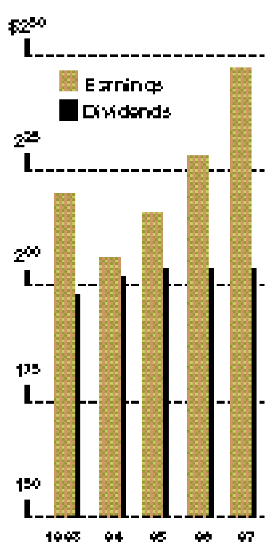
MINNESOTA POWER'S revenue and profit improved in 1997. Earnings per share increased to $2.47 in 1997 from $2.28 in 1996. Management strategy is to strengthen existing business segments and selectively evaluate growth opportunities to continually increase total shareholder return.

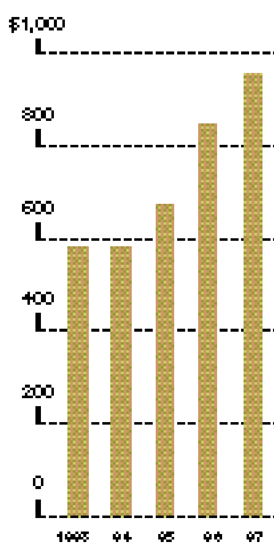
Financial Highlights

	1997	1996	1995
	Millions except per share amounts and employees		
Operating Revenue and Income	$953.6	$846.9	$672.9
Net Income	$77.6	$69.2	$64.7
Earnings Per Share of Common Stock*	$2.47	$2.28	$2.16
Average Shares Outstanding	30.6	29.3	28.5
Dividends Per Share of Common Stock	$2.04	$2.04	$2.04
Total Assets	$2,172.3	$2,146.0	$1,947.6
Capital Expenditures	$72.0	$101.0	$115.0
Return on Common Equity	12.1%	11.3%	10.7%
Employees	6,800	6,500	5,600

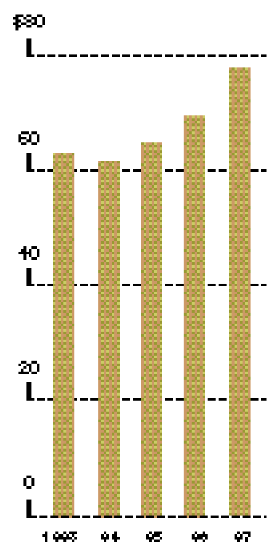
* Basic and diluted earnings per share are the same



Earnings and Dividends Per Share



Operating Revenue and Income
Millions



Net Income
Millions

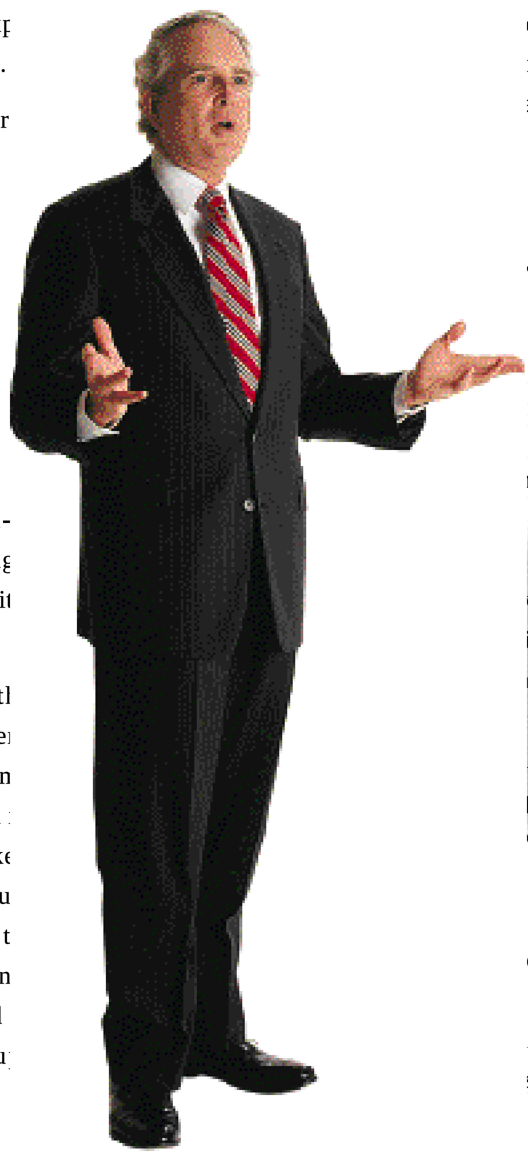
A Letter To Our Shareholders

In my mind, performance is the word that best described Minnesota Power in 1997. Our skilled employees performed by focusing on getting the job done and improving the way we do business. We performed to exceed the expectations of the financial community, which monitors our progress. Most importantly, we performed for you — our shareholders. Finally, we performed overall by doing what we said we would do — implementing our strategy. We call it “The Drive Toward 2000.”

The results of this performance as we move into 1998 are improved earnings, a stronger balance sheet, better capital discipline and increased cash flow — proof positive that our diversified company is performing. Net income grew by 12% over 1996 and our earnings exceeded exp tions by climbing from $2.28 to $2.47 per share.

The value of your investment in our company r dramatically. If you reinvested your dividends throughout the year, your Total Shareholder Return (TSR) was 69% in 1997. Over the past two years, our TSR is three times higher than that of the Philadelphia Utilities Index and also exceeds the S&P 500. I believe this increase in our company’s value is the result of the hard work by the many men and women at Minnesota Power and the fact that the investment community and shareholders like you are recognizing the value of our strategy and our ability to get it done.

Driving toward a higher TSR remains th cornerstone of our game plan. In order to be ver clear, we modified our compensation program when we began The Drive Toward 2000 back i 1996. To better motivate our managers, we linke pay incentives to TSR, free cash flow and retu on gross investment. Our employees across t Company responded with vigor. This respon coupled with our clarity of purpose, resulted solid results during 1997. We are, as a grou focused, challenged and excited.



