Wisconsin Electric Power Co.

Subsidiary of WEC Energy Group, Inc.

Full Rating Report

Ratings

Long-Term IDR	A
Senior Unsecured	A+
Preferred Stock	A–
Short-Term IDR and CP	F1

IDR – Issuer Default Rating.
CP – Commercial paper.

Rating Outlook

Stable

Financial Summary

Wisconsin Electric Power Co.

($ Mil.)	LTM 3/31/15	2014
Adjusted Revenue	3,933	4,077
Operating EBITDAR	934	947
Cash Flow from Operations	724	863
Total Adjusted Debt	3,224	3,222
Total Capitalization	6,717	6,650
Capex/ Depreciation (%)	1.9	1.9
FFO Fixed-Charge Coverage (x)	6.6	8.0
FFO-Adjusted Leverage (x)	4.1	3.3
Total Adjusted Debt/EBITDAR (x)	3.5	3.4

Related Research

Wisconsin Electric Power Co. - Ratings Navigator (February 2015)

2015 Outlook: U.S. Utilities, Power and Gas (Slow and Steady) (December 2014)

Analysts

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Key Rating Drivers

Balanced Rate Order: The rate decision in Wisconsin Electric Power Co.'s (WEPCO) most recent rate case was in line with Fitch Ratings' expectations, and provides earnings and cash flow predictability through 2016, at levels consistent with the utility's current financial profile. WEPCO received a net nonfuel electric base rate increase of approximately $2.7 million in 2015. The order was based on a 10.2% return on equity (ROE) and a 51% common equity ratio. The 10.2% ROE is above the average authorized ROE granted to utilities in 2014.

Integrys Acquisition: The completion of the acquisition of Integrys Energy Group (Integrys) and subsidiaries has no impact on WEPCO's credit profile, in Fitch's view. All acquisition funding was executed at WEPCO's parent holding company, WEC Energy Group, Inc. (WEC), with no effect on the utility's capital structure. The utility also benefits from ring-fencing measures that limit the amount of dividends that can be upstreamed to WEC and require maintaining a regulatory capital structure within a specified range.

Modestly Declining Credit Metrics: Fitch forecasts credit metrics to modestly decline over the next two years, as the utility completes the bulk of its capital investments. Fitch models WEPCO's debt/EBITDAR to range between 3.5x and 3.8x over 2015–2018, while funds FFO-adjusted leverage is expected to remain slightly below 4.0x. Debt/EBITDAR and FFO-adjusted leverage stood at 3.4x and 4.0x, respectively, for the LTM ended March 31, 2015.

Elevated Capex: Management plans to spend approximately $1.5 billion on utility capex over 2015–2017, earmarked primarily toward the upgrade of WEPCO's electric and gas base infrastructure. Projects are smaller in scope vis-à-vis the large renewable generation and environmental-related spending of prior years. Fitch expects WEPCO to continue receiving timely and adequate recovery of capital investments through rate proceedings and has assumed utility capex will be funded in a manner consistent with the authorized regulatory capital structure.

Low-Risk Business Model: WEPCO's ratings reflect the low-risk business profile of the regulated utility businesses that operate in what Fitch considers to be constructive regulatory compacts across the regulatory jurisdictions of Wisconsin and Michigan. Wisconsin is the largest contributor to WEPCO's revenues, with approximately 87% of total revenue in 2014. Wisconsin rate design features timely recovery of fuel and commodity costs, and a gas cost recovery mechanism that stabilizes earnings and cash flows.

Stable Outlook: The Stable Outlook assumes WEPCO will continue to benefit from favorable regulatory mechanisms, including annual adjustments for fuel and commodity costs, the use of forward-looking test years and above-average authorized ROEs.

Rating Sensitivities

Positive Rating Action: Given current rating levels and a sustained elevated capex program over the forecast period, positive rating actions are unlikely in the near term.

Negative Rating Action: Although not anticipated by Fitch, a deterioration of the regulatory compact could lead to negative rating actions. Debt/EBITDAR over 4.0x on a sustained basis could also have a negative effect on ratings.

Financial Overview

Liquidity and Debt Structure

WEPCO has adequate liquidity to meet working capital and other short-term obligations. The utility has access to a total capacity of $500 million under a bank credit facility that expires in December 2019. There was $510.2 million of unused funds, including $15.3 million of cash and cash equivalents, at March 31, 2015. There was also $316.5 million of commercial paper borrowings outstanding, which is supported by the credit facility. The bank agreement includes a financial covenant that total debt to capitalization should be no greater than 65%. WEPCO was in compliance at March 31, 2015.

