FitchRatings

Fitch Assigns Initial 'BBB+' IDR to Integrys; Affirms WEC at 'BBB+'

Fitch Ratings-New York-17 August 2015: Fitch Ratings has assigned Integrys Holding, Inc. (Integrys) an initial long-term Issuer Default Rating (IDR) of 'BBB+' and initial short-term IDR of 'F2' with a Stable Outlook. Fitch has also assigned an initial 'A' IDR to Wisconsin Public Service Corp. (Wisconsin Public Service), an initial 'A' IDR to North Shore Gas Co. (North Shore Gas) and an initial 'A-' IDR to The Peoples Gas Light & Coke Co. (Peoples Gas). Concurrently, Fitch has assigned initial 'F1' short-term IDRs and commercial paper (CP) ratings to Wisconsin Public Service and Peoples Gas. The Rating Outlook for all three entities is Stable.

Wisconsin Public Service, Peoples Gas, and North Shore Gas are wholly owned subsidiaries of intermediate parent holding company Integrys. WEC closed the acquisition of Integrys and subsidiaries on June 29, 2015.

In addition, Fitch has affirmed the long-term IDR of WEC Energy Group, Inc. (WEC) at 'BBB+' with a Stable Outlook. Fitch has also affirmed the existing IDRs of WEC's other subsidiaries as follows: Wisconsin Electric Power Co. (WEPCO) at 'A'; Wisconsin Gas LLC (WI Gas) at 'A-' and Elm Road Generating Station Supercritical LLC (ERGSS) at 'A'. The Rating Outlook for these entities is Stable. A full list of rating actions follows at the end of this release.

Rationale for Integrys' Ratings

The ratings reflect Integrys' conservative business model and regulatory scale and diversity provided by the ownership of financially sound regulated electric and gas utilities that operate in the balanced regulatory jurisdictions of Wisconsin, Illinois, Michigan, and Minnesota. In addition, the ratings incorporate enhanced financial flexibility under the ownership by WEC and operational ties stemming from the high level of senior-management overlap and centralized decision making.

Fitch recognizes the comparable financial profiles of WEC and Integrys, including strong cash flow generation that is almost entirely from regulated businesses operating in complementary territories, and the presence of relatively sizeable holding company debt in each standalone capital structure. Fitch estimates Integrys-level debt to represent about 30% of its total consolidated debt at June 30, 2015. The negative effect of high parent leverage is incorporated into Integrys 'BBB+' IDR.

The ratings also reflect Fitch's expectation that the regulatory concessions that were imposed as a condition of merger approval will be manageable within the utilities' credit profiles. Fitch's credit concerns relate to the integration risk of combining two relatively large utility holding companies coupled with WEC's lack of exposure to the Illinois regulatory framework.

KEY RATING DRIVERS

Integrys

WEC Ownership

Ownership of Integrys by WEC provides the former with enhanced financial flexibility to manage its capital structure, and expands earnings and cash flow capabilities through increased FERC exposure and through potential long-term operational efficiencies provided by a larger group with complementary businesses. Fitch believes management will commit to maintain utility credit quality, including by providing parental or operational support to fund capex requirements across the group, and follow a relatively conservative dividend policy with a dividend target of 65%-70%.

Conservative Business Model

Integrys' ratings reflect the stable and predictable operating cash flows derived from its ownership of five low-risk regulated electric and gas utilities that operate in balanced regulatory jurisdictions of WI, IL, MI, and MN. WI is the primary driver of earnings, and Fitch estimates Wisconsin Public Service will contribute approximately 48% of Integrys consolidated EBITDA in 2016. Integrys' financial profile further benefits from operating two gas local distribution companies (LDCs) in IL, which Fitch estimates will represent near 40% of consolidated EBITDA in 2016, and will almost entirely be contributed by Peoples Gas. Michigan Gas Utilities and Minnesota Energy Resources earnings contributions are not projected to be significant.

Integrys' stable credit profile also recognizes the lower business risk stemming from the sale of the former unregulated retail business to Exelon Generation in 2014. Integrys' remaining unregulated businesses are more manageable and consist of a compressed natural gas business and a portfolio of solar investments. Those businesses have no bearings on Integrys' ratings and their financial results are likely to be immaterial to consolidated earnings.