Our performance was strong, but we have much more to do. We have not fully achieved our potential — not by a long shot. That’s one reason why we updated our strategy in the latter half of 1997. We can now see more opportunities in front of us than just two years ago — it is an exciting view.

In Electric Operations we’ve undertaken a number of new initiatives and are actively investigating others that could materially impact our company. We have announced a strong alliance with Manitoba Hydro that positions us to jointly deliver low-cost power across the Midwest. Anew telecommunications subsidiary, MP Telecom, will allow us to leverage our own communications expertise and infrastructure into the ce of fiber optics and closely related ns opportunities. Our key account em has transformed the way we do larger customers, as we make their bjectives. MPEX, our power-market- has increased its contribution to arnings. In short, we’ve begun to look at ourselves as beneficiaries of impending electric deregulation rather than victims of it.

We’re also playing to our ngths in our Water Services business. rating results have improved, and we ortunities for growth outside of our vice territories. Guided by our strate- ing properties that have shown little and acquiring new systems with for expansion in Florida and North tion, two new subsidiaries are work- position beyond our prescribed utility Maintenance and Management was to provide predictive maintenance ter utility market. Americas’ Water entry into the growing trend toward d outsourcing of water and waste- ons for municipal government and stry alike.

Our Automotive Services group began to demonstrate its potential in 1997. Sales at ADESA climbed 21% to 769,000 vehicles, and we now operate 25 auctions in North America. We have expanded and renamed our car carrier subsidiary Great Rigs Inc. to service auctions both inside and outside the ADESA chain. The rapid expansion and growing profitability at Automotive Finance Corporation (AFC) has been exciting. That business has demonstrated the dual value that we derive by serving our dealer customers wherein we gain income from short-term loans while at the same time assisting these customers in financing additional purchases through the auction process. Importantly, AFC has grown beyond the boundaries of ADESA and works to serve dealer financing needs at independent auctions across the United States and Canada. We are excited by the opportunities at Automotive Services, but also determined to stay focused to further enhance our performance by doing the basics even better.

Momentum continues to build in our Investments group. Our portfolio managers continued their strong and steady performance. Minnesota Power's 21% share of Capital Re has consistently shown itself to be a prudent investment. The market value of that ownership increased by $51 million in 1997.

At Real Estate we are beginning to fully realize the value of the property we acquired at Palm Coast and Sugarmill Woods in Florida, with sales remaining strong at both locations. Highway improvements at our more mature Lehigh property will increase the marketability of our commercial land there in 1998 and beyond.

Do I see problems or risks or challenges ahead? Absolutely. The path to electric deregulation across the country, including Minnesota and Wisconsin, is not clear. MPAutomotive Services is monitoring the impact of new, large retail auto chains (such as Auto Nation and Car Max) and assessing the impact of the Internet and other information technology as it relates to the auction process. MP Water Services is moving into the non-regulated arena on a step-by-step basis. Each of these issues and more will test our ability to be a nimble company. We will need to exploit opportunities, be flexible and learn from our mistakes. We are developing a better sense of teamwork across Minnesota Power so that we can avoid redundancies and save on expenses in our diverse operations. Yet there's a delicate balance as our managers must differentiate between the distinct cultures and varying priorities that drive our respective businesses and not try to place everyone in a common mold.

We are fortunate to have strong senior executives in each of our business groups who can incorporate into their businesses what makes sense and avoid what doesn't. In all corners of our company, we are encouraging people to be more aggressive, to take prudent risks, to respond to a challenge and to admit an error.

By performing, we have set the bar higher for your expectations and ours as well.

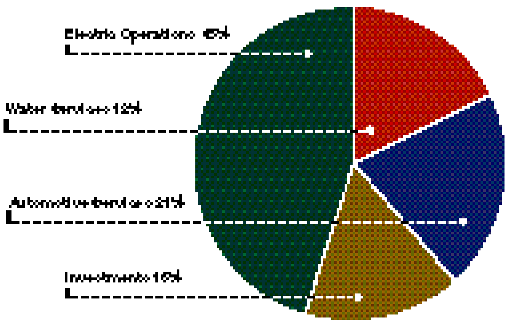
We need to be able to reassess our assumptions periodically, but stay tightly focused as we continue to move ahead to aggressively and successfully implement the game plan that we have put in place.

We had a strong year in 1997. By performing, we have set the bar higher for your expectations and ours as well. Thank you for placing your investment in Minnesota Power. We take the trust that it carries very seriously.

Sincerely,

Edwin L. Russell
Chief Executive Officer

Assets by
Business Segment



Electric
Operations

Electric Operations

- MP Electric
- Superior Water, Light and Power
- MPEX
- MP Enterprises
  - BNI Coal
  - Electric Outlet
  - MP Telecom

Water
Services

Water Services

- Florida Water Services
- Heater Utilities
- Instrumentation Services
- U.S. Maintenance and Management
- Americas' Water Services

Automotive
Services

Automotive Services

- ADESA Corporation
  - ADESA Auctions
  - Professional Auto Remarketing
  - Great Rigs
- Automotive Finance Corporation

Investments

Investments

- Securities Portfolio
- Capital Re
- Real Estate
  - Lehigh
  - Sugarmill Woods

MARKETS SERVED

We generate, transmit, distribute and sell electricity to 136,000 customers in northeastern Minnesota and northwest Wisconsin. Our large industrial customers include taconite producers, paper and pulp mills, and pipeline firms. We also sell water and natural gas in the Superior, Wisconsin, area and own North Dakota-based BNI Coal. Our MPEX division markets low-cost electricity across the Midwest.

