonably withheld. In any event, Seller and Buyer shall cooperate in the defense of any action or claim subject to this Section 8 and the records of each shall be available to the other with respect to such defense.

8.4 Monetary Limitations. Seller will not be obligated to indemnify the Buyer Indemnitees hereunder until the aggregate amount of Damages suffered by the Buyer Indemnitees exceeds Fifty Thousand Dollars (\$50,000) (the "Indemnification Threshold"); provided, however, that indemnification for Damages arising out of, resulting from or relating to a breach of any representation or warranty from fraud or willful misrepresentation shall not be subject to the Indemnification Threshold.

The Indemnification Threshold will not apply to Buyer's right to offset the Twelve Month Payment or Eighteen Month Payment due Seller to the extent Seller breaches any representation or warranty of Seller contained in this Agreement as set forth in Section 2.1(d).

(a) Once the aggregate amount of Damages suffered by the Buyer Indemnitees exceeds the Indemnification Threshold, the Buyer Indemnitees shall be entitled to indemnification from and against all Damages relating back to the first dollar.

(b) Notwithstanding the foregoing, the maximum amount of Damages payable to the Buyer Indemnitees hereunder with respect to indemnification hereunder is equal to the amount of the Purchase Price that has been actually received by the Seller as of the date of such Claim (the "Indemnification Cap"), except that the Indemnification Cap shall not apply to any Damages arising out of, resulting from or relating to a breach of any representation or warranty from fraud or willful misrepresentation by the Seller. Buyer shall have the right to offset any Damages in excess of the Indemnification Cap against the Twelve Month Payment or Eighteen Month Payment due Seller in accordance with Section 2.1(d).

(c) Buyer shall not be obligated to indemnify the Seller Indemnitees hereunder with respect to breaches of representations or warranties until the aggregate amount of Damages suffered by the Seller Indemnitees relating to breaches of representations or warranties exceeds the Indemnification Threshold. Once the aggregate amount of such Damages suffered by the Seller Indemnitees exceeds the Indemnification Threshold, the Seller Indemnitees shall be entitled to indemnification from and against all Damages relating back to the first dollar; provided, however, that indemnification for Damages arising out of, resulting from or relating to a breach of any representation or warranty from fraud or willful misrepresentation shall not be subject to the Indemnification Threshold. The maximum amount for which Buyer is obligated to indemnify the Seller Indemnitees hereunder with respect to breaches of representations and warranties is an amount equal to the Indemnification Cap; provided, however, that indemnification for Claims arising out of, resulting from or relating to a breach of any

representation or warranty from fraud or willful misrepresentation shall not be subject to the Indemnification Cap.

(d) In no event shall any indemnifying party be liable to any indemnified party for any punitive, incidental, consequential, special or indirect damages, including loss of future revenue or income, loss of business reputation or opportunity relating to the breach or alleged breach of this Agreement, or diminution of value or any damages based on any type of multiple.

(e) Each indemnified party shall take, and cause its Affiliates to take, all reasonable steps to mitigate any Damages upon becoming aware of any event or circumstance that would be reasonably expected to, or does, give rise thereto, including incurring costs only to the minimum extent necessary to remedy the breach that gives rise to such Damage.

(f) Seller shall not be liable under this Section 8 for any Damages based upon or arising out of any inaccuracy in or breach of any of the representations or warranties of Seller contained in this Agreement if Buyer has knowledge of such inaccuracy or breach prior to the Closing.

8.5 Survival of Representations and Warranties. The representations and warranties of the parties contained in this Agreement will survive the Closing until two (2) years from the Closing Date.

8.6 Dispute Resolution.

(a) Dispute. As used in this Agreement, "Dispute" means any dispute or disagreement between or among Seller and Buyer arising after the Closing concerning the interpretation of this Agreement, the validity of this Agreement, any breach or alleged breach by any party of this Agreement or any other matter relating in any way to this Agreement.

(b) Process. If a Dispute arises, the parties will follow the procedures specified in subsections (c) through (m) below.

(c) Notice of Dispute. If a Dispute arises, then Seller or Buyer, as applicable, will serve a written notice (the "Notice of Dispute") on the other party specifying the existence of the Dispute and set forth in reasonably specific detail the grounds of the Dispute. The Notice of Dispute shall be given not later than ten (10) business days after the Dispute has arisen. The parties will promptly attempt to resolve any Dispute by negotiations between Seller and Buyer. Either Seller or Buyer may give the other party written notice of any Dispute not resolved in the normal course of business. If the Dispute has not been resolved by these parties within thirty (30) business days of the Notice of Dispute, or if the parties fail to meet within such thirty (30) business days, either Seller or Buyer may initiate arbitration as provided in Section 8.6 (d).

(d) Arbitration. The Dispute will be settled by arbitration and be governed by the Commercial Rules of the American Arbitration Association ("AAA") in effect on the date of the Notice of Dispute, except that the terms of Section 8.6 will control in the event of any difference or conflict between such Rules and the terms of Section 8.6.

(e) Selection of Arbitrator. There will be one arbitrator except as provided

below. The arbitrator selected, in order to be eligible to serve, will be a lawyer in Phoenix, Arizona with at least fifteen (15) years experience in general corporate and commercial matters. If the parties cannot agree on a mutually acceptable single arbitrator within ten (10) business days of the initiation of arbitration, each party will select one arbitrator, and such arbitrators will select a third arbitrator within ten (10) business days. At the time of appointment and as a condition of the appointment, the arbitrator(s) will be apprised of the time limitations and other provisions of Section 8.6 and will agree to comply with such provisions and time limitations. The arbitrator(s) will reach a decision on the merits on the basis of applicable legal principles as embodied in the law of the State of Arizona. The arbitration hearing will take place in Phoenix, Arizona.

