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Global Credit Research
Credit Opinion
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Credit Opinion: North Shore Gas Company

North Shore Gas Company

Chicago, Illinois, United States

Ratings

Category	Moody's Rating
Outlook	Stable
First Mortgage Bonds	A1
Senior Secured MTN	A1
Ult Parent: Integrys Energy Group, Inc.	
Outlook	Stable
Sr Unsec Bank Credit Facility	A3
Senior Unsecured	A3
Jr Subordinate	Baa1
Commercial Paper	P-2
Parent: Peoples Energy Corporation	
Outlook	Stable
Bkd Senior Unsecured	A3

Contacts

Analyst	Phone
Scott Solomon/New York	212.553.4358
William L. Hess/New York	212.553.3837

Opinion

Corporate Profile

Peoples Gas Light and Coke Company (PG&L: A1 senior secured) is a regulated local gas distribution company that purchases, stores, distributes, sells and transports natural gas to approximately 830,000 customers through an approximately 4,000-mile distribution-mains system serving Chicago, Illinois. The customer base includes residential, commercial and industrial sales. PGL had revenue of approximately $1,343 million in 2007.

North Shore Gas Company (NSG: A1 senior secured) is also a regulated local gas distribution company, albeit quite smaller than PG&L. It purchases, stores, distributes, sells and transports natural gas to approximately 158,000 customers through an approximately 2,000-mile distribution-mains system serving 54 communities in northeastern Illinois representing a service territory of approximately 275 square miles. The customer base includes residential, commercial and industrial sales. NSG had revenue of $271 million in 2007.

PG&L and NSG's strategic focus is on maintaining and growing a strong regulated utility base in traditional market segments, which include space heating, water heating, clothes drying and cooking. The largest element of customer load, however, consists of space heating and PGL and NSG typically record approximately 70% of their respective revenues from January through March and November through December. In addition to the rate charged for the distribution of natural gas, PG&L and NSG also bill their customers a Gas Charge representing its cost of gas, transportation, storage service and gains, losses and costs under incurred under their respective hedging programs.

PG&L and NSG are wholly-owned subsidiaries of Peoples Energy Corporation (PEC) which is a subsidiary of Integrys Energy Group, Inc. (Integrys: A3 senior unsecured, stable outlook). PEC and Integrys completed a merger in February 2007.

Recent Developments

In February 2008, the Illinois Commerce Commission (ICC) approved a $71 million rate increase for PG&L based on a 10.19% return on equity. This decision, PGL's first rate case since 1995, compares to the company's request of a $102.5 million rate increase based on an 11.06% ROE and represents an allowed ROE that is inline with industry averages. In February 2008, the ICC ordered NGL to implement a slight rate decrease ($200,000) based on a 9.99% rate decrease. This decision compares to the company's request of a $6.3M base rate increase based on an 11.06% ROE.

The ICC conducts annual Gas Charge proceedings which review and determine the prudence of gas costs passed through to ratepayers through the Gas Charge. If the ICC were to find that the reconciliation was inaccurate or any gas costs were imprudently incurred, the ICC would order the utility to provide ratepayers a refund. This occurred in March 2006 for fiscal 2001-2004 costs, causing PGL to record a $103 million charge and provide a refund in April 2006. In a related action, PGL recorded an additional $23 million charge to earnings in 2007 related to the funding through 2011 of conservation and weatherization programs for low and moderate-income residential dwellings.

Rating Rationale

PGL and NSG's A1 senior secured ratings are supported by their low business risk profiles, an expectation for improving financial performance due to rate relief and merger-related synergies, strong ring-fencing measures and an improved regulatory environment.

Factor 1: Sustained Profitability - PGL's profitability for 2006 and 2007 was negatively impacted by the charges cited above. Net income was $(35.4) million for the year ended September 30, 2006 and $(13.7) million for the year ended December 31, 2007.

It is our opinion that the recent rate case decision, combined with an expectation of no further charges to earnings, provide PG&L the opportunity to return to profitability and make progress toward earning its authorized return which should improve cash flow metrics.

PG&L's net income for the six months ended June 30, 2008 is anticipated to be materially improved from the $10 million earned during the prior comparable period. Similarly, PG&L's CFO pre-W/C is expected to be improved compared to the six months ended June 30, 2008 compared to $55 million for the same period in the prior year. PG&L's ratios of retained cash flow to debt (RCF/Debt) and debt to capitalization for the twelve months ended June 30, 2008 are anticipated to be indicative of a low-A rating.

NSG's net income for the six months ended June 30, 2008 was $5.4 million compared to $6.2 million in the prior comparable period. CFO pre-W/C for the six months ended June 30, 2008 was approximately $9 million and compares favorably to capital expenditures (less than $4 million) and dividends to its parent (less than $1 million). NSG's ratios of retained cash flow to debt (RCF/Debt) and debt to capitalization for the twelve months ended June 30, 2008 were approximately 9% and 32%, respectively. These financial metrics are indicative of a low-A rating.

Factor 2: Regulatory Support - Moody's viewed the outcomes of PG&L and NGC's February 2008 rate cases as credit supportive as it provided PG&L an allowed ROE in line with its peers and, for both utilities, approved a decoupling mechanism and efficiency mechanism that will allow recovery of energy efficient costs. The Illinois regulatory environment has historically been challenging.

Factor 3: Ring-fencing - PG&L and NSG are subject to regulation and company practices that help to protect credit quality, including restrictions from providing loans to PEC or Integrys and separate sources for liquidity. Furthermore, PG&L and NSG's indentures relating to their first mortgage bonds contain provisions and covenants restricting the payment of cash dividends and the purchase or redemption of capital stock.

PG&L and NSG's ratings are also supported by their ownership by Integrys, whose credit profile is stronger than that of (pre-merger) PEC. Moody's changed the rating outlooks for PG&L and NSG to stable from negative in June 2006 when the merger was announced.

Liquidity:

PG&L maintains a $250 million unsecured revolving credit facility that expires in July 2010 to support a similarly sized commercial paper program and for general corporate purposes. Terms of the syndicated revolving credit facility include a representation that no material adverse change has occurred but only on the facility's effective date. The sole financial covenant is a 65% limitation on the debt component of PG&L's capital structure. The company has substantial flexibility under the capital structure covenant.