Millions

	1997	1996	1995
Operating Revenue and Income	$541.9	$529.2	$503.5
Net Income	$43.1	$39.4	$41.0

We serve water and wastewater customers through Florida Water Services and Heater Utilities, located in North Carolina. Florida Water, the largest investor-owned water utility in the Sunshine State, serves 119,000 water customers and 52,000 wastewater customers. At Heater, our customer numbers are 28,000 and 2,000, respectively. Non-regulated subsidiaries provide predictive maintenance services and outsourcing and privatization solutions to water utilities throughout the Americas.

	1997	1996	1995
Operating Revenue and Income	$95.5	$85.2	$66.1
Net Income	$8.2	$5.4	$(1.0)

We offer a complete menu of services to franchised automobile dealers, licensed used auto dealers, domestic and foreign auto manufacturers, fleet/lease companies, banks and finance companies in the United States and Canada. Our ADESA subsidiary is the nation's third-largest vehicle auction network with 25 facilities across North America. Another subsidiary, Automotive Finance Corporation (AFC), provides short-term inventory financing to automotive wholesale and retail dealers in 57 locations. Great Rigs is our newly expanded auto transport company.

	1997	1996	1995*
Operating Revenue and Income	$255.5	$183.9	$61.6
Net Income	$14.0	$3.7	$0.0

*Acquired July 1,

Our investments provide liquidity for our business units and returns to stockholders. Capital Re serves insurance companies desiring reinsurance of municipal bonds, mortgages and other financial guaranties. Residential, commercial and industrial property is available to buyers and brokers through our three Florida real estate holdings, at Lehigh, Palm Coast and Sugarmill Woods.

	1997	1996	1995
Operating Revenue and Income	$60.9	$49.9	$43.7
Net Income	$32.1	$38.1	$41.3

Presentation does not include corporate charges

Electric Operations

Minnesota Power's unique place among investor-owned utilities puts us in a position of strength as electric industry deregulation moves forward. The transition toward restructured electricity markets has been slow to reach the upper Midwest, but MP Electric is taking the time to tune up its performance, retool itself for the future and expand beyond the markets it has established over seven decades.

What makes us unique among power providers?

- First and foremost, MP Electric is a low-cost producer of electricity. According to recent data compiled by the Edison Electric Institute, the average cost of electricity to customers of MP Electric is 3.9 cents per kilowatthour. That cost, which factors in retail customers — industrial, commercial and residential — is the second lowest among 119 utilities surveyed in the United States (see table on page 7).
- MP Electric's assigned service territory is situated amidst abundant northern forests, contains the biggest deposit of iron ore in America, and is crossed by major petroleum and natural gas pipelines. Every year this geography yields an abundance of paper and wood products and millions of tons of taconite, a refined iron ore used in steelmaking.
- MPElectric's roster of large power customers puts us in a league of our own with regard to load factor, the ratio of average electric load in a designated period compared to the peak load occurring in that period.

MP Electric employees maintain 2,200 miles of electric transmission lines and nearly 6,000 miles of distribution lines in Minnesota and Wisconsin.

MP ELECTRIC HAS LEVERAGED its unique characteristics — low-cost power, large industrial customers and high load factor —into a strong competitive position. With open access to transmission a reality and retail supply competition on the doorstep, low-cost power has never been more crucial.

Over the past few years, MP Electric has renegotiated new all-requirements contracts with all of its largest customers. In November, EVTAC Mining signed a new electric service agreement that provides for MP Electric to serve all of the taconite producer's electric power needs through October 2008. Early in 1998, a similar agreement was signed with Hibbing Taconite Company, another major iron ore mining complex. These agreements, subject to Minnesota Public Utilities Commission (MPUC) approval, follow a new contract in 1996 between MP Electric and its biggest customer, the USX Minntac facility in Mountain Iron, Minnesota. In November, the MPUC approved MP Electric's new contract for electric service to Lake Superior Paper Industries and Superior Recycled Fiber Industries. All told, we have large power contracts with five taconite producers, four paper and pulp mills, and two pipeline companies. These customers account for about 40% of the revenue and 51% of the kilowatthours sold by MPElectric. We know how to serve customers with large power needs. In addition, we've also secured long-term electric supply contracts with numerous municipal customers in our service territory.

Customers like Lakehead Pipe Line's Rick Sandahl were the focus of a refined Key Account Management system undertaken at MP Electric. Sandahl, a Lakehead vice president, is pictured at his company's petroleum storage facility in Superior, Wisconsin.

The success of MPEX, MP Electric's power marketing division, continues despite less power being available for sale. The region's transmission capability was reduced due to historically severe spring storms in the Midwest, and less hydro-power generation was available in Canada. These limiting factors notwithstanding, higher profit margins were realized on the sales that were made.

Kilowatthour sales were strong to Iron Range taconite producers, who approached their highest production level in 16 years due to improved equipment reliability, efficient operations and continued strong demand for steel. Overall production of taconite at northeastern Minnesota's seven plants reached about 47 million tons.

WE LAID THE GROUNDWORK in 1997 for a new non-regulated telecommunications subsidiary, MPTelecom Inc. that will provide high volume fiber optic communications. Utilizing an extensive fiber optic system, MPTelecom will build new telecommunications distribution systems, interconnect major industrial and commercial customers, and provide them with access to long distance telephone and Internet providers.

MPEX and Manitoba Hydro signed a three-year agreement whereby MPEX will provide hourly power trading and energy scheduling services in the United States for Canada's fourth-largest electric utility. The exclusive agreement calls for MPEX to serve Manitoba Hydro with real-time and short-term power trading services.

Lowest Average Cost of Electricity to Retail Customer

Rank	Company	Average Cost Cents per kWh
1	Idaho Power Company	3.65
2	Minnesota Power	3.90
3	Kentucky Utilities Company	4.03
4	South Beloit Water, Gas & Electric Company	4.31
5	Cheyenne Light, Fuel & Power Company	4.47
6	Southwestern Public Service Company	4.58
7	Washington Water Power Company	4.72
8	Wisconsin Public Service Corporation	4.72
9	PacifiCorp	4.73
10	PSI Energy, Inc.	4.74

Based on data from 119 U.S. utilities, Edison Electric Institute's Typical Bill Report, 1997

Minnesota Power and Manitoba Hydro, physically linked since the 1970s, also signed an alliance to market electric energy throughout the Midwest. Owned by the Province of Manitoba, Manitoba Hydro generates much of its electricity from self-renewing water power.