Capex Winding Down: Management plans on spending approximately $1.3 to $1.4 billion annually on capital investments, with Integrys representing about 50% of total spending. Capex is primarily driven by investments in base infrastructure, installation of environmental control equipment, and accelerated gas main replacement. Fitch expects utilities to fund capex in a manner that is consistent with their authorized regulatory capital structures, using a balanced mix of internal cash flows, debt, and parent cash infusions as required.

Improving Credit Metrics: For the latest 12 month period ended June 30, 2015, funds from operations (FFO)-adjusted leverage and adjusted debt/EBITDAR were 4.5x and 4.4x, respectively. FFO fixed charge coverage stood at 3.9x. Fitch projects FFO-adjusted leverage and adjusted debt/EBITDAR to improve to 4x by 2017, and FFO fixed charge coverage to rise to 4.7x.

The improved metrics primarily result from tariff or rider increases at Wisconsin Public Service and Peoples Gas in 2015 and 2016. The credit metrics also reflect a partial wind down of Integrys parent-level debt. Integrys parent-level debt currently represents about 30% of total consolidated debt, and a material acceleration in debt reduction would be credit constructive, in Fitch's view.

Wisconsin Public Service

Pending Rate Case

Fitch expects Wisconsin Public Service to receive a balanced rate outcome in its pending rate proceeding in Wisconsin. The utility is seeking a $96.9 million electric rate increase and a $9.1 million gas rate increase based on a 10.2% return on equity (ROE), a 51% common equity ratio and a 2016 forward-looking test year. The new rates are to be effective Jan. 1, 2016.

The main drivers of the electric rate request include the recovery of environmental capex associated with the coal-fired Weston 3 plant and upgrades to Fox Energy Center units 1 and 2. The request also relates to increased transmission costs allocated from ATC and MISO. Drivers of the gas rate request include recovery of spent capex and an increase in non-fuel O&M costs.

Elevated Capex

The utility is spending approximately $345 million over 2013-2016 to install emission-control equipment at the coal-fired Weston 3 plant. Management projects to complete the project in early 2016. In addition, the company plans on spending approximately $220 million over 2014-2018 as part of the System Modernization and Reliability Project (SMRP).

In the context of merger provisions, the Public Service Commission of Wisconsin (PSCW) required Wisconsin Public Service and WEPCO to file a joint integrated resource plan (IRP) for the utilities' combined loads in third quarter 2015 (3Q15) to evaluate the need for new generation capacity. As a result, Wisconsin Public Service withdrew its application for a previously proposed $517 million 400MW combined cycle plant at the Fox Energy site, and capacity needs will be reviewed in the context of the joint IRP.

Modestly Declining Credit Metrics: For the LTM period ended June 30, 2015, FFO-adjusted leverage and adjusted debt/EBITDAR stood at 3.6x and 3.7x, respectively. Despite the benefit of a rate increase in 2016, Fitch projects credit metrics to be under modest pressure over 2015-2016 as the utility completes its environmental spending. Fitch expects FFO-adjusted leverage to range between 4.4x-4.6x in 2015-2016, and improve to below 4x by 2018 onwards. Adjusted debt/EBITDAR is projected to weaken to 4.2x in 2015 and improve to 3.6x by 2017. The FFO-based metrics also reflect the negative cash flow effect from the expiration of bonus depreciation in 2014.

Peoples Gas

Balanced Rate Order: Peoples Gas received a $71.1 million gas base rate increase, approximately 70% of the utility's revised rate request. The order was based on a 9.05% ROE and a 50.33% common equity ratio. New rates became effective in January 2015. The rate request was primarily driven by the recovery of infrastructure investments and increased operating costs.