NSG does not have its own revolving credit facility or commercial paper program. Instead it has the ability to borrow up to $50 million from PEC and to loan to or borrow from PG&L up to $50 million. As of June 30, 2008, there were advances of $26.2 million from NSG to PG&L.

PGL's long-term debt consists entirely of first mortgage bonds totaling $451 million. The most near-term maturity is $50 million in 2010. NSG long-term debt consists of two series of first mortgage bonds totaling $69 million. Its most near-term maturity is $40 million in 2013.

Rating Outlook

The stable rating outlook is supported by an expectation that the financial performance for PG&L and, to a lesser extent, NSG will improve due to rate relief and merger synergies.

What Could Change the Rating - Up

An upgrade is not expected over the medium-term. Longer-term, upward rating pressure for PG&L and NSG could be triggered by an upgrade of its parent or significant improvement in its financial metrics such that the ratio of RCF to debt exceeds 20% on a sustainable basis.

What Could Change the Rating - Down

A decline in the financial metrics of the consolidated Integrys enterprise or a decline in PG&L and NSG's financial metrics such that the ratio of RCF to debt falls below 8% for an extended period.

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RESEARCH

North Shore Gas Co.

Publication date: 26-Nov-2008
Primary Credit Analyst: Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

Major Rating Factors

Strengths:

- Lower risk regulated gas distribution business;
- Sound management of regulatory risk; and
- Relatively healthy service territories.

Corporate Credit Rating

A-/Negative/NR

View Recovery Ratings >>

Weaknesses:

- Volatility of Integrys' non-regulated energy marketing business; and
- Weak consolidated cash flow measures.

Rationale

The ratings on North Shore Gas Co. reflect parent Integrys Energy Group Inc.'s consolidated credit profile. The ratings also reflect North Shore's excellent business profile and Integrys' intermediate financial profile. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.) As of Sept. 30, 2008, Integrys had $3.4 billion in total debt outstanding

North Shore, which accounted for approximately 4% of Integrys's consolidated funds from operations (FFO) in 2007, is a regulated entity that sells, stores, and distributes natural gas to about 158,000 customers in Lake and Cook Counties, Ill.

In most circumstances, Standard & Poor's will not rate a wholly owned subsidiary higher than the parent. Exceptions can be made on the basis of structural or regulatory insulation, which in the case of North Shore, in our view, is not present. Therefore, regardless of the excellent business profile and relatively healthy financial condition of North Shore as a stand-alone basis, Standard & Poor's views the rating on the regulated entity to be affected by Integrys' non-regulated businesses.

Integrys is a diversified energy company with regulated electric and gas utilities and non-regulated retail and wholesale energy and gas marketing operations. The integrated regulated electric businesses have generating capacity of about 2,200 megawatts, of which approximately 74% is coal. The regulated electric businesses also purchase, transmit, distribute, and sell electricity to about 485,000 customers in Wisconsin and Michigan's Upper Peninsula. Recently, the company completed Weston 4, a 500 MW supercritical pulverized coal plant, of which Integrys owns 70%. Integrys also owns about 34% of FERC-regulated American Transmission Company, which is an electric transmission company primarily located in Wisconsin and Michigan's Upper Peninsula. The regulated gas businesses purchase, sell, and distribute natural gas to more than 1.6 million customers in Illinois, Michigan, Minnesota, and Wisconsin. The non-regulated business, serve about 140,000 customers throughout the U.S. and Canada. The non-regulated businesses expose the consolidated entity to speculative trading, counterparty credit risk, market risk, customer demand risk, liquidity risk, and weather risk. Approximately 80% of FFO is generated by the regulated businesses.

North Shore's excellent business profile reflects the company's regulated utility gas operations. In February 2008, the Illinois Commerce Commission approved a gas revenue decrease of about $182,000 based on a 9.99% return on equity and allowed for decoupling, which we view as credit supportive. North Shore is currently under-earning on its allowed return primarily because of the regulatory lag. (North Shore filed its last rate case using a 2006 test year.) In future rate cases, North Shore expects to use a forecasted test year which should improve its actual returns compared to its allowed return. North Shore may also recover commodity costs through the purchased gas adjustment; however, the prudence of the gas costs recovered is subject to audit, which has previously resulted in multi-million dollar settlements.

Integrys' intermediate financial profile is characterized by improving although still weak cash flow protection that have not met our expectations since the company's 2007 merger with Peoples Energy Co. Specifically, we expect adjusted FFO to debt to exceed 25%, adjusted FFO interest coverage to surpass 3.5x, and for adjusted debt to total capital to be below 50%. To meet these financial measures, the company must continue to properly manage its regulatory risk and maintain sound risk-management policies and systems in order to manage all of the aforementioned risks at its non-regulated businesses.

Also affecting the financial profile is the expected negative discretionary cash flow for the near to intermediate future. This is mostly driven by the large capital expenditures, which should average about $550 million annually though 2010 and annual dividend payments of about $200 million. The company expects that its long-term dividend payout ratio will target 60%-65% of earnings.

Liquidity

North Shore has adequate cash flow and sufficient alternative sources to cover current liquidity needs, including ongoing capital requirements, and upcoming debt maturities. North Shore was net cash flow positive for the nine months ended Sept. 30, 2008. In addition to cash generated by operating activities, the company has the ability to borrow $50 million from Peoples Energy Corporation and $50 million from The Peoples Gas Light & Coke Co. As of Sept. 30, 2008, North Shore borrowed $4.9 million. North Shore has minimal refinancing risk, as it has no debt maturities until 2013 when $40 million matures.

On a monthly basis, Standard and Poor's assess Integrys' liquidity adequacy based on stress case scenarios, which analyze the company's collateral exposure resulting from a hypothetical downgrade to speculative grade and a commodity price stress scenario (15% in the first year and 20% thereafter). Recently, we identified that the company had adequate liquidity for a hypothetical downgrade to speculative grade but did not have sufficient liquidity for a simultaneous commodity price stress. Although the company subsequently boosted its liquidity by $400 million, we expect that a company rated in the 'A' category should sufficiently manage its liquidity so that it is constantly able to meet our concurrent stress scenarios.

Outlook

The negative outlook highlights Integrys' marginal liquidity position, and weak financial measures. The ratings on Integrys and its subsidiaries could be lowered if its liquidity is not further enhanced so that there is a sufficient liquidity cushion to constantly meet our multiple and simultaneous stress scenarios or there is no improvement to the financial measures. The outlook could be revised to stable if sufficient liquidity is maintained on a consistent basis, the financial measures improve as expected, and there is a substantial decrease of the company's risk exposure from its non-regulated companies. A ratings upgrade is currently unlikely.