Long-term debt maturities are considered manageable, with $250 million due in each of 2015 and 2018. WEPCO enjoys good access to debt capital markets and issued $250 million of 10-year senior unsecured debentures with a 3.10% coupon rate (85 bps over Treasury rate) in May 2015.

WEPCO has an atypical debt structure due to the accounting treatment as an on-balance sheet item of the Power the Future (PTF) lease obligation that is related to WEPCO's lease arrangement with its unregulated affiliate We Power, LLC (We Power). Under the lease arrangement, WEPCO leases the generating capacity of the Oak Creek expansion units and Port Washington plants from We Power. Fitch treats a percentage of the present value of the lease obligation as a debt equivalent in calculating WEPCO leverage measures, taking into consideration the high level of assured recovery associated with lease payments to We Power. Under the terms of the 2001 Wisconsin Generation Law, WEPCO can recover lease payments and operating and maintenance costs through retail rates.

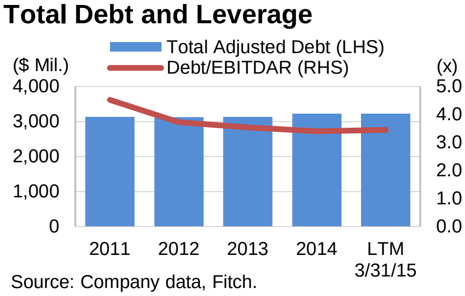
Debt Maturities and Liquidity

($ Mil., As of March 31, 2015)

2015	250
2016	—
2017	—
2018	250
Thereafter	1,937
Cash and Cash Equivalents	15
Undrawn Committed Facilities	495

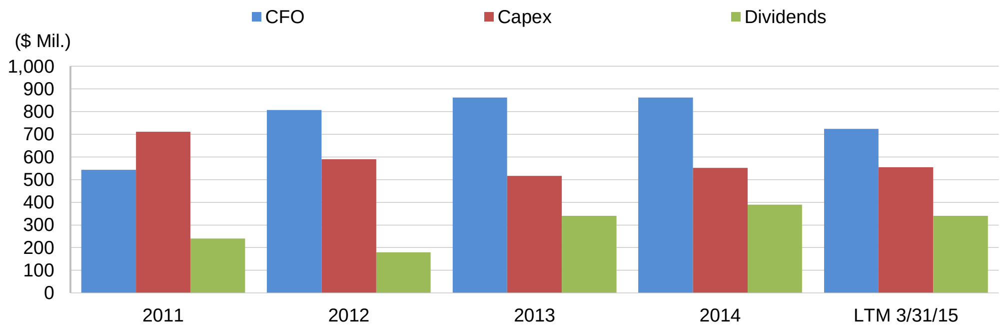
Source: Company data, Fitch.

Total Debt and Leverage



Source: Company data, Fitch.

CFO and Cash Use



Source: Company data, Fitch.

Related Criteria

Recovery Ratings and Notching Criteria for Utilities (March 2015)

Corporate Rating Methodology — Including Short-Term Ratings and Parent and Subsidiary Linkage (May 2014)

Rating U.S. Utilities, Power and Gas Companies (Sector Credit Factors) (March 2014)

Parent and Subsidiary Rating Linkage Fitch's Approach to Rating Entities within a Corporate Group Structure (August 2013)

Cash Flow Analysis

Fitch expects WEPCO's internally generated cash flows to fund, on average, 65% of capex requirements over the forecast period, with the remainder funded via long-term debt issuances to align with the authorized regulatory capital structure. The expiration of bonus depreciation, one-time customer refunds of $26.6 million and the termination of System Support Resource (SSR) payments from Midcontinent Independent System Operator (MISO) cause operating cash flows to moderately weaken in year one of new base rates. Cash flows will rebound in 2016 and beyond as bill credits expire, major construction projects come online and WEPCO benefits from incremental rate relief.

Peer and Sector Analysis

Peer Group

Issuer	Country
A	
Oklahoma Gas & Electric Co.	U.S.
A–	
Northern States Power Co. — Wisconsin	U.S.
Northern States Power Co. — Minnesota	U.S.