(f) **Arbitration Procedures and Timing.** During the thirty (30) day period following appointment of the arbitrator(s), either party may serve on the other a request for limited numbers of documents directly related to the dispute. Such documents will be produced within seven (7) days of the request. Following the thirty (30) day period of document production, there will be a ten (10) day period during which limited depositions will be permissible. Neither party will take more than five (5) depositions, and no deposition will exceed three (3) hours of direct testimony. Disputes as to discovery or prehearing matters of a procedural nature will be promptly submitted to the arbitrator(s) pursuant to telephone conference call or otherwise. The arbitrator(s) will make every effort to render a ruling on such interim matters at the time of the hearing (or conference call) or within five (5) business days thereafter. Following the period of depositions, the arbitration hearing will promptly commence. The arbitrator(s) will make every effort to commence the hearing within thirty (30) days of the conclusion of the deposition period and, in addition, will make every effort to conduct the hearing on consecutive business days to conclusion.

(g) **Decision of Arbitrator.** The arbitrator(s) will render a decision, at the latest, within fifteen business days (15) of the close of the arbitration hearing. The award will set forth the grounds for the decision (findings of fact and conclusions of law) in reasonably specific detail. The award will be final and nonappealable.

(h) **Provisional Remedies.** At any time during the procedures specified in subsections (c) and (g), a party may seek a preliminary injunction or other provisional judicial relief if in its judgment such action is necessary to avoid irreparable damage or to preserve the status quo. Despite such action, the parties will continue to participate in good faith in the procedures specified in this Section 8.6.

(i) **Tolling Statutes of Limitations.** All applicable statutes of limitation and defenses based upon the passage of time will be tolled with respect to matters that are the subject of the procedures specified in this Section 8.6 while such procedures are pending. The parties will take such action, if any, as is required to effectuate such tolling.

(j) **Performance to Continue.** Each party is required to continue to perform its obligations under this Agreement pending final resolution of any Dispute.

(k) **Extension of Deadlines.** All deadlines specified in this Section 8.6 may be extended by mutual agreement between Seller and Buyer.

(l) Enforcement. The parties regard the obligations in this Section 8.6 to constitute an essential provision of this Agreement and one that is legally binding on them. In case of a violation of the obligations in this Section 8.6 by any party, the other party may bring an action to seek enforcement of such obligations in any court of law having jurisdiction thereof.

(m) Costs. The party that prevails shall pay the fees and expenses of the arbitrator in connection with the application of the provisions of this Section 8.6.

SECTION 9.

DEFINITIONS

Whenever used in this Agreement, the following terms and phrases will have the following respective meanings:

“Affiliate” will mean, with respect to any Person, (i) each Person that, directly or indirectly, owns or controls, whether beneficially, or as a trustee, guardian or other fiduciary, 50% or more of the stock having ordinary voting power in the election of directors of such Person, (ii) each Person that controls, is controlled by or is under common control with such Person or any Affiliate of such Person, and (iii) each of such Person’s officers, directors, joint ventures and partners. For the purpose of this definition, “control” of a Person will mean the possession, directly or indirectly, of the power to direct or cause the direction of its management or policies, whether through the ownership or voting securities, by contract or otherwise.

“Knowledge of Seller” or any variation thereof, shall mean the knowledge, after reasonable inquiry, of Mr. Jeff Holmes, Mr. Greg Holmes and Mr. Kevin Asher.

“Person” means an individual, a partnership, a corporation, a limited liability company, an association, a joint stock company, a business or other trust, a joint venture, a company, any other business entity, and an unincorporated organization.

SECTION 10.

ADDITIONAL PROVISIONS.

10.1 Termination.

(a) Anything herein or elsewhere to the contrary notwithstanding, this Agreement may be terminated by written notice of termination at any time before the Closing Date only as follows:

(i) by mutual consent of Seller and Buyer;

(ii) by Buyer at any time if any or representation or warranty of Seller contained in Section 3 hereof is incorrect in any material respect, or if Seller breaches any material covenant contained in this Agreement;

(iii) by Seller at any time if any representation and warranty of Buyer contained in Section 4 hereof is incorrect in any material respect, or if Buyer breaches any material covenant contained in this Agreement;

(iv) by Seller if the Second Advance (as that term is defined in the Shotey Note) is not made to Seller; or

(v) by either party if the Closing has not occurred by September 7, 2012, subject to Section 2.2 hereof.

(b) In the event of the termination of this Agreement pursuant to the provisions of this Section 10.1, this Agreement will become void and have no effect, without any liability on the part of any of the parties or their directors, managers, officers, stockholders or members in respect of this Agreement, except that the termination will not relieve a breaching party from liability incurred for the breach of this Agreement. The obligations of Seller under Section 5.2 and the obligations of Buyer under Section 6.2 will survive the termination of this Agreement for a period of two (2) years.

10.2 Non-Competition; Non-Solicitation.

(a) As an inducement for Buyer to enter into this Agreement and as additional consideration for the consideration to be paid to Seller under this Agreement, during the Restricted Period (defined below), Seller will not, nor will Seller allow any of its respective Affiliates to, directly or indirectly, engage in, acquire, participate in, assist, provide services to, own or hold a business in the Restricted Area (defined below) that competes with the Business.

(b) During the Restricted Period, Seller will not, nor will Seller allow its respective Affiliates to, without the prior written consent of Buyer, directly or indirectly, (i) hire or attempt to hire away any employee of Buyer or any of its subsidiaries or the Business or persuade any such employee to leave employment with Buyer or the Business; (ii) solicit, divert, or take away, or attempt to solicit, divert or take away, the business of any Person with whom Buyer or the Business has established, or are actively seeking to establish a business or customer relationship with respect to competing services or products; (iii) accept the business or customer relationship of any Person with whom Buyer or the Business has established, or are actively seeking to establish, a business or customer relationship with respect to competing services or products; or (iv) solicit, induce or attempt to induce any salesperson, distributor, supplier, vendor, manufacturer, representative, agent, jobber or other person transacting business with Buyer or the Business to terminate their relationship or association with Buyer or the Business, or to represent, distribute or sell services or products in competition with the business of Buyer or the Business.