WITH OPEN ACCESS TO TRANSMISSION A REALITY AND RETAIL SUPPLY COMPETITION ON THE DOORSTEP, LOW-COST POWER HAS NEVER BEEN MORE CRUCIAL.

OUR GOVERNMENT RELATIONS staff worked in 1997 to help inform the Minnesota Legislature on taxes and their effect on business. Ultimately, state lawmakers revised the business tax structure in Minnesota, resulting in a tax savings to our corporation of $2.8 million. But tax equalization among electric providers in the state remains a crucial objective as yet unrealized. For Minnesota Power and for other investor-owned utilities in Minnesota, the question of tax fairness is a prerequisite to any legislation on restructuring or deregulating the industry. We'll continue to push hard for a "level playing field" so that Minnesota electric companies can compete on an equal footing with those from neighboring states.

The Electric Outlet, our retail store in Duluth completely redesigned with a fresh mix of innovative products in 1996, expanded its marketing efforts in 1997. We produced a lively mail order catalog full of distinctive "electric wonders" and sent it to shareholders and thousands of other selected customers. The Electric Outlet also launched a brand new website (www.electric-outlet.com). Try it out!

Strengthening successful relationships with its industrial customers is one of the key moves highlighting MP Electric's strategic update. At Inland Steel Mining Company, Reed Rosandich and Larry Tokarczyk of MP Electric (left and top) work with Inland's Marty Zuponcic

ROUGHLY HALFWAY THROUGH the strategic road map outlined by our Drive Toward 2000, MP Electric President Bob Edwards and many others spent long hours reassessing markets and mapping out our future. The result was an updated strategic vision called "Key Moves," communicated to our employees as 1998 dawned. In short, all of our key moves revolve around a comprehensive understanding of quality and reliable service for all of our customers. Our organizational structure was realigned and divided into marketing, operations and support to reinforce our revised strategy. A frank self-analysis of what we do best guided this process, and we believe it sets us on a sound course to compete now and well into the new century.

As a Minnesota-based electric utility operation with no nuclear generation and the largest percentage of hydro generation in the state, MP Electric is proud of its relationship to the environment. Our environmental sensitivity was underscored in 1997 by completion of a transfer to the state of Minnesota certain pristine lands held by Minnesota Power. Working with the state of Minnesota and responding to citizen input, we agreed to sell and/or donate to the state 22,600 acres of land fronting about

His all-terrain vehicle headlight-deep in mud, MP Electric lineman Carl Thesing teamed with more than 50 MP Electric workers last winter to help restore power along the Minnesota-North Dakota line after catastrophic storms and flooding.

150 miles of the St. Louis River and its two largest tributaries. The land is ideal for wilderness canoeing and lined by acres of aspen and conifer. MPElectric retains land adjacent to dams and reservoirs that is managed with public recreation and wildlife habitat in mind.

ANY REVIEW OF 1997 would be incomplete without mention of the cataclysmic events of early April along the Red River of the North and its vast watershed. A disastrous blizzard and flood combination struck northwestern Minnesota and southeastern North Dakota, toppling thousands of power poles and blacking out electricity to wide areas. Huge portions of the Dakotas and Minnesota were declared official disaster areas. Teams from Minnesota Power and other utilities responded to the scene to help neighboring Otter Tail Power and Minnkota Power Cooperative restore their devastated systems. On short notice, MP Electric sent 57 workers equipped with a fleet of all-terrain vehicles to assist in virtually reconstructing the area's electric system. They remained on the scene for a week of grueling repair work.

While heightened competition is inevitable in our industry, last spring's disaster was a reminder that cooperation and neighborliness have enduring value.

System Operator Christine Laskowski uses a state-of-the-art control system to monitor MP Electric's power grid from the Rowe Energy Control Center in Duluth.

Water Services

Water: it's a basic essential of life, and a fundamental part of Minnesota Power's diversity that contributed to our performance. Early in 1997, our Florida utility changed its name to Florida Water Services to accurately reflect its marketplace and to rededicate itself to outstanding customer service. We reaffirmed our commitment to Florida's water resources and environmental stewardship.

PROVIDING RELIABLE WATER AND WASTEWATER SERVICE involves the main-tenance of an infrastructure fundamental and essential to every customer. And yet this seemingly basic service can be a complex undertaking when serving as many customers in as many localities as we do. Florida Water serves fresh water and provides wastewater service in about 120 communities, from Marco Island in the southwest to Amelia Island in the northeastern part of the state. The largest investor-owned water utility in the state, Florida Water provides its customers with some 14 billion gallons of water every year.

Reverse osmosis water filtration equipment, Marco Island, Florida.

Because of the multiplicity of our service territories and the diversity of our customer base, arriving at a fair and equitable rate structure has proven to be a challenge, both for us and for state regulators.

In 1997, the debate over refunds for customers deemed by the Florida Public Service Commission (FPSC) to have paid too much between 1993 and 1996 was taken up by the Florida First District Court of Appeals, which ruled that a 1996 FPSC order to refund was only valid if it provided for surcharges to customers who paid too little over the same period. With this ruling, the FPSC reversed its prior order of refunds and ruled that surcharges were not required and neither were refunds. There was one exception regarding refunds in a locality, which we are disputing.

FLORIDA WATER'S MANAGERS BELIEVE that with the refund/surcharge court ruling behind them, they can concentrate on more essential tasks: providing reliable, clean water to more than half a million people while preserving and enhancing the environment at a fair cost.

Both operating revenue and net income moved higher in 1997 at Florida Water. New rates allowing Florida Water to collect $11.1 million more in annual revenue became effective in late 1996 and added revenue during 1997.