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
Oct. 1, 2014	A	Stable
Aug. 12, 2014	A	Stable
April 7, 2014	A	Stable
June 14, 2013	A	Stable
June 11, 2013	A	Stable
June 20, 2012	A	Stable
June 23, 2011	A	Stable
June 21, 2010	A	Stable
June 8, 2009	A	Negative
April 30, 2008	A	Stable
June 15, 2006	A	Stable
Dec. 6, 2005	A	Stable
Oct. 15, 2003	A+	Stable
July 18, 2002	AA–	Stable
April 26, 2000	AA–	Stable
Dec. 5, 1995	AA	Stable

LT IDR – Long-term Issuer Default Rating.
Source: Fitch.

Peer Group Analysis

($ Mil.)	Wisconsin Electric Power Co.	Northern States Power Co. — Minnesota	Northern States Power Co. — Wisconsin	Oklahoma Gas & Electric Co.
As of	3/31/15	3/31/15	3/31/15	3/31/15
IDR	A	A–	A–	A
Outlook	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable
Fundamental Ratios (x)				
Operating EBITDAR/ (Gross Interest Expense + Rents)	7.92	4.96	7.03	5.36
FFO Fixed-Charge Coverage	6.64	6.62	6.87	5.73
Total Adjusted Debt/Operating EBITDAR	3.45	4.13	3.02	3.32
FFO/Total Adjusted Debt (%)	24.5	32.3	32.4	32.2
FFO-Adjusted Leverage	4.08	3.10	3.09	3.10
Common Dividend Payout (%)	91.6	91.4	73.9	41.7
Internal Cash/Capex (%)	69.0	86.1	33.9	115.4
Capex/Depreciation (%)	185.0	290.5	375.6	179.7
Return on Equity (%)	10.7	6.5	10.2	9.9
Financial Information				
Revenue	3,933	4,856	989	2,373
Revenue Growth (%)	(3.5)	(1.1)	2.3	0.3
EBITDA	934	1,045	217	814
Operating EBITDA Margin (%)	25.9	13.1	24.2	27.3
FCF	(172)	(195)	(206)	78
Total Adjusted Debt with Equity Credit	3,224	4,348	658	2,719
Cash and Cash Equivalents	15	91	1	—
Funds Flow from Operations	671	1,192	182	723
Capex	(555)	(1,249)	(308)	(505)

IDR – Issuer Default Rating.
Source: Company data, Fitch.

Key Rating Issues

Merger-Related Concessions

Fitch does not expect the concessions resulting from the Public Service Commission of Wisconsin's (PSCW) approval of the Integrys merger to have a material impact on WEPCO's credit profile. The PSCW required a three-year earnings cap and sharing mechanism, effective in 2016, under which 50% of the first 50 bps of earnings above the 10.2% authorized ROE would be shared with ratepayers and used to reduce the company's transmission escrow. All additional earnings above the first 50 bps will be used to pay down the transmission escrow.

The merger terms that resulted from the Michigan Public Service Commission's approval of the transaction are manageable within WEPCO's existing financial profile, in Fitch's opinion. The key provisions include WEPCO retaining ownership of the Presque Isle Power Plant (Presque Isle) and its electric distribution assets in the Upper Peninsula region, and the utility either investing in and/or purchasing power from a new power plant if requested, which would lead to the retirement of Presque Isle. Furthermore, the SSR payments associated with running Presque Isle were terminated as a result of the return of the iron ore mines as customers of WEPCO in February 2015.

Elevated Capex

Management plans to spend approximately $1.5 billion on utility capex over 2015–2017, earmarked primarily toward the upgrade of WEPCO's electric and gas base infrastructure. Projects are smaller in scope vis-à-vis the large renewable generation and environmental-related spending of prior years, including previous spending associated with the PTF Oak Creek and Port Washington plants. Key projects include the conversion of the Valley Power Plant from coal to natural gas for a total cost of approximately $65 million–$70 million with a target completion date for late 2015, and the construction of a new powerhouse at Twin Falls for an estimated cost of approximately $60 million–$65 million with a target completion date in 2016. Both projects have received approval from the PSCW.