(c) Seller acknowledges that because a remedy at law for any violation or breach of the provisions of this Section 10.2 may be inadequate, in addition to any relief at law that may be available to Buyer for such violation or breach and regardless of any other provision contained in this Agreement, Buyer will be entitled to injunctive and other equitable relief restraining such violation or breach.

(d) For purposes of this Section, (i) "Restricted Period" means the period commencing on the Closing Date and continuing until the 5th anniversary of the Closing Date, provided that the period will be extended to include any period in which Seller is not in compliance with the terms of this Section, and (ii) "Restricted Area" means any state in which Buyer conducts the Business during the Restricted Period.

10.3 Headings. The headings of the Sections and Subsections herein are inserted for convenience of reference only and will be ignored in the construction or interpretation hereof.

10.4 Further Assurances. Following the Closing Date, the parties will execute and deliver such documents and take such other actions as may be reasonably requested from time to time by Buyer or Seller in order to fully consummate the transactions contemplated hereby.

10.5 Third Party Beneficiaries. Nothing in the Agreement will be construed to confer any right, benefit or remedy upon any Person that is not a party hereto or a permitted assignee of a party hereto, except as otherwise expressly set forth in this Agreement.

10.6 Costs and Expenses. After execution of this Agreement by the parties, if Seller fails to close the transaction contemplated by this Agreement after satisfaction or waiver of all required conditions to Closing as set forth in Sections 5, 6 and 7 of this Agreement, then Seller will pay Buyer Two Hundred Fifty Thousand Dollars (\$250,000) plus all reasonable out of pocket expenses incurred by Buyer (including without limitation attorneys' fees) in an amount not to exceed One Hundred Thousand Dollars (\$100,000) to compensate and reimburse Buyer for expenses incurred by Buyer in connection with pursuing the transaction contemplated by this Agreement. The provisions of this Section 10.6 will not waive or limit any of Buyer's rights or remedies available at law, equity or under this Agreement. Except as otherwise expressly provided herein, each party will bear its own expenses in connection herewith.

10.7 Notices. All notices or other communications permitted or required under this Agreement will be in writing and will be sufficiently given if and when hand delivered to the Persons set forth below or if sent by documented overnight delivery service or registered or certified mail, postage prepaid, return receipt requested, or by telegram, telex or telecopy or e-mail, receipt acknowledged, addressed as set forth below or to such other Person or Persons and/or at such other address or addresses as will be furnished in writing by any party hereto to the others. Any such notice or communication will be deemed to have been given as of the date received, in the case of personal delivery, or on the date shown on the receipt or confirmation therefor in all other cases.

To Seller: Calibus, Inc.
1225 West Washington, #213
Tempe, Arizona 85281
Phone: (602) 778-7500
Fax: (602) 778-7569

With a copy to: Quarles & Brady LLP
One Renaissance Square
Two North Central Avenue
Phoenix, Arizona 85004
Phone: (602) 229-5336
Fax: (602) 420-5008
Email: chris.hoffmann@quarles.com
Attn: Christian J. Hoffmann, III

To Buyer: Calibus Hosted Business Solutions, LLC
1225 West Washington, Suite 213
Tempe, Arizona 85281
Phone: (602) 741-7402

With a copy to: Gallagher & Kennedy, P.A.
2575 East Camelback Road
Phoenix, Arizona 85016
Phone: (602) 530-8000
Fax: (602) 530-8500
Attn: Timothy D. Brown, Esq.

10.8 Assignment and Benefit. A party will not assign this Agreement or any rights hereunder, or delegate any obligations hereunder, without prior written consent of the other party. Subject to the foregoing, this Agreement and the rights and obligations set forth herein will inure to the benefit of, and be binding upon, the parties hereto, and each of their respective successors, heirs and assigns.

10.9 Amendment, Modification and Waiver. The parties may amend or modify this Agreement in any respect if such amendment or modification is in writing and agreed to by both parties. The waiver by a party of any breach of any provision of this Agreement will not constitute or operate as a waiver of any other breach of such provision or of any other provision hereof, nor will any failure to enforce any provision hereof operate as a waiver of such provision or of any other provision hereof.

10.10 Governing Law. This Agreement is made pursuant to, and will be construed and enforced in accordance with, the laws of the State of Arizona (and United States federal law, to the extent applicable), irrespective of the principal place of business, residence or domicile of the parties hereto, and without giving effect to otherwise applicable principles of conflicts of law. Nothing contained herein will prevent or delay either party from seeking, in any court of competent jurisdiction, specific performance or other equitable remedies in the event of any breach or intended breach by the other party of any of its obligations hereunder.

10.11 Severability. The invalidity or unenforceability of any particular provision, or part of any provision, of this Agreement will not affect the other provisions or parts hereof, and this Agreement will be construed in all respects as if such invalid or unenforceable provisions or parts were omitted.

10.12 Counterparts. This Agreement may be executed in one or more counterparts, each of which will be deemed an original (including facsimile signatures).

10.13 Entire Agreement. This Agreement and the agreements, exhibits, schedules and certificates referred to herein or delivered pursuant hereto, constitutes the entire agreement between the parties hereto with respect to the purchase and sale of the Purchased Assets and supersedes all prior agreements and understandings. The submission of a draft of this Agreement or portions or summaries thereof does not constitute an offer to purchase or sell the Purchased Assets, it being understood and agreed that neither Buyer nor Seller will be legally obligated with respect to such a purchase or sale or to any other terms or conditions set forth in such draft or portion or summary unless and until this Agreement has been duly executed and delivered by all parties.