Table 1

Integrys Energy Group Inc. -- Peer Comparison*

Industry Sector: Combo

	--Average of past three fiscal years--				
	Integrys Energy Group Inc.	**Alliant Energy Corp.**	**Great Plains Energy Inc.**	**Westar Energy Inc.**	**Wisconsin Energy Corp.**
Rating as of Nov. 25, 2008	A-/Negative/A-2	BBB+/Stable/A-2	BBB/Stable/--	BBB-/Stable/NR	BBB+/Positive/A-2
(Mil. $)					
Revenues	8,002.9	3,358.9	2,849.1	1,638.6	4,016.6
Net income from cont. oper.	161.1	273.1	150.3	156.2	317.5
Funds from operations (FFO)	291.0	630.4	378.2	396.8	726.7
Capital expenditures	393.7	493.2	441.4	447.3	949.4
Debt	2,356.4	3,233.0	1,700.8	2,429.1	4,606.2
Equity	2,119.4	2,665.6	1,363.6	1,573.4	2,965.5
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	5.8	26.7	17.4	33.5	23.5
EBIT interest coverage (x)	2.8	2.7	3.0	2.7	3.1
EBITDA interest coverage (x)	3.6	4.2	4.5	3.9	4.2
Return on capital (%)	9.1	8.5	9.0	7.5	8.7
FFO/debt (%)	12.4	19.5	22.2	16.3	15.8
Debt/EBITDA (x)	5.2	3.7	3.5	4.6	4.9

*Fully adjusted (including postretirement obligations).

Table 2

Integrys Energy Group Inc. -- Financial Summary*

Industry Sector: Combo

--Fiscal year ended Dec. 31--

	2007	2006	2005	2004	2003
Rating history	A-/Stable/A-2	A/Watch Neg/A-1	A/Watch Neg/A-1	A/Stable/A-1	A/Stable/A-1
(Mil. $)					
Revenues	10,292.4	6,890.7	6,825.5	4,890.6	4,321.3
Net income from continuing operations	181.1	151.6	150.6	156.2	110.6
Funds from operations (FFO)	388.5	304.2	180.4	276.9	224.6
Capital expenditures	410.2	348.3	422.7	287.3	190.1
Cash and short-term investments	41.2	23.2	27.7	40.0	50.7
Debt	3,157.3	2,343.2	1,568.5	1,423.7	1,230.5
Preferred stock	175.6	175.6	51.1	51.1	51.1
Equity	3,411.4	1,709.2	1,237.7	1,009.0	960.2
Debt and equity	6,568.7	4,052.4	2,806.3	2,432.7	2,190.7
Adjusted ratios					
EBIT interest coverage (x)	2.6	2.7	3.6	4.2	3.3
FFO int. cov. (x)	3.0	3.3	3.4	5.6	4.6
FFO/debt (%)	12.3	13.0	11.5	19.4	18.3
Discretionary cash flow/debt (%)	(10.6)	(14.9)	(28.7)	(9.3)	(16.5)
Net Cash Flow / Capex (%)	48.9	59.3	21.7	67.0	78.8
Debt/debt and equity (%)	48.1	57.8	55.9	58.5	56.2
Return on common equity (%)	7.4	10.4	12.2	14.4	11.7
Common dividend payout ratio (un-adj.) (%)	99.4	64.6	57.9	53.1	66.8

*Fully adjusted (including postretirement obligations).

Table 3

Reconciliation Of Integrys Energy Group Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $) *

--Fiscal year ended Dec. 31, 2007--										
Integrys Energy Group Inc. reported amounts										
	Debt	**Shareholders' equity**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	2,788.5	3,286.9	562.5	562.5	367.4	164.5	238.5	238.5	180.1	392.6
Standard & Poor's adjustments										
Operating leases	36.3	--	7.0	2.0	2.0	2.0	4.9	4.9	--	17.9
Intermediate hybrids reported as debt	(150.0)	150.0	--	--	--	(9.3)	9.3	9.3	9.3	--
Intermediate hybrids reported as equity	25.6	(25.6)	--	--	--	1.6	(1.6)	(1.6)	(1.6)	--
Postretirement benefit obligations	98.2	--	12.4	12.4	12.4	--	(5.1)	(5.1)	--	--
Capitalized interest	--	--	--	--	--	0.3	(0.3)	(0.3)	--	(0.3)
Power purchase agreements	267.7	--	40.4	40.4	18.3	18.3	22.1	22.1	--	--
Asset retirement obligations	91.1	--	6.8	6.8	6.8	6.8	(3.5)	(3.5)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	64.1	--	--	--	--	--

Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	124.1	--	--
Total adjustments	368.8	124.5	66.5	61.6	103.6	19.6	25.9	150.0	7.8	17.6

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	3,157.3	3,411.4	629.0	624.1	471.0	184.1	264.4	388.5	187.9	410.2

*Integrys Energy Group Inc. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Ratings Detail (As Of 26-Nov-2008)*

North Shore Gas Co.	
Corporate Credit Rating	A-/Negative/NR
Senior Secured (1 Issue)	A
Senior Secured (1 Issue)	A/Negative
Corporate Credit Ratings History	
25-Nov-2008	A-/Negative/NR
13-Nov-2007	A-/Stable/NR
13-Feb-2006	A-/Negative/NR
11-Jan-2005	A-/Stable/NR
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Related Entities	
Integrys Energy Group Inc.	
Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated (1 Issue)	BBB
Senior Unsecured (2 Issues)	BBB+
Senior Unsecured (1 Issue)	BBB+/A-2
Peoples Energy Corp.	
Issuer Credit Rating	A-/Negative/NR
Senior Unsecured (1 Issue)	BBB+
Peoples Gas Light & Coke Co. (The)	
Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Senior Secured (4 Issues)	A-
Senior Secured (5 Issues)	A/Negative
Senior Secured (1 Issue)	AAA/Stable
Senior Unsecured (0 Issues)	AA/Negative
Wisconsin Public Service Corp.	
Issuer Credit Rating	A/Negative/A-2
Commercial Paper	
Local Currency	A-2
Preferred Stock (5 Issues)	BBB+
Senior Secured (8 Issues)	A+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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RESEARCH

Summary:

North Shore Gas Co.