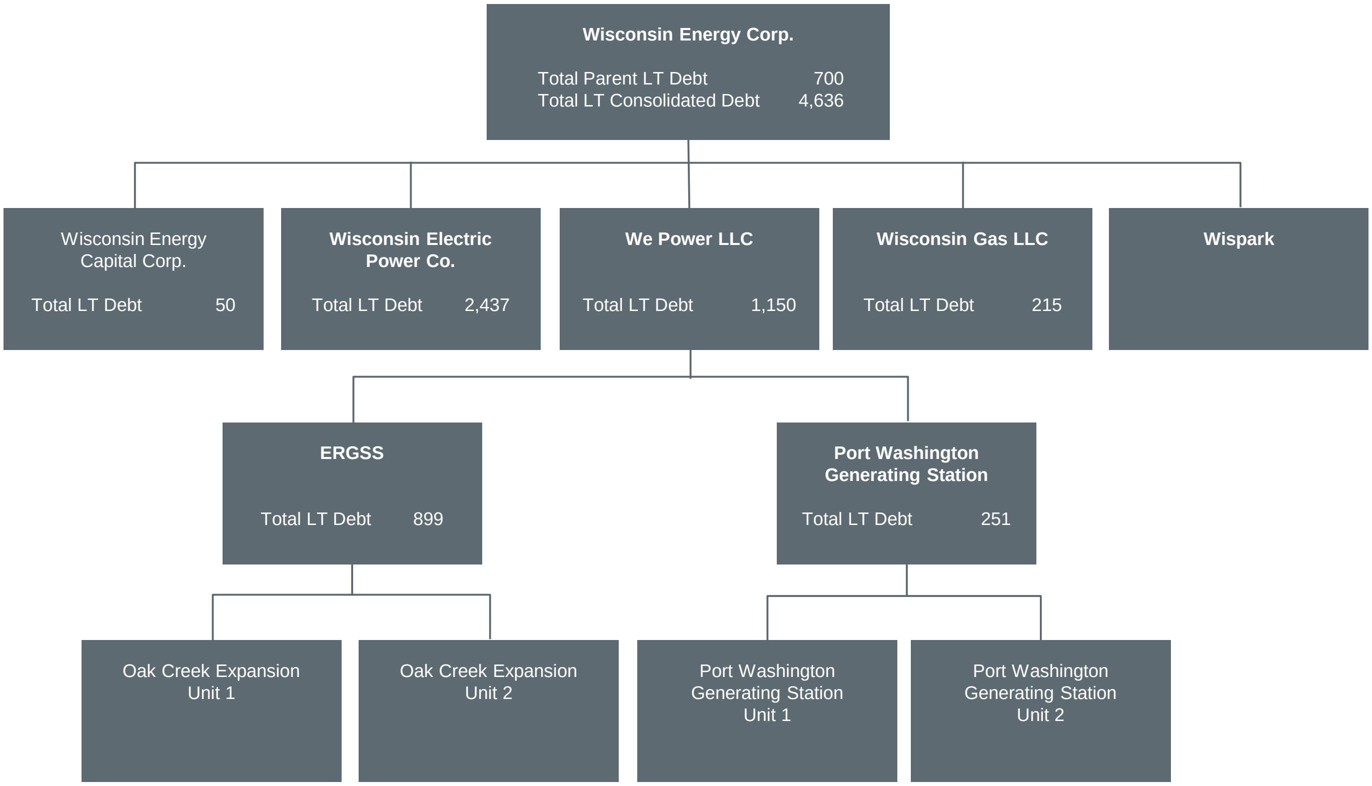
The PSCW also approved approximately $79 million of capex associated with upgrades at the new Oak Creek plants that will permit WEPCO to burn both Powder River Basin and bituminous coal at the plants. Fitch expects WEPCO to continue receiving timely and adequate recovery of capital investments through rate proceedings. Fitch has assumed utility capex will be funded in a manner consistent with the authorized regulatory capital structure, which reflects a 51% common equity ratio per the most recent rate order.

Wisconsin Regulatory Framework

Fitch views the Wisconsin regulatory framework to be generally supportive of utility credit quality. Constructive regulatory mechanisms include forward-looking test years, a partial cash return on construction work in progress for infrastructure investments, annual fuel adjustments and above average authorized ROEs. WEPCO was granted a 10.2% ROE in the most recent rate order, which was above the 9.8% national median authorized ROE in 2014. Favorably, the new rates reflected an increased allocation to fixed charges from 7.8% to 13.6% of total electric revenue requirements to better align WEPCO's cost structure. The rate order also included SSR revenues of $90.7 million associated with the continued operation of Presque Isle. The PSCW allows escrow accounting for SSR revenue from MISO.