10.14 Schedules and Exhibits. All schedules and exhibits to this Agreement are an integral part of this Agreement and are incorporated herein by reference in this Agreement for all purposes of this Agreement. All Schedules delivered with this Agreement will be arranged to correspond with the numbered and lettered Sections and Subsections contained in this Agreement, and the disclosures in such Schedules will qualify only the corresponding Sections and Subsections contained in this Agreement, unless otherwise expressly provided herein.

10.15 Publicity. Pending and following the Closing, no party will issue a press release or make any other public announcement concerning the transactions contemplated by this Agreement without the prior written consent of the other party, except to the extent required by law.

[Signature blocks to appear on the following page.]

IN WITNESS WHEREOF, each of the parties hereto has duly executed this Agreement, and it will be effective as of the Effective Date.

SELLER:

CALIBRUS, INC., a Nevada corporation

By: _____

Name: _____

Title: _____

BUYER:

CALIBRUS HOSTED BUSINESS SOLUTIONS, LLC, an Arizona limited liability company

By: _____

Name: _____

Title: _____

[SIGNATURE PAGE TO ASSET PURCHASE AGREEMENT]

Exhibit B

Calibrus, Inc.
2012 Stock Option and Restricted Stock Plan

1. PURPOSES.

(a) Background. This 2012 Stock Option and Restricted Stock Plan was adopted on July 13, 2012 by the Board of Directors, subject to the approval of the Company's stockholders. Options granted under the Plan prior to the stockholders' approval will be effective upon approval of the stockholders as of their respective dates of grant.

(b) Eligible Award Recipients. The persons eligible to receive Awards are the Employees and Directors of the Company and its Affiliates.

(c) Available Awards. The purpose of the Plan is to provide a means by which eligible recipients may be given an opportunity to benefit from increases in value of the Common Stock through the granting of the following:

(i) Incentive Stock Options, (ii) Nonqualified Stock Options, (iii) rights to acquire restricted stock, and (iv) stock appreciation rights.

(d) General Purpose. The Company, by means of the Plan, seeks to retain the services of the group of persons eligible to receive Awards, to secure and retain the services of new members of this group and to provide incentives for such persons to exert maximum efforts for the success of the Company and its Affiliates.

2. DEFINITIONS.

(a) "Affiliate" means any entity that controls, is controlled by, or is under common control with the Company.

(b) "Award" means any right granted under the Plan, including an Option, a right to acquire restricted Common Stock, and a stock appreciation right.

(c) "Award Agreement" means a written agreement between the Company and a holder of an Award (other than an Option) evidencing the terms and conditions of an individual Award grant.

(d) "Board" means the board of directors of the Company.

(e) "Code" means the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder.

(f) "Committee" means a pre-existing or newly formed committee of members of the Board appointed by the Board in accordance with subsection 3(c).

(g) "Common Stock" means the shares of the Company's common stock par value \$0.001 and other rights with respect to such shares.

(h) "Company" means Calibrus, Inc., a Nevada corporation.

(i) "Continuous Service" means that the Participant's service with the Company or an Affiliate, whether as an Employee or Director is not interrupted or terminated. Unless otherwise provided in an Award Agreement or Option Agreement, as applicable, the Participant's Continuous Service shall not be deemed to have terminated merely because of a change in the capacity in which the Participant renders service to the Company or an Affiliate as an Employee or Director or a

change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service to the Company or an Affiliate as an Employee or Director. The Board, in its sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of any leave of absence, including sick leave, military leave or any other personal leave.

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(j) “Covered Employee” means the Company’s chief executive officer and the four (4) other highest compensated officers of the Company for whom total compensation is required to be reported to stockholders under the Exchange Act, as determined for purposes of Section 162(m) of the Code.

(k) “Director” means a member of the Board of the Company.

(l) “Disability” means the Participant’s inability, due to illness, accident, injury, physical or mental incapacity or other disability, to carry out effectively the duties and obligations to the Company and its Affiliates performed by such person immediately prior to such disability for a period of at least six (6) months, as determined in the good faith judgment of the Board.

(m) “Dollars” or “\$” means United States dollars.

(n) “Employee” means any person employed by the Company or an Affiliate. Service as a Director or payment of a director’s fee by the Company or an Affiliate alone shall not be sufficient to constitute “employment” by the Company or an Affiliate.

(o) “Exchange Act” means the Securities Exchange Act of 1934, as amended.

(p) “Fair Market Value” means, as of any date, the value of the Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange, or traded on the Nasdaq Global Market, the Nasdaq Capital Market or the Nasdaq OTC Bulletin Board, the Fair Market Value of the Common Stock shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or market (or the exchange or market with the greatest volume of trading in Common Stock if such stock is traded on more than one such exchange or market) on the last market trading day prior to the day of determination, as reported by such exchange or market or such other source as the Board reasonably deems reliable.

(ii) In the absence of such markets for the Common Stock, the Fair Market Value shall be determined in good faith by the Board.

(q) “Incentive Stock Option” means an option designated as an incentive stock option in an Option Agreement and that is granted in accordance with the requirements of, and that conforms to the applicable provisions of, Section 422 of the Code.

(r) “Independent Director” means (i) a Director who satisfies the definition of Independent Director or similar definition under the applicable stock exchange or Nasdaq rules and regulations upon which the Common Stock is traded from time to time and (ii) a Director who either (A) is not a current employee of the Company or an “affiliated corporation” (within the meaning of Treasury Regulations promulgated under Section 162(m) of the Code), is not a former employee of the Company or an “affiliated corporation” receiving compensation for prior services (other than benefits under a tax qualified pension plan), was not an officer of the Company or an “affiliated corporation” at any time and is not currently receiving direct or indirect remuneration from the Company or an “affiliated corporation” for services in any capacity other than as a Director or (B) is otherwise considered an “outside director” for purposes of Section 162(m) of the Code.

(s) “Nonqualified Stock Option” means an option that is not designated in an Option Agreement as an Incentive Stock Option or was not granted in accordance with the requirements of, and does not conform to the applicable provisions of, Section 422 of the Code.