At year's end, we finalized a sale of four Florida Water service areas in Orange County. The water and wastewater plants served about 4,000 customers. The funds from the sale are being retained by Florida Water for reinvestment into other water or water-related opportunities.

The strategic emphasis at our Heater Utilities affiliate continues to be growth in North Carolina. In September, Heater completed acquisition of the LaGrange Waterworks Corporation, a water utility serving 5,300 customers near Fayetteville. This purchase increased Heater's size by more than 20%.

Nine-year-old Brittany Brown of Fort Myers works out with her Swim Florida team in the Lehigh Acres Community Pool, served by Florida Water Services.

THE ESTABLISHMENT OF TWO NEW BUSINESSES in the non-regulated environment set the stage for future growth in our Water Services business.

The goal of U.S. Maintenance and Management Services Corporation, incorporated in 1997, is to provide predictive maintenance services to water utility companies and other industrial operations.

Americas' Water Services, launched in June, provides Minnesota Power the opportunity to pursue growth in the expanding market for privatized and out-sourced water and wastewater systems. Headquartered near Chicago, the company offers its contract management, operations and maintenance services to governments and industrial clients throughout the Americas. With this new subsidiary we plan to capitalize on the movement toward privatizing municipal and industrial services. Americas' Water has already secured a five-year contract with the City of Chicago to participate with Chicago Water Partners in a joint venture engineering project.

President John Cirello and the people at Water Services have come a long way in the two years since our corporate Drive Toward 2000 strategy was implemented. We've cut costs, improved revenue and net income, and secured the ability to market our water expertise outside our traditional utility boundaries. Most importantly to our investors, we've made Water Services a profitable operation while laying the groundwork for future growth in several new areas of the water business.

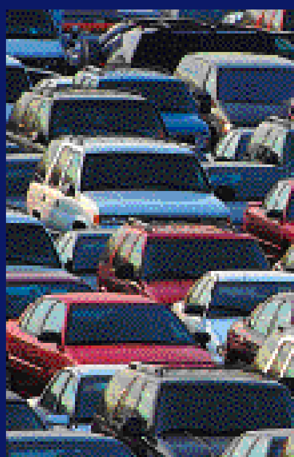
Burnt Store Marina near Cape Coral, Florida, provides beautiful access to the Gulf of Mexico. As a high-growth condominium and apartment development, Burnt Store represents a growing customer base for Florida Water Services.

Automotive Services

Fueled by accelerated activity at ADESA auctions and boosted by the major expansion of Automotive Finance Corporation, Automotive Services significantly enhanced its performance in 1997.

Net income at Automotive Services grew from $3.7 million to $14 million. The ADESA Auction component consists of 25 strategic locations across North America and Automotive Finance Corporation broadened its franchise, growing from 29 to 54 sites during the year. Three more sites were added in January, 1998.

To further capitalize on its position in remarketing and dealer financing, Automotive Services moved to double the size of its vehicle hauling fleet and renamed the subsidiary Great Rigs, Inc. As consumers turn to the value and quality of used cars and trucks, Minnesota Power's Automotive Services has positioned itself as a full-service provider of remarketing, finance and transport services.



Automobiles ready for sale at ADESA Boston.

ADESA, THE THIRD LARGEST NETWORK OF VEHICLE AUCTIONS in North America, served notice of its emerging strength with improved sales, better technology and enhanced profitability. The number of cars sold at ADESA auctions increased from 637,000 in 1996 to 769,000 in 1997 — a growth rate of 21%. With revenues and sales increasing, 1997 was also also a year of selective geographic repositioning.

ADESA moved westward and opened ADESA Sacramento early in the year. This expansion provides ADESA with the opportunity to compete in the California market, which is one of America's largest markets. ADESA also consolidated its Concord, Massachusetts facility with ADESA Boston, the world's largest indoor auto auction, and acquired additional land necessary to renovate and improve the existing facility at ADESA Halifax in Nova Scotia.

Although selective expansion is important, the primary emphasis for ADESA during the year was improving the basics of the business. The fundamentals guiding its direction were operational enhancements focusing on productivity improvement, capital discipline, cost reductions and customer service.

Technology also played a key role in Automotive Services. Information technology experts from across the Company worked in Indianapolis to design a new computerized auction management system. The auction management system simplifies our customers' ability to interact with us and it is being aggressively rolled out to other auctions around the country.

Jim Hallett, ADESA's president, has heard ADESA's customers comment on the improved service they've received.

"THE BEST THING THAT CAN HAPPEN is that customers say good things about you; but we are not yet satisfied — not by a long shot," said Hallett.

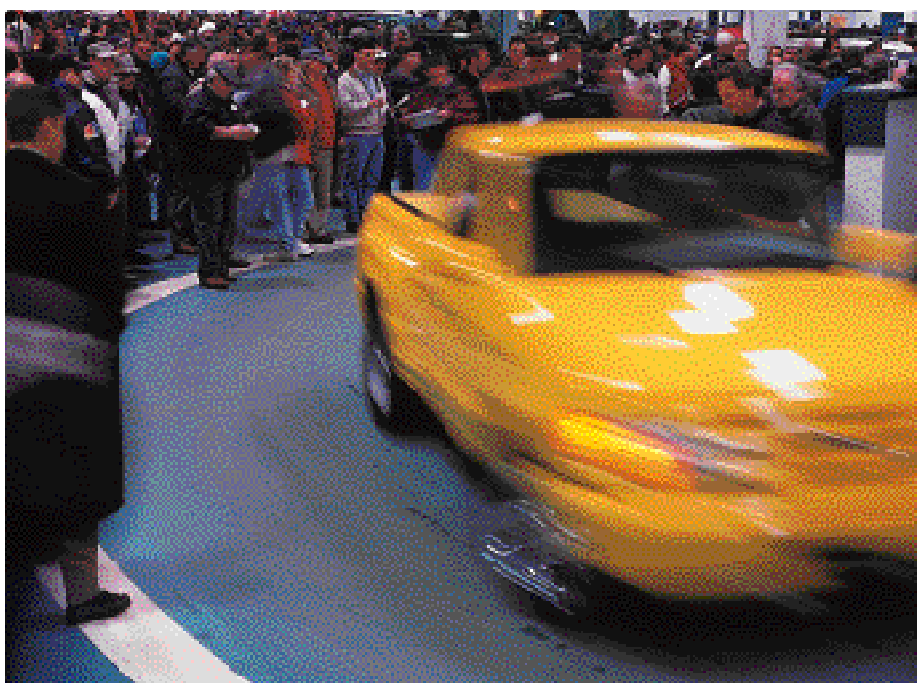
A 21% increase in automobile sales is only part of the Automotive Services success story for 1997. Customers at ADESA auctions can avail themselves of auto reconditioning, transport and inventory financing.