Organizational Structure

Organizational and Debt Structure
($ Mil., As of March 31, 2015)



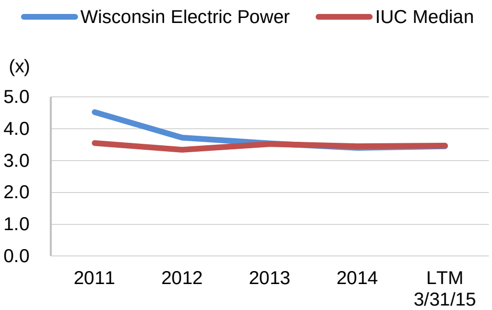
LT – Long-term. Note: Wisconsin Energy Corp. changed its name to WEC Energy Group, Inc. effective June 29, 2015. The name change followed the completion of the acquisition of Integrys Energy Group.
Source: Company reports, Fitch estimate.

Key Metrics

Definitions

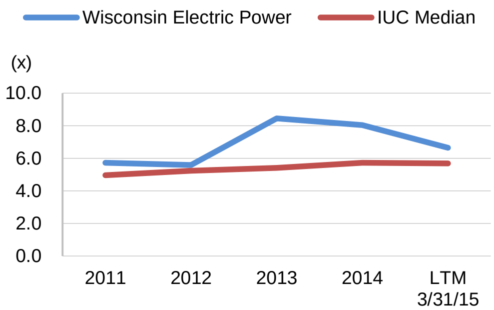
- Total Adjusted Debt/Op. EBITDAR: Total balance sheet adjusted for equity credit and off-balance sheet debt divided by operating EBITDAR.
- FFO Fixed-Charge Coverage: FFO plus gross interest minus interest received plus preferred dividends plus rental payments divided by gross interest plus preferred dividends plus rental payments.
- FFO-Adjusted Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.

Total Adjusted Debt/Op. EBITDAR



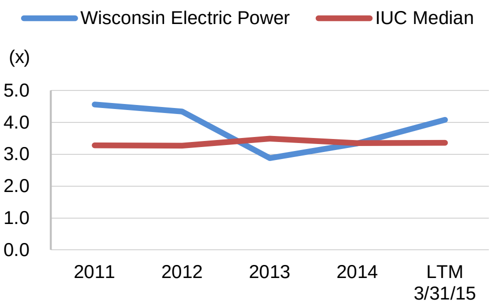
IUC – Integrated utility company.
Source: Company data, Fitch.

FFO Fixed-Charge Coverage



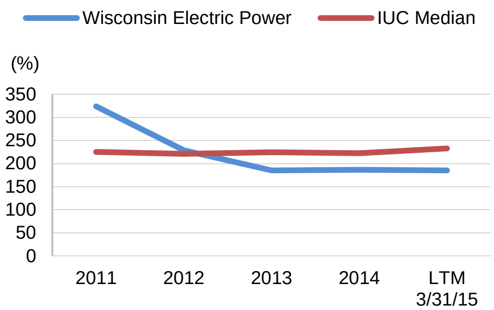
IUC – Integrated utility company.
Source: Company data, Fitch.

FFO-Adjusted Leverage



IUC – Integrated utility company.
Source: Company data, Fitch.

Capex/Depreciation



IUC – Integrated utility company.
Source: Company data, Fitch.

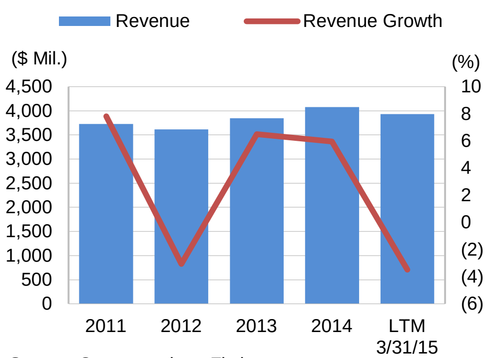
Company Profile

WEPCO is an integrated regulated utility that operates in the regulatory jurisdictions of Wisconsin and Michigan. Wisconsin contributed 87% of total revenue in 2014. The utility serves approximately 1,133,600 electric customers in Wisconsin and the Upper Peninsula of Michigan, approximately 475,100 gas customers in Wisconsin and approximately 440 steam customers in metropolitan Milwaukee. The electric sales mix is well diversified and was 33% residential, 36% small commercial, 30% large commercial and 1% other in 2014. The largest commercial and industrial sectors — excluding iron ore mines — include office (12.5%), retail (6.3%) and primary metals (5.9%). WEPCO estimates annual retail electric sales will grow about 0.5% over the next five years, in line with the industry trend.