Publication date: 26-Nov-2008
Primary Credit Analyst: Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

Credit Rating: A-/Negative/NR

Rationale

The ratings on North Shore Gas Co. reflect parent Integrys Energy Group Inc.'s consolidated credit profile. The ratings also reflect North Shore's excellent business profile and Integrys' intermediate financial profile. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.) As of Sept. 30, 2008, Integrys had $3.4 billion in total debt outstanding

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In most circumstances, Standard & Poor's will not rate a wholly owned subsidiary higher than the parent. Exceptions can be made on the basis of structural or regulatory insulation, which in the case of North Shore, in our view, is not present. Therefore, regardless of the excellent business profile and relatively healthy financial condition of North Shore as a stand-alone basis, Standard & Poor's views the rating on the regulated entity to be affected by Integrys' non-regulated businesses.

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Integrys' intermediate financial profile is characterized by improving although still weak cash flow protection that have not met our expectations since the company's 2007 merger with Peoples Energy Co. Specifically, we expect adjusted FFO to debt to exceed 25%, adjusted FFO interest coverage to surpass 3.5x, and for adjusted debt to total capital to be below 50%. To meet these financial measures, the company must continue to properly manage its regulatory risk and maintain sound risk-management policies and systems in order to manage all of the aforementioned risks at its non-regulated businesses.

Also affecting the financial profile is the expected negative discretionary cash flow for the near to intermediate future. This is mostly driven by the large capital expenditures, which should average about $550 million annually though 2010 and annual dividend payments of about $200 million. The company expects that its long-term dividend payout ratio will target 60%-65% of earnings.

Liquidity

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Outlook

The negative outlook highlights Integrys' marginal liquidity position, and weak financial measures. The ratings on Integrys and its subsidiaries could be lowered if its liquidity is not further enhanced so that there is a sufficient liquidity cushion to constantly meet our multiple and simultaneous stress scenarios or there is no improvement to the financial measures. The outlook could be revised to stable if sufficient liquidity is maintained on a consistent basis, the financial measures improve as expected, and there is a substantial decrease of the company's risk exposure from its non-regulated companies. A ratings upgrade is currently unlikely.

Moody's Investors Service

Global Credit Research
Rating Action
21 FEB 2007
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Rating Action: Peoples Energy Corporation

Moody's upgrades Peoples Energy Corp

Approximately $325 million of debt securities affected

New York, February 21, 2007 -- Moody's Investors Service upgraded Peoples Energy Corp.'s (Peoples) senior unsecured debt rating to A3 from Baa2 with a stable outlook. These rating actions follow the closing of Integrys Energy Group, Inc.'s (Integrys, formerly known as WPS Resources Corp.) acquisition of Peoples for an exchange of stock valued at approximately $1.6 billion plus the assumption of $1.1 billion of debt. The upgrade conforms Peoples' rating and outlook with Integrys' and is contingent upon Integrys providing a guaranty on a senior unsecured basis of Peoples' long-term debt as proposed. These rating actions end a review for possible upgrade that was begun on July 10, 2006.

"The two-notch upgrade for Peoples reflects its new ownership and support by a solid utility parent company," says Moody's Vice President Mihoko Manabe. "Over the course of this year, we expect Peoples' business risk to improve with the announced sale of its E&P business."

It remains to be seen how much Integrys will raise with the E&P sale, and how it will apply the proceeds, though its ratings assume a substantial portion will be used to pay down debt at some level within the combined organization. Risks related to E&P were a catalyst for Peoples' two-notch downgrade last year, so that its sale would be a credit-positive. On the other hand, the divestiture will focus the ratings more on the challenges facing Peoples' core LDC business.

Peoples Energy Corp., the parent company, has only one long-term debt issue outstanding: $325 million of 6.9% notes due in 2011. The company is in midst of soliciting those noteholders for the consent to amend the indenture so as to allow Integrys to issue a guaranty of those notes. Moody's upgrade is based on Peoples obtaining the requisite consents and the guaranty being issued as proposed over the next month.

Not affected by today's rating actions are those ratings that were affirmed last July when the Integrys merger was first announced. Those ratings include the long-term ratings of Peoples' utility subsidiaries Peoples Gas Light and Coke Co. (PGLC) and North Shore Gas Co. (both A1 senior secured) and the commercial paper ratings for Peoples (Prime-2) and PGLC (Prime-1). PGLC and North Shore's outlooks remain stable.

PGLC and North Shore are expected to be weak for their rating category for the near term while they undergo their first rate case in eleven years. A rate filing is planned soon after the merger close, and their ratings anticipate some rate relief beginning sometime in 2008. The use of a significant portion of the E&P sale proceeds to reducing Peoples' debt would be supportive of the ratings.

Upgrades:

..Issuer: Peoples Energy Corporation

....Senior Unsecured Regular Bond/Debenture, Upgraded to A3 from Baa2

Outlook Actions:

..Issuer: Peoples Energy Corporation

....Outlook, Changed To Stable From Rating Under Review

Headquartered in Chicago, Illinois, Peoples Energy Corporation is a subsidiary of Integrys Energy Group, Inc.

New York
William L. Hess
Managing Director

Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

New York
Mihoko Manabe
VP - Senior Credit Officer
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Moody's Investors Service

Global Credit Research
Liquidity Risk Assessment
22 FEB 2007

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NS WPD-8(1)
Page 13 of 24

Liquidity Risk Assessment: Peoples Energy Corporation

Peoples Energy Corporation

Chicago, Illinois, United States

Broad Industry:	Public Utility
Specific Industry:	Gas Distribution
Short Term Rating:	P-2

Contacts

Analyst	**Phone**
Mihoko Manabe/New York	1.212.553.1653
Edward Tan/New York	
John Diaz/New York	

Opinion

Peoples Energy Corp. (Peoples, Prime-2) is an intermediate holding company whose core holdings are regulated gas utilities Peoples Gas Light and Coke Company (PGLC, Prime-1) and North Shore Gas Company. In 2/07, Peoples was acquired by Integrys Energy Group, Inc. (Integrys, formerly known as WPS Resources Corp.).

Moody's believes Peoples has adequate liquidity resources to meet foreseeable cash needs for the next four quarters, based on the company's existing credit facilities and PGLC and North Shore's stable, though seasonal cash flows.