- (t) “Officer” means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.
- (u) “Option” means an Incentive Stock Option or a Nonqualified Stock Option granted pursuant to the Plan.
- (v) “Option Agreement” means a written agreement between the Company and an Optionholder evidencing the terms and conditions of an individual Option grant.
- (w) “Optionholder” means a person to whom an Option is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Option.
- (x) “Participant” means a person to whom an Award is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Award.
- (y) “Plan” means this Calibus, Inc. 2012 Stock Option and Restricted Stock Plan.
- (z) “Rule 16b-3” means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.
- (aa) “Securities Act” means the Securities Act of 1933, as amended.
- (bb) “Ten Percent Stockholder” means a person who owns (or is deemed to own pursuant to Section 424(d) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any parent corporation or any subsidiary corporation, both as defined in Section 424 of the Code.

3. ADMINISTRATION.

- (a) Administration by Board. The Board shall administer the Plan unless and until the Board delegates administration to a Committee, as provided in subsection 3(c). The Board may, at any time and for any reason in its sole discretion, rescind some or all of such delegation.
- (b) Powers of Board. The Board shall have the power, subject to, and within the limitations of, the express provisions of the Plan:
- (i) To determine from time to time which of the persons eligible under the Plan shall be granted Awards; when and how each Award shall be granted; what type or combination of types of Award shall be granted; the provisions of each Award granted (which need not be identical), including the time or times when a person shall be permitted to receive Common Stock pursuant to an Award; and the number of shares of Common Stock with respect to which an Award shall be granted to each such person.
- (ii) To construe and interpret the Plan, Awards granted under it, Option Agreements and Award Agreements, and to establish, amend and revoke rules and regulations for their administration. The Board, in the exercise of this power, may correct any defect, omission or inconsistency in the Plan or in any Option Agreement or Award Agreement, in a manner and to the extent it shall deem necessary or expedient to make the Plan fully effective.
- (iii) To amend the Plan, an Award, an Award Agreement or an Option Agreement as provided in Section 12, provided that, the Board shall not amend the exercise price of an option, the Fair Market Value of an Award or extend the term of an Option or Award without obtaining the approval of the stockholders if required by the rules of any stock exchange upon which the Common Stock is listed.

(iv) Generally, to exercise such powers and to perform such acts as the Board deems necessary or expedient to promote the best interests of the Company which are not in conflict with the provisions of the Plan.

(c) Delegation to Committee.

(i) General. The Board may delegate administration of the Plan and its powers and duties thereunder to a Committee or Committees, and the term "Committee" shall apply to any person or persons to whom such authority has been delegated. Upon such delegation, the Committee shall have the powers theretofore possessed by the Board, including the power to delegate to a subcommittee any of the administrative powers the Committee is authorized to exercise (and references in this Plan to the Board shall thereafter be deemed to include the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. In its absolute discretion, the Board may at any time and from time to time exercise any and all rights and duties of the Committee under this Plan, except respecting matters under Rule 16b-3 of the Exchange Act or Section 162(m) of the Code, or any rules or regulations issued thereunder, which are required to be determined in the sole discretion of the Committee.

(ii) Committee Composition. A Committee shall consist solely of two or more Independent Directors. Within the scope of its authority, the Board or the Committee may (1) delegate to a committee of one or more members of the Board who are not Independent Directors the authority to grant Awards to eligible persons who are either (a) not then Covered Employees and are not expected to be Covered Employees at the time of recognition of income resulting from such Award or (b) not persons with respect to whom the Company wishes to comply with Section 162(m) of the Code, and/or (2) delegate to a committee of one or more members of the Board who are not Independent Directors or to the Company's Chief Executive Officer the authority to grant Awards to eligible persons who are not then subject to Section 16 of the Exchange Act.

(d) Effect of Board's Decision; No Liability. All determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons. No member of the Board or the Committee or any person to whom duties hereunder have been delegated shall be liable for any action, interpretation or determination made in good faith, and such persons shall be entitled to full indemnification and reimbursement consistent with applicable law and in the manner provided in the Company's Articles of Incorporation and Bylaws, as the same may be amended from time to time, or as otherwise provided in any agreement between any such member and the Company.

4. STOCK SUBJECT TO THE PLAN.

(a) Stock Reserve. Subject to the provisions of Section 11 relating to adjustments upon changes in Common Stock, the shares of Common Stock that may be issued pursuant to Awards shall not exceed in the aggregate three million (3,000,000) shares of Common Stock.

(b) Evergreen; Reversion of Stock to the Stock Reserve. If any Award granted under this Plan is exercised, canceled, terminates, expires, or lapses for any reason, any shares subject to such Award again shall be available for the grant of an Award under the Plan. If any Award shall for any reason expire or otherwise terminate, in whole or in part, without having been exercised in full, the shares of Common Stock not acquired under such Award shall revert to and again become available for issuance under the Plan.

(c) Source of Stock. The Common Stock subject to the Plan may be unissued stock or reacquired stock, bought on the market or otherwise.

5. ELIGIBILITY.

(a) Eligibility for Specific Awards. Incentive Stock Options may be granted only to Employees. Awards other than Incentive Stock Options may be granted to Employees and Directors.

(b) Ten Percent Stockholders. A Ten Percent Stockholder shall not be granted an Incentive Stock Option unless the exercise price of such Option is at least one hundred ten percent (110%) of the Fair Market Value of the Common Stock at the date of grant and the Option is not exercisable after the expiration of five (5) years from the date of grant.

6. OPTION PROVISIONS.

Each Option Agreement shall be subject to the terms and conditions of this Plan. Each Option and Option Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. All Options shall be separately designated Incentive Stock Options or Nonqualified Stock Options at the time of grant, and, if certificates are issued, a separate certificate or certificates will be issued for the shares of Common Stock purchased on exercise of each type of Option. The provisions of separate Options need not be identical.

(a) Provisions Applicable to All Options.