WEPCO owned and leased from We Power approximately 6,024 MW of generation capacity in 2014. The utility met 69% of retail sales requirements with its own generation and 31% through purchased power in 2014. WEPCO's own generation consisted of 56% coal, 9% natural gas and 4% renewables. Fitch believes WEPCO's exposure to environmental regulations is manageable in the near term, given the sizeable investments in environmental controls made by the utility over the last decade.

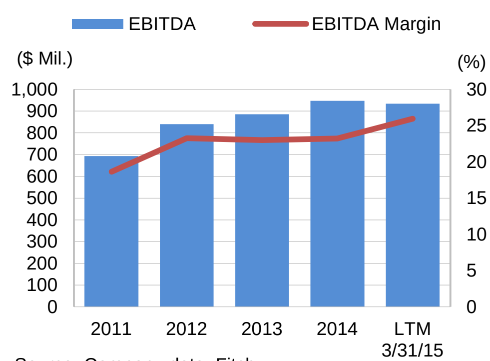
Business Trends

Revenue Dynamics



Source: Company data, Fitch.

EBITDA Dynamics



Source: Company data, Fitch.

Financial Summary — Wisconsin Electric Power Co.

(IDR: A/Rating Outlook Stable) ($ Mil., As of March 31, 2015)	2011	2012	2013	2014	LTM Ended 2015
Fundamental Ratios (x)					
Operating EBITDAR/(Gross Interest Expense + Rents)	5.8	6.6	6.9	8.0	7.9
FFO Fixed-Charge Coverage	5.7	5.6	8.4	8.0	6.6
Total Adjusted Debt/Operating EBITDAR	4.5	3.7	3.5	3.4	3.5
FFO/Total Adjusted Debt (%)	21.9	23.0	34.7	30.0	24.5
FFO-Adjusted Leverage	4.6	4.3	2.9	3.3	4.1
Common Dividend Payout (%)	71.0	49.2	94.4	103.4	91.6
Internal Cash/Capex (%)	42.4	106.1	101.0	85.5	69.0
Capex/Depreciation (%)	323.6	228.7	184.9	186.5	185.0
Return on Equity (%)	10.8	11.2	10.6	11.1	10.7
Profitability					
Revenues	3,727	3,613	3,848	4,077	3,933
Revenue Growth (%)	7.8	(3.1)	6.5	6.0	(3.5)
Net Revenues	2,247	2,281	2,412	2,416	2,408
Operating and Maintenance Expense	1,448	1,328	1,417	1,355	1,360
Operating EBITDA	694	840	885	947	934
Operating EBITDAR	694	840	885	947	934
Depreciation and Amortization Expense	220	258	279	296	300
Operating EBIT	474	582	606	651	634
Gross Interest Expense	119	128	128	119	118
Net Income for Common	338	366	360	377	371
Operating Maintenance Expense % of Net Revenues	64.4	58.2	58.7	56.1	56.5
Operating EBIT % of Net Revenues	21.1	25.5	25.1	26.9	26.3
Cash Flow					
Cash Flow from Operations	543	807	862	863	724
Change in Working Capital	(24)	216	(98)	18	53
Funds from Operations	567	591	960	845	671
Dividends	(241)	(181)	(341)	(391)	(341)
Capex	(712)	(590)	(516)	(552)	(555)
FCF	**(410)**	**36**	**5**	**(80)**	**(172)**
Net Other Investment Cash Flow	(92)	(19)	(47)	(15)	(13)
Net Change in Debt	441	—	18	82	161
Net Equity Proceeds	—	—	—	—	—
Capital Structure					
Short-Term Debt	379	129	198	329	337
Total Long-Term Debt	2,756	2,995	2,936	2,893	2,887
Total Debt with Equity Credit	**3,135**	**3,124**	**3,134**	**3,222**	**3,224**
Total Adjusted Debt with Equity Credit	3,135	3,124	3,134	3,222	3,224
Total Hybrid Equity and Minority Interest	15	15	15	15	15
Total Common Shareholder's Equity	3,177	3,366	3,407	3,413	3,478
Total Capital	**6,327**	**6,505**	**6,556**	**6,650**	**6,717**
Total Debt/Total Capital (%)	49.6	48.0	47.8	48.5	48.0
Total Hybrid Equity and Minority Interest/Total Capital (%)	0.2	0.2	0.2	0.2	0.2
Common Equity/Total Capital (%)	50.2	51.7	52.0	51.3	51.8

IDR – Issuer Default Rating.
Source: Company data, Fitch.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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