It remains to be seen how cash management practices for the Peoples' entities will evolve under Integrys's ownership. Peoples' liquidity needs will lessen with the announced sale of Peoples' E&P business and the transfer of Peoples' energy marketing business to another Integrys subsidiary. The Peoples parent-level liquidity resources have been used as credit support for E&P's production hedge counterparties and for marketing's seasonal borrowings.

Peoples' liquidity profile continues to be dominated by the seasonal working capital requirements of PGLC and North Shore. Seasonal borrowings typically peak in the December quarter, self-liquidates through the spring, and bottoms out in the June quarter. Working capital, mostly related to customer receivables and inventory, swings to a net usage position in the September and December quarters and swings back to net sources position in the March and June quarters.

Calendar year ending 12/31/07 will be a transitional year for Peoples. The amount of proceeds and the timing of the E&P sale will affect its liquidity needs. Excluding the impact of an E&P sale, consolidated cash flow from operations has generally been in the $200 million range, depending on working capital changes. With budgeted capital expenditures of $250 million in 2007, Peoples could have a free cash flow deficit. PGLC and North Shore combined have cash flow from operations generally in the upper $100 million range and account for half the 2007 capex budget.

Peoples has a $400 million CP program backstopped by a $400 million syndicated facility due on 6/13/11 unless it is extended. PGLC has a $250 million CP program backstopped by a $250 million syndicated facility due on 7/12/10. North Shore can access up to $50 million of Peoples' facility as well as $50 million of PGLC's. Borrowings even at the seasonal peak are expected to remain comfortably within the CP program size.

In the last 12 months, Peoples' peak CP outstanding was about $300 million; PGLC's was $170 million. Moody's notes that Peoples' CP outstanding stayed unusually high during this period because of not only the borrowings related to a $139 million E&P acquisition and a $107 million gas cost settlement, but also the pending Integrys merger that kept Peoples from terming out its short-term debt as it might have otherwise.

None of the credit facilities has a general material adverse change clause, which Moody's views favorably. A limit on debt-to-capitalization of 65% is the sole financial covenant in each of Peoples' and PGLC's credit agreements.

Both Peoples and PGLC's leverage is sufficiently under this calculation.

Refinancing risk is not significant, since long-term debt maturities are well staggered. PGLC has $50 million of bonds maturing in 2008 and another $50 million in 2010. Peoples has $325 million of debt maturing in 2011, and North Shore has $40 million maturing in 2013.

After the sale of E&P and transfer of marketing, Peoples will be left with only its gas utility assets, so that asset sales will no longer be a viable alternative for raising cash at the Peoples level. Instead, additional liquidity could come from Integrys, which has a $1.1 billion CP program (Prime-2) at the parent level.

Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Peoples Energy Corporation

Peoples Energy Corporation

Chicago, Illinois, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	A3
Commercial Paper	P-2
Parent: Integrys Energy Group, Inc.	
Outlook	Stable
Sr Unsec Bank Credit Facility	A3
Senior Unsecured	A3
Jr Subordinate	Baa1
Commercial Paper	P-2
Peoples Gas Light and Coke Company	
Outlook	Stable
First Mortgage Bonds	A1
Senior Secured MTN	A1
Commercial Paper	P-1
North Shore Gas Company	
Outlook	Stable
First Mortgage Bonds	A1
Senior Secured MTN	A1

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Key Indicators

Peoples Energy Corporation

	2006	2005	2004	2003
ROE (NPATBUI / Avg. Equity)	3.9%	6.5%	8.4%	10.2%
EBIT / Interest Expense	1.8x	2.9x	3.1x	3.6x
RCF / Debt	3.1%	13.8%	12.8%	18.1%
Debt / Book Capitalization (Excluding Goodwill)	50.5%	40.2%	41.1%	46.8%

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Peoples Energy Corporation (Peoples) is an intermediate holding company for Peoples Gas Light and Coke Co. (PGLC) and North Shore Gas Co. (both A1 senior secured), two regulated local gas distribution utility companies (LDC) serving the Chicago area.

Recent Developments

In 2/07, Integrys Energy Group, Inc. (Integrys, formerly known as WPS Resources Corporation) acquired Peoples for an exchange of stock valued at approximately $1.6 billion plus the assumption of $1.1 billion of debt. Following the closing of the transaction, Moody's upgraded to A3 from Baa2 Peoples' senior unsecured rating, conforming it with those of Integrys, contingent upon Integrys providing a guaranty of Peoples' long-term debt on a senior unsecured basis as proposed.

Rating Rationale

Peoples' credit profile will be in transition following its merger with Integrys. Over the course of this year, we expect Peoples' business risk to improve with the announced sale of its E&P business (about 20% of 2006 operating income, normalized for non-recurring gas settlement expenses) as well as the pending transfer of its energy marketing business (roughly 10% of operating income) to Integrys' marketing subsidiary. After these transactions, Peoples will be left only with its two regulated LDC subsidiaries (about 70% of normalized operating income).

Without Integrys' guaranty, Peoples' standalone credit profile remains of Baa-quality according to Moody's rating methodology for LDCs. This reflects at best a weak A-quality for Peoples' combined LDC operations, burdened further at the parent level with $325 million of long-term debt (post-merger, guaranteed by Integrys) plus seasonal working capital borrowings under its $400 million CP program (post-merger, excluding those of the marketing business).

It remains to be seen how much Integrys will raise with the E&P sale, and how it will apply the proceeds. Risks related to E&P were a catalyst for Peoples' two-notch downgrade last year, so that its sale would be a credit-positive. On the other hand, the divestiture will focus the ratings more on the challenges facing Peoples' core LDC business.

Factor 1: Sustainable Profitability

PGLC dominates the Peoples' LDC business, accounting for roughly 80% of earnings and assets. North Shore has better metrics but is too small to offset PGLC's weaknesses. PGLC's earnings have been eroding from rising costs and flat margins, indicating a need for rate relief. PGLC serves a large, diverse market in urban Chicago. However, the market lacks customer growth, while volumes have been declining due to perennially warm weather, more energy-efficient appliances and homes, and recently, customer conservation. Cost containment is more of a challenge for PGLC than for some of its peers, because of its older infrastructure that requires more maintenance and a component of low-income customers that exposes it to bad debt expense.