(i) Consideration. The purchase price of the shares of Common Stock acquired pursuant to an Option shall be paid as follows: (a) in cash or by certified or official bank check, payable to the order of the Company, in the amount (the "Purchase Price") equal to the exercise price of the Option multiplied by the number of shares plus payment of all taxes applicable upon such exercise; (b) with shares owned by the Optionholder having a Fair Market Value at the time the Option is exercised equal to the Purchase Price plus payment in cash of all taxes applicable upon such exercise, with the prior approval of the Board; (c) by surrendering to the Company the right to acquire a number of shares having an aggregate value such that the amount by which the Fair Market Value of such shares exceeds the aggregate exercise price is equal to the Purchase Price plus payment in cash of all taxes applicable upon such exercise, with the prior approval of the Board; (d) any combination of the foregoing; or (e) a manner acceptable to the Board.

(ii) Vesting Generally. An Option may (A) vest, and therefore become exercisable, in periodic installments that may, but need not, be equal, or (B) be fully vested at the time of grant. The Option may be subject to such other terms and conditions on the time or times when it may be exercised (which may be based on performance or other criteria) as the Board may deem appropriate. The vesting provisions, if any, of individual Options may vary. The provisions of this subsection 6(a)(ii) are subject to any Option Agreement provisions governing the minimum number of Common Stock as to which an Option may be exercised.

(iii) Termination of Continuous Service. Unless otherwise provided in the Option Agreement, in the event an Optionholder's Continuous Service terminates (other than upon the Optionholder's death, Disability, retirement or as a result of a Change of Control), all Options held by the Optionholder shall immediately terminate; provided, however, that an Option Agreement may provide that if an Optionholder's Continuous Service is terminated for reasons other than for cause, all vested Options held by such person shall continue to be exercisable until the earlier of the expiration date of such Option or ninety (90) days after the date of such termination. All such vested Options not exercised within the period described in the preceding sentence shall terminate.

(iv) Disability or Death of Optionholder. Unless otherwise provided in the Option Agreement, in the event of an Optionholder's Disability or death, all unvested Options shall immediately terminate, and all vested Options held by such person shall continue to be exercisable for twelve months after the date of such Disability or death. All such vested Options not exercised within such twelve-month period shall terminate.

(v) Retirement. Unless otherwise provided in the Option Agreement, in the event of the Optionholder's retirement, all unvested Options shall automatically vest on the date of such retirement and all Options shall be exercisable for the earlier of twelve (12) months after such retirement date or the expiration date of such Options. All such Options not exercised within the period described in the preceding sentence shall terminate.

(b) Provisions Applicable to Incentive Stock Options.

(i) Term. Subject to the provisions of subsection 5(b) regarding Ten Percent Stockholders, no Incentive Stock Option shall be exercisable after the expiration of ten (10) years from the date it was granted. Further, no grant of an Incentive Stock Option shall be made under this Plan more than ten (10) years after the date the Plan is approved by the stockholders of the Company.

(ii) Exercise Price of an Incentive Stock Option. Subject to the provisions of subsection 5(b) regarding Ten Percent Stockholders, the exercise price of each Incentive Stock Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted.

(iii) Transferability of an Incentive Stock Option. An Incentive Stock Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder.

(iv) Incentive Stock Option \$100,000 Limitation. Notwithstanding any other provision of the Plan or an Option Agreement, the aggregate Fair Market Value of the Common Stock with respect to which Incentive Stock Options are exercisable for the first time by an Optionholder in any calendar year, under the Plan or any other option plan of the Company or its Affiliates, shall not exceed One Hundred Thousand Dollars (\$100,000). For this purpose, the Fair Market Value of the Common Stock shall be determined as of the time an Option is granted. The Options or portions thereof which exceed such limit (according to the order in which they were granted) shall be treated as Nonqualified Stock Options.

(c) Provisions Applicable to Nonqualified Stock Options.

(i) Exercise Price of a Nonqualified Stock Option. The exercise price of each Nonqualified Stock Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted.

(ii) Transferability of a Nonqualified Stock Option. A Nonqualified Stock Option shall be transferable, if at all, to the extent provided in the Option Agreement. If the Option Agreement does not provide for transferability, then the Nonqualified Stock Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder.

7. PROVISIONS OF AWARDS OTHER THAN OPTIONS.

(a) Restricted Stock Awards. Each restricted stock Award agreement shall be in such form and shall contain such restrictions, terms and conditions, if any, as the Board shall deem appropriate and shall be subject to the terms and conditions of this Plan. The terms and conditions of restricted stock Award Agreements may change from time to time, and the terms and conditions of separate restricted stock Award Agreements need not be identical, but each restricted stock Award Agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

(i) Consideration. A restricted stock Award may be awarded in consideration for past services actually rendered, or for future services to be rendered, to the Company or an Affiliate for its benefit.

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(ii) Vesting. Common Stock awarded under the restricted stock Award Agreement may (A) be subject to a vesting schedule to be determined by the Board or (B) be fully vested at the time of grant.

(iii) Termination of Participant's Continuous Service. Unless otherwise provided in the restricted stock Award Agreement, in the event a Participant's Continuous Service terminates prior to a vesting date set forth in the restricted stock Award Agreement, any unvested restricted stock Award shall be forfeited and automatically transferred to and reacquired by the Company at no cost to the Company, and neither the Participant nor his or her heirs, executors, administrators or successors shall have any right or interest in the restricted stock Award. Notwithstanding the foregoing, unless otherwise provided in the restricted stock Award agreement, in the event a Participant's Continuous Service terminates as a result of (A) being terminated by the Company for reasons other than for cause, (B) death, (C) Disability, (D) retirement, or (E) a Change of Control (subject to the provisions of Section 11(c) hereof), then any unvested restricted stock Award shall vest immediately upon such date.