GREAT RIGS, INC.

To add value to auction operations, Automotive Services in the third quarter expanded its transport business. We beefed up our fleet of automobile hauling trucks and renamed the subsidiary Great Rigs. The new name will symbolize the addition, by the middle of this year, of about 90 new trucks for hauling vehicles. While the business of hauling new vehicles is dominated by a few large companies, the used-car transport industry is more fragmented among smaller, independent firms. Our goal is to provide first-class transport to anyone interested in moving vehicles, while offering a value-added enhancement to our ADESA network of auctions.

PROFESSIONAL AUTO REMARKETING

For customers not in close proximity to an ADESA auction, there is Professional Auto Remarketing, or PAR. It's the perfect remarketing solution for banks, leasing customers, or anyone with cars to sell who may not have the expertise or employees to handle vehicle fleets. PAR has relationships with more than 300 auctions nationwide, including ADESA auctions, other chains and independents.



Customers surround the auction action at ADESA Boston, described in a national magazine as "one of the seven wonders of the auto auction world."

AUTOMOTIVE FINANCE CORPORATION

AFC is an integral part of the strong earnings growth underway at Automotive Services. AFC has carved out a special niche in the automobile finance market — writing short-term inventory loans for wholesale and retail car dealers who purchase vehicles at auction. This type of financing, called floorplanning, is a specialty that AFC has exported to vehicle auctions outside the ADESA network. AFC floorplanned 300,000 vehicles in 1997, a more than twofold increase over the 140,000 cars and trucks similarly financed in 1996. With 57 locations in the United States and Canada, AFC has continued, year after year, to increase the number of its floorplan contracts. We do not anticipate this growth to slow in the near future. Sound impossible? Consider that our list of dealer / customers has grown from about 4,000 a year ago to some 10,000 today. Or that the number of vehicle auctions we serve has grown approximately 35% since early 1997.

WITH AFC, DEALERS CAN MORE EASILY ADJUST THEIR INVENTORY... AND INCREASE THE NUMBER OF VEHICLES ON DISPLAY AT THEIR SALES LOTS.

Since its founding in 1987 under President John Fuller's leadership, AFC has been providing short-term inventory financing for independent automobile dealers. Since Minnesota Power acquired the majority interest in the ADESA auction network, John and his team have led an aggressive and successful expansion of the AFC financing network.

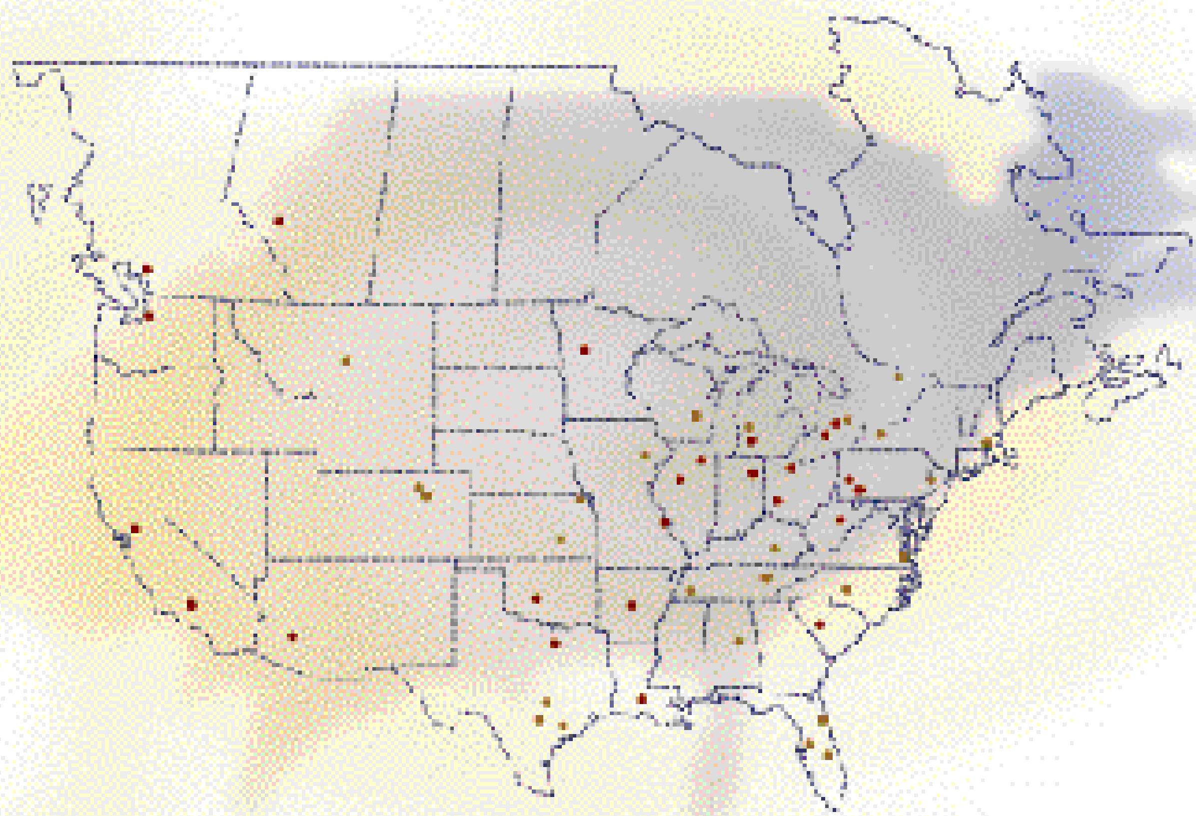
WITH A GROWING CUSTOMER BASE of approved, licensed dealers, AFC has become the largest exclusive provider of dealer floorplan financing in North America. AFC intends to maintain this position by offering other products and services to its customers. In July, AFC entered into an agreement with ACC Consumer Finance Corporation. Together, these two companies will test a program designed to promote ACC's purchase of installment contracts that finance the purchase of used vehicles floorplanned by AFC. In October, ACC was acquired by Household International, a leading provider of consumer finance and credit card products. One of Household's primary businesses is HFC, the nation's oldest consumer finance company. The alliance with Household International is expected to give AFC a strong partnership to further expand its floorplanning operations.