Factor 2: Regulatory Support

PGLC and North Shore have not had a rate increase in eleven years. Integrys expects to file a rate case for PGLC and North Shore soon after the merger closes. Given the eleven-month statutory review period in Illinois, PGLC and North Shore will not get rate relief until sometime in 2008 at the earliest.

As evidenced by the adverse outcome on Peoples' 2006 gas cost case that resulted in the payout of roughly $70 million after-tax, Peoples operates in a challenging regulatory environment which has been exacerbated by high energy costs.

Given the challenges facing utilities in Illinois, Moody's believes that there is substantial risk that Peoples would not be granted a rate increase that would sufficiently cure its regulatory lag. There is risk, too, that the order will not introduce progressive rate design elements that would address the negative effects the company has been experiencing from warmer-than-normal weather, bad debt expense, and falling per-customer usage.

There is no precedent of the Illinois Commerce Commission granting such mechanisms, and Illinois has lagged other states in adopting rate design mechanisms that reduce earnings and cash flow volatility.

Factor 3: Financial Strength -

The sale of E&P will reduce Peoples' cash flow, though it will also reduce the capital requirements related to it. Without rate relief, the weakness in the LDCs' earnings is likely to persist from continuing cost pressures and flat margin growth.

Pro forma for the E&P sale and the transfer of energy marketing, Peoples' financial performance will be dominated by PGLCs'. Consolidated credit metrics will be weaker than PGLCs' because of the parent-level debt and will overall map to Baa ratings: EBIT/interest in the 2x range and debt/capital (excluding goodwill) estimated to reach a seasonal peak of around 60%. It remains to be seen what dividend policy Integrys will implement for Peoples.

Rating Outlook

Stable. PGLC and North Shore are expected to be weak for their rating category for the near term. Their ratings anticipate some rate relief that keeps their EBIT/interest ratios at least in the 3x range. The use of a significant portion of the E&P sale proceeds to reducing Peoples' debt would be supportive of the ratings. The ratings reflect ownership by Integrys, a solid utility parent company.

What Could Change the Rating - Up

PGLC and North Shore could be upgraded by an increase in rates that sustains their EBIT/interest ratios in the 6-7x range, combined with a rate design that effectively immunizes their financial performance from the effects of weather, bad debt expense, declining per-customer usage, and conservation.

What Could Change the Rating - Down

The ratings could face downward pressure if Peoples suffers a worse-than-expected outcome in its rate case that results in its LDCs' EBIT/interest ratios falling below 3x.

RESEARCH

Peoples Energy Corp.

Publication date: 26-Nov-2008
Primary Credit Analyst: Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

Major Rating Factors

Corporate Credit Rating
A-/Negative/NR

Strengths:

- Lower-risk regulated gas distribution business;
- Stable regulatory customer base; and
- Sound management of regulatory risk.

Weaknesses:

- Volatility of Integrys' non-regulated energy marketing business; and
- Weak consolidated cash flow measures.

Rationale

The ratings on Peoples Energy Corp. reflect parent Integrys Energy Group Inc's consolidated credit profile. The ratings also reflect Peoples Energy's excellent business profile and Integrys' intermediate financial profile. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.). As of Sept. 30, 2008, Integrys had $3.4 billion in total debt outstanding

Peoples Energy is the holding company for Peoples Gas Light & Coke Co. and North Shore Gas Co. In 2007, Peoples Energy accounted for approximately 20% of Integrys' consolidated funds from operations (FFO) and is a regulated entity that sells, stores, and distributes natural gas to about one million customers in Chicago, and Lake and Cook Counties, Ill.

In most circumstances, Standard & Poor's will not rate a wholly owned subsidiary higher than the parent. Exceptions can be made on the basis of structural or regulatory insulation, which in the case of Peoples Energy, in our view, is not present. Therefore, regardless of the excellent business profile and relatively healthy financial condition of Peoples Energy as a stand-alone basis, Standard & Poor's views the rating on the regulated entity to be affected by Integrys' non-regulated businesses.

Integrys is a diversified energy company with regulated electric and gas utilities and non-regulated retail and wholesale energy and gas marketing operations. The integrated regulated electric businesses have generating capacity of about 2,200 megawatts, of which approximately 74% is coal. The regulated electric businesses also purchase, transmit, distribute, and sell electricity to about 485,000 customers in Wisconsin and Michigan's Upper Peninsula. Recently, the company completed Weston 4, a 500 MW supercritical pulverized coal plant, of which Integrys owns 70%. Integrys also owns about 34% of FERC-regulated American Transmission Company, which is an electric transmission company primarily located in Wisconsin and Michigan's Upper Peninsula. The regulated gas businesses purchase, sell, and distribute natural gas to more than 1.6 million customers in Illinois, Michigan, Minnesota, and Wisconsin. The non-regulated business, serve about 140,000 customers throughout the U.S. and Canada. The non-regulated businesses expose the consolidated entity to speculative trading, counterparty credit risk, market risk, customer demand risk, liquidity risk, and weather risk. Approximately 80% of FFO is generated by the regulated businesses.

Peoples Energy's excellent business profile reflects the company's regulated utility gas operations. In February 2008, the Illinois Commerce Commission approved a net gas revenue increase of about $71 million and allowed for decoupling, which we view as credit supportive. Peoples Energy's subsidiaries are currently under-earning on their allowed return primarily because of the regulatory lag. (The last rate cases filed used a 2006 test year.) In future rate cases, the company expects to use a forecasted test year which should improve its actual return compared to its allowed return. Peoples Energy's subsidiaries may also recover commodity costs through the purchased gas adjustment, however, the prudence of the gas costs recovered is subject to audit, which has previously resulted in multi-million dollar settlements.

Integrys' intermediate financial profile is characterized by improving although still weak cash flow protection that have not met our expectations since the company's 2007 merger with Peoples Energy Co. Specifically, we expect adjusted FFO to debt to exceed 25%, adjusted FFO interest coverage to surpass 3.5x, and for adjusted debt to total capital to be below 50%. To meet these financial measures, the company must continue to properly manage its regulatory risk and maintain sound risk-management policies and systems in order to manage all of the aforementioned risks at its non-regulated businesses.

Also affecting the financial profile is the expected negative discretionary cash flow for the near to intermediate future. This is mostly driven by the large capital expenditures, which should average about $550 million annually though 2010 and annual dividend payments of about $200 million. The company expects that its long-term dividend payout ratio will target 60%-65% of earnings.