(iv) Transferability. Rights to acquire Common Stock under the restricted stock Award Agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the restricted stock Award Agreement, as the Board shall determine in its discretion, so long as Common Stock awarded under the restricted stock Award Agreement remain subject to the terms of the restricted stock Award Agreement.

(b) Grant of Stock Appreciation Rights. Stock appreciation rights to receive in shares of Common Stock the excess of the Fair Market Value of Common Stock on the date the rights are surrendered over the Fair Market Value of Common Stock on the date of grant may be granted to any Employee or Director selected by the Board. A stock appreciation right may be granted (i) in connection and simultaneously with the grant of another Award, (ii) with respect to a previously granted Award, or (iii) independent of another Award. A stock appreciation right shall be subject to such terms and conditions not inconsistent with this Plan as the Board shall impose and shall be evidenced by a written stock appreciation right agreement, which shall be executed by the Participant and an authorized officer of the Company. The Board, in its discretion, may determine whether a stock appreciation right is to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code and stock appreciation right agreements evidencing stock appreciation rights intended to so qualify shall contain such terms and conditions as may be necessary to meet the applicable provisions of Section 162(m) of the Code. The Board may, in its discretion and on such terms as it deems appropriate, require as a condition of the grant of a stock appreciation right that the Participant surrender for cancellation some or all of the Awards previously granted to such person under this Plan or otherwise. A stock appreciation right, the grant of which is conditioned upon such surrender, may have an exercise price lower (or higher) than the exercise price of the surrendered Award, may contain such other terms as the Board deems appropriate, and shall be exercisable in accordance with its terms, without regard to the number of shares, price, exercise period or any other term or condition of such surrendered Award.

8. AVAILABILITY OF STOCK. Subject to the restrictions set forth in Section 4(a), during the terms of the Awards, the Company shall keep available at all times the number of shares of Common Stock required to satisfy such Awards.

9. USE OF PROCEEDS FROM STOCK.

Proceeds from the sale of Common Stock pursuant to Awards shall constitute general funds of the Company.

10. MISCELLANEOUS.

(a) Exercise of Awards. Awards shall be exercisable at such times, or upon the occurrence of such event or events as the Board shall determine at or subsequent to grant. Awards may be exercised in whole or in part. Common Stock

purchased upon the exercise of an Award shall be paid for in full at the time of such purchase.

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(b) Acceleration of Exercisability and Vesting. The Board shall have the power to accelerate the time at which an Award may first be exercised or the time during which an Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Award stating the time at which it may first be exercised or the time during which it will vest.

(c) Stockholder Rights.

(i) Options. Unless otherwise provided in and upon the terms and conditions in the Option Agreement, no Participant shall be deemed to be the holder of, or to have any of the rights of a holder with respect to, any Common Stock subject to an Option unless and until such Participant has satisfied all requirements for exercise of, and has exercised, the Option pursuant to its terms.

(ii) Restricted Stock. Unless otherwise provided in and upon the terms and conditions in the restricted stock Award Agreement, a Participant shall have the right to receive all dividends and other distributions paid or made respecting such restricted stock, provided, however, no unvested restricted stock shall have any voting rights of a stockholder respecting such unvested restricted stock unless and until such unvested restricted stock become vested.

(d) No Employment or other Service Rights. Nothing in the Plan or any instrument executed or Award granted pursuant thereto shall confer upon any Participant any right to continue to serve the Company or an Affiliate in the capacity in effect at the time the Award was granted, or any other capacity, or shall affect the right of the Company or an Affiliate to terminate with or without notice and with or without cause (i) the employment of an Employee or an Affiliate or (ii) the service of a Director of the Company or an Affiliate.

(e) Withholding Obligations. If the Company has or will have a legal obligation to withhold the taxes related to the grant, vesting or exercise of the Award, such Award may not be granted, vested or exercised in whole or in part, unless such tax obligation is first satisfied in a manner satisfactory to the Company. To the extent provided by the terms of an Award Agreement or Option Agreement, the Participant may satisfy any federal, state or local tax withholding obligation relating to the exercise or acquisition of Common Stock under an Award by any of the following means (in addition to the Company's right to withhold from any compensation paid to the Participant by the Company) or by a combination of such means: (i) tendering a cash payment in Dollars; (ii) authorizing the Company to withhold Common Stock from the Common Stock otherwise issuable to the Participant as a result of the exercise or acquisition of Common Stock under the Award, provided, however, that no shares of Common Stock are withheld with a value exceeding the minimum amount of tax required to be withheld by law; or (iii) delivering to the Company owned and unencumbered Common Stock.

(f) Listing and Qualification of Stock. This Plan and the grant and exercise of Awards hereunder, and the obligation of the Company to sell and deliver Common Stock under such Awards, shall be subject to all applicable United States federal and state laws, rules and regulations, and any other laws applicable to the Company, and to such approvals by any government or regulatory agency as may be required. The Company, in its discretion, may postpone the issuance or delivery of Common Stock upon any exercise of an Award until completion of any stock exchange listing, or the receipt of any required approval from any stock exchange or other qualification of such Common Stock under any United States federal or state law rule or regulation as the Company may consider appropriate, and may require any individual to whom an Award is granted, such individual's beneficiary or legal representative, as applicable, to make such representations and furnish such information as the Board may consider necessary, desirable or advisable in connection with the issuance or delivery of the Common Stock in compliance with applicable laws, rules and regulations.

(g) Non-Uniform Determinations. The Board's determinations under this Plan (including, without limitation, determinations of the persons to receive Awards, the form, term, provisions, amount and timing of the grant of such

Awards and of the agreements evidencing the same) need not be uniform and may be made by it selectively among persons who receive, or are eligible to receive, Awards under this Plan, whether or not such persons are similarly situated.