The growing availability of AFC floorplan financing makes it easier for automobile dealers to stock up on vehicles and trucks at ADESA facilities as well as at independently-owned auctions and other auction chains. With AFC, dealers can more easily adjust their inventories to reflect the ever-changing tastes of the public. They can increase the number of cars on display at their sales lots during special promotions or peak selling periods. AFC's unique service is a direct incentive to automotive dealers to purchase more vehicles through auction lanes.

Automotive Finance Corporation President John Fuller, with AFC Controller Roberta Goldberg, at their headquarters office in Indianapolis.

Recent expansion of loan production offices in Seattle, Toronto and St. Louis gives AFC the opportunity to market short-term inventory loans in areas under-served by auction facilities or in places where it's not possible for AFC to be on the premises of an auction location. To meet the demands of this increased business, AFC's staff grew from 102 to 189 people during 1997.

With its industry-leading experience in this specialty market, AFC is in a unique position to stimulate sales at auction facilities throughout North America. The continued growth of AFC strengthens the performance of Minnesota Power's Automotive Services by expanding its base of customers and broadening the range of services available to them.



Automotive Finance Corporation Locations

- AFC locations in 1996
- AFC sites added since January 1997

Investment performance contributed soundly to the success of Minnesota Power in 1997. It continued to create short- and intermediate-term cash flow and earnings while serving as a repository of funds and sustaining the Company's credit rating.

AS INVESTORS KNOW, diversification is often a key to consistent financial returns. Minnesota Power invests in a diverse blend of instruments designed to mitigate risk. The first is an actively traded securities portfolio, consisting primarily of utility stock holdings hedged against market downturns and aimed at an after-tax return of 7% to 9% (about 13% pre-tax). While these returns may seem modest compared to broader market indices over the past few years, this hedge strategy is a wise course in a volatile economic environment.

Minnesota Power stock certificates

The second is an intermediate-term investment strategy consisting of our 21% ownership in Capital Re, a reinsurance and specialty insurance firm listed on the New York Stock Exchange. Since 1987, Capital Re has successfully evolved into a leading reinsurance provider within the financial guaranty, mortgage, and title insurance sectors. Beginning in 1996, Capital Re has provided corporate capital and syndicate management through its Lloyd's corporate venture and managing agency. Minnesota Power's $119 million investment in Capital Re has a current market value of approximately $203 million. Minnesota Power is Capital Re's largest stockholder and holds two seats on the reinsuror's 10-member board of directors. Capital Re is a core component of MP Investments.

MINNESOTA POWER REAL ESTATE'S STRATEGY remains simple: Search out value, buy property at bulk prices and resell it at prevailing market rates. Using this strategy, Minnesota Power has successfully invested in Florida land since the 1980s. The Company's current holdings are through an 80% ownership of Lehigh Acquisition Corporation. Lehigh Acquisition has properties in Lehigh Acres, adjacent to Fort Myers; Palm Coast, between Daytona Beach and St. Augustine; and Sugarmill Woods, north of Tampa.

Bolstered by a strong Florida economy, growing population and low interest rates, 1997 property sales reached an all-time high of $32 million, doubling 1996's sales. The growth was due in large part to the 1996 acquisition of the Palm Coast property. In Palm Coast, originally developed by the ITT Community Development Corporation, Lehigh Acquisition purchased 13,000 acres of undeveloped land. Of this, 600 acres were sold in 1997, including choice residential waterfront property along with several commercial parcels.

During 1997, Lehigh Acquisition also completed a state-mandated registration process that now allows the company to market its Palm Coast and Sugarmill Woods home sites outside Florida. As a result, Palm Coast home site sales increased from $1 million in 1996 to $6 million in 1997. Interest in Florida properties has been strong among buyers from North America, Europe and South America.

A new home under construction in the Bethany Trace development at Lehigh Acres, Florida.

The Lehigh property, located in Lee County, is Lehigh Acquisition's most mature holding. Lehigh continues to yield steady income, as evidenced by the sale of several major parcels in 1997, which drove sales over $10 million compared to $7 million in 1996. Commercial and residential growth in Lehigh is expected to accelerate with the completion of major road projects, such as the widening of Lee Boulevard to six lanes in the heart of the community. This project will provide Lehigh with excellent access to the best of Lee County's commerce and beaches.

BECAUSE OF ITS WARM CLIMATE, recreational opportunities and low income taxes, Florida is expected to continue as a primary retirement destination. The people at Lehigh Acquisition expect to capitalize on this growing market while maintaining a track record of consistent earnings and searching for ways to replenish their inventory of property.

The nimble management of assets across a range of investments has added to Minnesota Power's strength. Beyond that, MPInvestments has proven itself as a key contributor of earnings for the corporation.