Liquidity

Peoples Energy has adequate cash flow and sufficient alternative sources to cover current liquidity needs, including ongoing capital requirements, and upcoming debt maturities. Peoples Energy was cash flow positive for the nine months ended Sept. 30, 2008. In addition to cash generated by operating activities, the company has a $400 million revolving credit facility of which about $150 million is currently available. Peoples Energy lone maturity is a $325 million maturity due in 2011.

On a monthly basis, Standard and Poor's assess Integrys' liquidity adequacy based on stress case scenarios, which analyze the company's collateral exposure resulting from a hypothetical downgrade to speculative grade and a commodity price stress scenario (15% in the first year and 20% thereafter). Recently, we identified that the company had adequate liquidity for a hypothetical downgrade to speculative grade but did not have sufficient liquidity for a simultaneous commodity price stress. Although the company subsequently boosted its liquidity by $400 million, we expect that a company rated in the 'A' category should sufficiently manage its liquidity so that it is constantly able to meet our concurrent stress scenarios.

Outlook

The negative outlook highlights Integrys' marginal liquidity position, and weak financial measures. The ratings on Integrys and its subsidiaries could be lowered if its liquidity is not further enhanced so that there is a sufficient liquidity cushion to constantly meet our multiple and simultaneous stress scenarios or there is no improvement to the financial measures. The outlook could be revised to stable if sufficient liquidity is maintained on a consistent basis, the financial measures improve as expected, and there is a substantial decrease of the company's risk exposure from its non-regulated companies. A ratings upgrade is currently unlikely.

Table 1

Integrys Energy Group Inc. -- Peer Comparison*

Industry Sector: Combo

	--Average of past three fiscal years--				
	Integrys Energy Group Inc.	**Alliant Energy Corp.**	**Great Plains Energy Inc.**	**Westar Energy Inc.**	**Wisconsin Energy Corp.**
Rating as of Nov. 25, 2008	A-/Negative/A-2	BBB+/Stable/A-2	BBB/Stable/--	BBB-/Stable/NR	BBB+/Positive/A-2
(Mil. $)					
Revenues	8,002.9	3,358.9	2,849.1	1,638.6	4,016.6
Net income from cont. oper.	161.1	273.1	150.3	156.2	317.5
Funds from operations (FFO)	291.0	630.4	378.2	396.8	726.7
Capital expenditures	393.7	493.2	441.4	447.3	949.4
Debt	2,356.4	3,233.0	1,700.8	2,429.1	4,606.2
Equity	2,119.4	2,665.6	1,363.6	1,573.4	2,965.5
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	5.8	26.7	17.4	33.5	23.5
EBIT interest coverage (x)	2.8	2.7	3.0	2.7	3.1
EBITDA interest coverage (x)	3.6	4.2	4.5	3.9	4.2
Return on capital (%)	9.1	8.5	9.0	7.5	8.7
FFO/debt (%)	12.4	19.5	22.2	16.3	15.8
Debt/EBITDA (x)	5.2	3.7	3.5	4.6	4.9

*Fully adjusted (including postretirement obligations).

Table 2

Integrys Energy Group Inc. -- Financial Summary*

Industry Sector: Combo

--Fiscal year ended Dec. 31--

	2007	2006	2005	2004	2003
Rating history	A-/Stable/A-2	A/Watch Neg/A-1	A/Watch Neg/A-1	A/Stable/A-1	A/Stable/A-1
(Mil. $)					
Revenues	10,292.4	6,890.7	6,825.5	4,890.6	4,321.3
Net income from continuing operations	181.1	151.6	150.6	156.2	110.6
Funds from operations (FFO)	388.5	304.2	180.4	276.9	224.6
Capital expenditures	410.2	348.3	422.7	287.3	190.1
Cash and short-term investments	41.2	23.2	27.7	40.0	50.7
Debt	3,157.3	2,343.2	1,568.5	1,423.7	1,230.5
Preferred stock	175.6	175.6	51.1	51.1	51.1
Equity	3,411.4	1,709.2	1,237.7	1,009.0	960.2
Debt and equity	6,568.7	4,052.4	2,806.3	2,432.7	2,190.7
Adjusted ratios					
EBIT interest coverage (x)	2.6	2.7	3.6	4.2	3.3
FFO int. cov. (x)	3.0	3.3	3.4	5.6	4.6
FFO/debt (%)	12.3	13.0	11.5	19.4	18.3
Discretionary cash flow/debt (%)	(10.6)	(14.9)	(28.7)	(9.3)	(16.5)
Net Cash Flow / Capex (%)	48.9	59.3	21.7	67.0	78.8
Debt/debt and equity (%)	48.1	57.8	55.9	58.5	56.2
Return on common equity (%)	7.4	10.4	12.2	14.4	11.7
Common dividend payout ratio (un-adj.) (%)	99.4	64.6	57.9	53.1	66.8

*Fully adjusted (including postretirement obligations).

Table 3

Reconciliation Of Integrys Energy Group Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $) *

	--Fiscal year ended Dec. 31, 2007--									
Integrys Energy Group Inc. reported amounts										
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	2,788.5	3,286.9	562.5	562.5	367.4	164.5	238.5	238.5	180.1	392.6
Standard & Poor's adjustments										
Operating leases	36.3	--	7.0	2.0	2.0	2.0	4.9	4.9	--	17.9
Intermediate hybrids reported as debt	(150.0)	150.0	--	--	--	(9.3)	9.3	9.3	9.3	--
Intermediate hybrids reported as equity	25.6	(25.6)	--	--	--	1.6	(1.6)	(1.6)	(1.6)	--
Postretirement benefit obligations	98.2	--	12.4	12.4	12.4	--	(5.1)	(5.1)	--	--
Capitalized interest	--	--	--	--	--	0.3	(0.3)	(0.3)	--	(0.3)
Power purchase agreements	267.7	--	40.4	40.4	18.3	18.3	22.1	22.1	--	--
Asset retirement obligations	91.1	--	6.8	6.8	6.8	6.8	(3.5)	(3.5)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	64.1	--	--	--	--	--

Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	124.1	--	--
Total adjustments	368.8	124.5	66.5	61.6	103.6	19.6	25.9	150.0	7.8	17.6

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	3,157.3	3,411.4	629.0	624.1	471.0	184.1	264.4	388.5	187.9	410.2

*Integrys Energy Group Inc. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Ratings Detail (As Of 26-Nov-2008)*