11. ADJUSTMENTS UPON CHANGES IN STOCK.

(a) Capitalization Adjustments. If any change is made in the Common Stock subject to the Plan, or subject to any Award, without the receipt of consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of stock, exchange of stock, change in corporate structure or other transaction), the Plan will be appropriately adjusted in the class(es) and maximum number of securities subject to the Plan pursuant to subsection 4(a) and the maximum number of securities subject to award to any person pursuant to subsection 5(c), and the outstanding Awards will be appropriately adjusted in the class(es) and number of securities and price per stock of Common Stock subject to such outstanding Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive. (The conversion of any convertible securities of the Company shall not be treated as a transaction “without receipt of consideration” by the Company.)

(b) Dissolution or Liquidation. In the event of a dissolution or liquidation of the Company, then all outstanding Awards shall terminate immediately prior to such event.

(c) Asset Sale, Merger, Consolidation or Reverse Merger. In the event of a Change of Control (as defined below), any unvested Awards shall vest immediately prior to the closing of the Change of Control, and the Board shall have the power and discretion to provide for the Participant’s election alternatives regarding the terms and conditions for the exercise of, or modification of, any outstanding Awards granted hereunder, provided, however, such alternatives shall not affect the then current exercise provisions without such Participant’s consent. The Board may provide that Awards granted hereunder must be exercised in connection with the closing of such transaction, and that if not so exercised such Awards will expire. Any such determinations by the Board may be made generally with respect to all Participants, or may be made on a case-by-case basis with respect to particular Participants. For the purpose of this Plan, a “Change of Control” shall have occurred in the event one or more persons acting individually or as a group (i) acquires sufficient additional stock to constitute more than fifty percent (50%) of (A) the total Fair Market Value of all Common Stock issued and outstanding or (B) the total voting power of all shares of capital stock authorized to vote for the election of directors; (ii) acquires, in a twelve (12) month period, thirty-five percent (35%) or more of the voting power of all shares of capital stock authorized to vote for the election of directors, or alternatively a majority of the members of the board is replaced during any twelve (12) month period by directors whose appointment was not endorsed by a majority of the members of the board; or (iii) acquires, during a twelve (12) month period, more than forty percent (40%) of the total gross fair market value of all of the Company’s assets. Notwithstanding the foregoing, the provisions of this Section 11(c) shall not apply to (i) any transaction involving any stockholder that individually or as a group owns more than fifty percent (50%) of the outstanding Common Stock on the date this Plan is approved by the Company’s stockholders, until such time as such stockholder first owns less than forty percent (40%) of the total outstanding Common Stock, or (ii) any transaction undertaken for the purpose of reincorporating the Company under the laws of another jurisdiction, if such transaction does not materially affect the beneficial ownership of the Company’s capital stock.

12. AMENDMENT OF THE PLAN AND AWARDS.

(a) Amendment of Plan. The Board at any time, and from time to time, may amend the Plan. However, except as provided in Section 11 relating to adjustments upon changes in Common Stock, no amendment shall be effective unless approved by the stockholders of the Company to the extent stockholder approval is necessary to satisfy the requirements of Section 422 of the Code, Rule 16b-3 or any applicable Nasdaq or securities exchange listing requirements.

(b) Stockholder Approval. The Board may, in its sole discretion, submit any other amendment to the Plan for stockholder approval, including, but not limited to, amendments to the Plan intended to satisfy the requirements of Section 162(m) of the Code and the regulations thereunder regarding the exclusion of performance-based compensation from the limit on corporate deductibility of compensation paid to certain executive officers.

(c) Contemplated Amendments. It is expressly contemplated that the Board may amend the Plan in any respect the Board deems necessary or advisable to provide eligible Employees with the maximum benefits provided or to be provided under the provisions of the Code and the regulations promulgated thereunder relating to Incentive Stock Options and/or to bring the Plan and/or Incentive Stock Options granted under it into compliance therewith.

(d) No Impairment of Rights. Rights under any Award granted before amendment of the Plan shall not be impaired by any amendment of the Plan unless the Participant consents in writing.

(e) Amendment of Awards. Subject to Section 3(b)(iii), the Board at any time, and from time to time, may amend the terms of any one or more Awards; including, expressly, that the Board and/or the Compensation Committee, may, from time to time, amend an Award to decrease the exercise price per share of any issued and outstanding Award, provided however, that no Award may be amended to have an exercise price less than the current market price of the Company's common stock on the date of the amendment of an Award. In addition, no amendment under this Section 12(e) shall impair the rights under any Award, by any such amendment, unless the applicable Participant consents in writing.

13. TERMINATION OR SUSPENSION OF THE PLAN.

(a) Plan Term. The Board may suspend or terminate the Plan at any time. Unless sooner terminated, the Plan shall terminate on the day before the tenth (10th) anniversary of the date the Plan is adopted by the stockholders of the Company. No Awards may be granted under the Plan while the Plan is suspended or after it is terminated.

(b) No Impairment of Rights. Suspension or termination of the Plan shall not impair rights and obligations under any Award granted while the Plan is in effect except with the written consent of the Participant.

(c) Savings Clause. This Plan is intended to comply in all aspects with applicable laws and regulations. In case any one or more of the provisions of this Plan shall be held invalid, illegal or unenforceable in any respect under applicable law or regulation, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby and the invalid, illegal or unenforceable provision shall be deemed null and void; however, to the extent permissible by law, any provision which could be deemed null and void shall first be construed, interpreted or revised retroactively to permit this Plan to be construed in compliance with all applicable laws so as to foster the intent of this Plan.

14. EFFECTIVE DATE OF PLAN.

The Plan shall become effective as determined by the Board, but no Award shall be exercised (or, in the case of a restricted stock Award, shall be granted) unless and until the Plan has been approved by the stockholders of the Company, which approval shall be within twelve (12) months before or after the date the Plan is adopted by the Board.

15. CHOICE OF LAW.

The law of the state of Nevada shall govern all questions concerning the construction, validity and interpretation of this Plan, without regard to such state's conflict of laws rules.

(The Plan was adopted by the Board of Directors on July 13, 2012).