Johann Pfuner, center, and sons Thomas, left, and Heinz inspect a Lehigh property destined for residential development. Austrian natives, the Pfuners will manage the project for Gassner Development Inc., a company with German roots.

Minnesota Power Corporate Officers

John Cirello
Executive Vice President
President and Chief Executive Officer - MPWater Resources

Donnie R. Crandell
Senior Vice President
President - MPReal Estate Holdings

Robert D. Edwards
Executive Vice President
President - MP Electric

John Fuller
Senior Vice President
President and Chief Executive Officer - AFC

Laurence H. Fuller
Vice President - Corporate Development

David G. Gartzke
Senior Vice President - Finance and Chief Financial Officer

James P. Hallett
Executive Vice President
President and Chief Executive Officer - ADESA

Philip R. Halverson
Vice President, General Counsel and Secretary

James A. Roberts
Vice President - Corporate Relations

Edwin L. Russell
Chairman, President and Chief Executive Officer

Mark A. Schober
Controller

James K. Vizanko
Treasurer

Investor Information

SHAREHOLDER INFORMATION AND ASSISTANCE

For shareholder information and assistance, write or call Shareholder Services at our corporate headquarters.

Minnesota Power
30 West Superior Street
Duluth, MN 55802

Toll-free phone: 1-800-535-3056
Duluth area number: 723-3974
FAX: 218-720-2502
E-mail: mhunter@mnpower.com

INVEST DIRECT

Minnesota Power offers Invest Direct —a multi-featured direct stock purchase and dividend reinvestment plan. For information, contact Shareholder Services.

FORM 10-K AND STATISTICAL SUPPLEMENT

The Company's Form 10-K Annual Report to the Securities and Exchange Commission is available upon request. A Statistical Supplement to the 1997 Annual Report is also available. Contact Shareholder Services for them; there's no charge.

ANALYST INQUIRIES

Security analysts seeking information about the Company may contact Director of Investor Relations Timothy J. Thorp.
Phone: 218-723-3953 FAX: 218-720-2507
E-mail: tthorp@mnpower.com.

ANNUAL MEETING

Our Annual Meeting of Shareholders is held the second Tuesday in May. Shareholders are invited to attend the 1998 Annual Meeting, beginning at 10:30 a.m., May 12, at the Duluth Entertainment and Convention Center, 350 Harbor Drive, Duluth.

STOCK EXCHANGE LISTINGS

Minnesota Power common stock is listed on the New York Stock Exchange under the symbol MPL. The American Stock Exchange lists our 5% Preferred Stock (MPLpf5). Daily price quotes on our common stock may be found in many newspapers under the New York Stock Exchange composite transaction listing.

TRANSFER AGENTS FOR COMMON AND PREFERRED STOCK

Minnesota Power, Duluth
Norwest Bank Minnesota, N.A.

REGISTRARS FOR COMMON AND PREFERRED STOCK

Minnesota Power, Duluth
Norwest Bank Minnesota, N.A.

COMMON STOCK DIVIDEND PAYMENT DATES

March 1, June 1, September 1 and December 1

PREFERRED STOCK PAYMENT DATES

January 1, April 1, July 1 and October 1

ANNUAL REPORT

This annual report and the financial statements it contains are submitted for the general information of the shareholders of the Company and not in connection with the sale or offer for sale of, or solicitation of an offer to buy, any securities.

CORPORATE WEBSITE

www.mnpower.com

Minnesota Power wishes to thank two of its customers for invaluable assistance in the production of this annual report. BANTA Direct Marketing Group printed the report and Potlatch Corporation supplied the paper.

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Minnesota Power's Board of Directors

(seated, left to right) Bruce Stender, Paula McQueen, Jack Rajala, Bob Nickoloff, Kathleen Brekken, Arend Sandbulte, Peter Johnson;
(standing, left to right) Edwin Russell, Merrill Cragun, George Mayer, Dennis Evans, Nick Smith, Don Wegmiller.

ABOUT THE BOARD OF DIRECTORS

KATHLEEN BREKKEN, 48, is President and CEO of Midwest of Cannon Falls, Inc., a designer, wholesaler and distributor of giftware.

MERRILL CRAGUN, 65, is President of Cragun Corp., which owns and operates a resort and conference center in Brainerd, Minnesota.

DENNIS EVANS, 59, is President and CEO of Hanrow Financial Group, Ltd., a merchant banking firm, Minneapolis, Minnesota.

PETER J. JOHNSON, 61, is Chairman and CEO of Hoover Construction Co., Virginia, Minnesota, and Chairman of Michigan Limestone Operations, Rogers City, Michigan.

GEORGE MAYER, 53, is President of Manhattan Realty Group, Larchmont, New York.

PAULA MCQUEEN, 51, is a Partner of Webb, McQueen & Co., an accounting firm, and President and CEO of Allied Engineering & Testing Inc., Punta Gorda, Florida.

ROBERT NICKOLOFF, 68, is Chairman of KMN, Inc. and General Partner of Medical Innovation Fund, venture capital firms, and a self-employed attorney, St. Paul, Minnesota.

JACK RAJALA, 58, is Chairman and President of Rajala Companies, lumber manufacturing and trading firms, Grand Rapids, Minnesota.

EDWIN RUSSELL, 53, is Chairman, President and CEO of Minnesota Power, Duluth, Minnesota.

AREND SANDBULTE, 64, is the retired Chairman, President and CEO of Minnesota Power, Duluth, Minnesota.

NICK SMITH, 61, is Chairman of Fryberger, Buchanan, Smith and Frederick, P.A., a Duluth, Minnesota, law firm, and Chairman and CEO of Northeast Ventures, a venture capital firm.

BRUCE STENDER, 56, is President and CEO of Labovitz Enterprises, a hotel management company, Duluth, Minnesota.

DONALD WEGMILLER, 59, is President and CEO of Management Compensation Group / HealthCare, a benefits consulting firm, Minneapolis, Minnesota.