Peoples Energy Corp.	
Corporate Credit Rating	A-/Negative/NR
Senior Unsecured (1 Issue)	BBB+
Corporate Credit Ratings History	
25-Nov-2008	A-/Negative/NR
07-Dec-2007	A-/Stable/NR
13-Nov-2007	A-/Stable/A-2
13-Feb-2006	A-/Negative/A-2
Business Risk Profile	Excellent
Financial Risk Profile	Intermediate
Related Entities	
Integrys Energy Group Inc.	
Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated (1 Issue)	BBB
Senior Unsecured (2 Issues)	BBB+
Senior Unsecured (1 Issue)	BBB+/A-2
North Shore Gas Co.	
Issuer Credit Rating	A-/Negative/NR
Senior Secured (1 Issue)	A
Senior Secured (1 Issue)	A/Negative
Peoples Gas Light & Coke Co. (The)	
Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Senior Secured (4 Issues)	A-
Senior Secured (5 Issues)	A/Negative
Senior Secured (1 Issue)	AAA/Stable
Senior Unsecured (0 Issues)	AA/Negative
Wisconsin Public Service Corp.	
Issuer Credit Rating	A/Negative/A-2
Commercial Paper	
Local Currency	A-2
Preferred Stock (5 Issues)	BBB+
Senior Secured (8 Issues)	A+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements

RESEARCH

Summary:

Peoples Energy Corp.

Publication date: 23-May-2008
Primary Credit Analyst: Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

Credit Rating: A-/Stable/NR

Rationale

The ratings on Peoples Energy Corp. reflect the consolidated credit quality of the Integrys Energy Group Inc. companies. Peoples and Integrys merged in February 2007. Integrys is a diversified energy company with regulated electric and gas utilities in Wisconsin, Minnesota, Michigan, and Illinois, and unregulated energy and gas marketing operations throughout the U.S. and Canada. The ratings also reflect Peoples' excellent business profile and Integrys' intermediate financial profile. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.) Integrys has about $2.4 billion of total debt.

Peoples is expected to account for about 25% of consolidated cash flows and is the holding company for The Peoples Gas Light & Coke Co. and North Shore Gas Co. These regulated entities purchase, sell, and distribute natural gas to about 1 million customers in Chicago and northeastern Illinois. Overall, the customer base is expected remain steady with only minimal increases for the near to intermediate future.

In most circumstances, Standard & Poor's will not rate a wholly owned subsidiary higher than the parent. Exceptions can be made based on structural or regulatory insulation, which we believe is lacking in Peoples' case. Therefore, regardless of the excellent business profile and relatively healthy financial condition of Peoples as a stand-alone basis, Standard & Poor's deems that Integrys' nonregulated business affects the rating on the regulated entity.

Chicago-based Integrys, through its regulated subsidiaries, generates and distributes electricity to about 485,000 customers in northern Wisconsin and Michigan's Upper Peninsula. It also delivers gas to about 1.7 million customers in Chicago, northeastern Illinois, northeastern Wisconsin, various communities throughout Minnesota, and portions of lower Michigan and its Upper Peninsula. Integrys has a 34.5% investment in regulated American Transmission Co. that operates in Wisconsin, Michigan, Minnesota, and Illinois. Through its unregulated subsidiary, Integrys Energy Services Inc. (ESI), Integrys engages in the marketing of gas and electricity to wholesale and retail customers. ESI is expected to account for about 25%-30% of consolidated operating earnings. ESI's activities expose the consolidated entity to counterparty credit, market, customer demand, and weather-related risks. To manage these risks, ESI must employ sound risk-management policies and systems.

The excellent business profile reflects Peoples' lower-risk operations, steady customer base, and improving regulation risk. The customer base is largely a residential customer base, which limits its susceptibility to economic downturns and mitigates its vulnerability to threats from other energy providers. In February 2008, Peoples Gas Light & Coke Co. and North Shore Gas Co. had a net gas rate increase of about $71 million. Both authorizations contained decoupling mechanisms, which Standard & Poor's views as favorable for credit quality. These mechanisms should mitigate the decreasing trend in throughput due to conservation and global warming. In addition, the companies have a purchased gas-adjustment clause, which is subject to prudence reviews.

Integrys' intermediate financial profile reflects its decreased leverage ratio following its merger with Peoples and the subsequent sale of its Production Co. For the 12 months ended Dec. 31, 2007, adjusted debt to total capital dropped to 48.1% from 57.8% at the end of 2006. Consolidated cash flow protection is on the weaker side for the rated level, but should improve as synergies and rate case increases take hold. For the 12 months ended Dec. 31, 2007, after adjustments, consolidated funds from operations (FFO) interest coverage was 3x, down from the 3.3x at the end of 2006 and FFO to total debt was at 12.3%, lower than 13% at the end of 2006.

Free and discretionary cash flows are expected to remain negative. The company has an extensive capital program that is projected to approximate $600 million for 2008 and 2009. Wisconsin Public Service Corp.'s Weston 4, a 500-megawatt supercritical pulverized coal plant, is expected to become commercially operational in June 2008. Dividends are estimated to approximate $200 million, which may exceed the company's long-term payout target of 60% to 65%.

Liquidity

The short-term rating on Integrys is 'A-2' and reflects the consolidated short-term credit profile of Integrys' companies. Integrys' short-term credit profile reflects adequate cash flow and sufficient alternative sources to cover current liquidity needs, including ongoing capital requirements, dividend payments, margin calls, and upcoming debt maturities.

As of March 31, 2008, Integrys had cash and cash equivalents of $97.8 million. In addition, Integrys' revolving credit facilities approximated $2 billion of which $1.6 billion was available after reducing for outstanding commercial paper, letters of credit, and loans. Upcoming debt maturities for the consolidated entity include $155.6 million, $119.2 million, and $476.7 million in 2009, 2010, and 2011, respectively. Of this amount, Peoples has a $50 million maturity in 2010 and a $325 million maturity in 2011.

Outlook

The outlook on Peoples is stable. The ratings could be pressured if Integrys' consolidated financial risk profile does not improve and does not support the credit metrics appropriate for the rating. The ratings or outlook could also decline if ESI's risk tolerance increases. An outlook revision to positive is currently unlikely and would be predicated on a considerable improvement of the financial measures, including the company's ability to generate positive free and discretionary cash flows.