Merger Concessions: Fitch believes the merger terms imposed by the Illinois Commerce Commission (ICC) should be manageable within Peoples Gas' credit ratings. Key provisions include implementation of a two-year base rate freeze effective at merger closing, the commitment by the utility to invest at least $1 billion in its distribution infrastructure over the 2015-2017 period, and the prohibition to recover transaction-related costs and acquisition premiums from ratepayers. On a positive note, all existing supportive regulatory mechanisms, including decoupling, riders for gas pipeline replacement and bad debt, and a purchased gas adjustment clause, will remain in place. Fitch views these types of regulatory mechanisms as supportive of utility credit quality during the two-year rate freeze.

The ICC decision alleviates Fitch's concerns regarding the public scrutiny and commission investigation stemming from Peoples Gas' alleged mismanagement of its accelerated main replacement program (AMRP) which made the approval process more contentious than what WEC experienced in other jurisdictions. The ICC has required WEC to file a transition plan for the management of AMRP 75 days after the final order.

As a first line of action, WEC parted ways with the existing project managers following an audit that revealed material cost overruns. WEC publicly stated it is confident it can effectively manage the project. The commission investigation remains ongoing. Fitch's projections do not reflect any potential fines that could result from the investigation.

High Capex: The primary driver of capex is the 20-year AMRP program to modernize gas infrastructure in Chicago. Management expects an average annual investment of approximately $250 million over the next five years. Favorably, Peoples Gas benefits from the Qualified Infrastructure Plant Rider (QIP) which provides near immediate cash return on capital investments.

Adequate Credit Metrics: Fitch models FFO-adjusted leverage and adjusted debt/EBITDAR to average 4x and 3.6x, respectively, over 2015-2019. The ratios of FFO fixed charge coverage and EBITDAR/interest are projected to be strong for the rating category and average 6.3x and 7x over the same forecast period. For the LTM period ended June 30, 2015, FFO-adjusted leverage and adjusted debt/EBITDAR were 3.6x and 3.4x, respectively.

North Shore Gas

Balanced Rate Order: North Shore Gas received a $3.5 million gas base rate increase, approximately 55% of the utility's revised rate request. The order was based on a 9.05% ROE and a 50.48% common equity ratio. New rates became effective in January 2015. The rate request was primarily driven by the recovery of infrastructure investments and increased operating costs. Importantly, the ICC allowed the utility to continue the use of a decoupling mechanism and riders for bad debt and environmental remediation expenses.

Strong Credit Metrics: Projected credit metrics are consistent with Fitch's benchmark ratios for the 'A' rating category. FFO-adjusted leverage and adjusted debt/EBITDAR should average 3x and 3.1x, respectively, over 2015-2019. FFO and EBITDAR coverage ratios are projected to average 8.8x and 8.3x, respectively, over the same forecast period. For the LTM period ended June 30, 2015, the ratios of FFO-adjusted leverage, EBITDAR leverage, and FFO coverage were 2.5x, 2.8x, and 9.25x, respectively. The projected credit metrics reflect the two-year rate freeze imposed as part of the merger approval and expiration of bonus depreciation and other tax credits in 2014.

Modest Capex Requirements: Merger provisions include a requirement that the utility spends at least $43 million through 2017 on capital investments.

WEC

Regulatory Diversification: The addition of Integrys' five low-risk regulated electric and natural gas utility businesses increases regulatory scale and provides further diversity to consolidated earnings and cash flows. The utilities operate in the relatively supportive regulatory jurisdictions of WI, IL, MI, MN, and FERC via its ownership in American Transmission Co. (ATC; 'A' IDR). WI is estimated to represent approximately 70% of the combined company's rate base, with FERC and IL contributing about 14% and 13% of projected rate base, respectively.

Notably, the ownership of gas LDCs in IL, and on a smaller scale, LDCs in MI and MN, provide cash flow stability and earnings growth through committed investments in upgrades of gas infrastructure over the next several years. Management estimates the proportion of gas utility earnings mix to grow to 23% from 17% pre-merger.

Importantly, with the acquisition of Integrys, WEC's ownership of ATC will increase to approximately 60% from 26%. Accordingly, management expects investments in transmission rate base to continue to grow over the next few years, despite the anticipated reduction in allowed ROEs for MISO transmission owners as a result of complaint cases currently pending before FERC.

Balanced Regulatory Frameworks: Fitch views the WI regulatory compact to be generally supportive of utility credit quality, as evidenced by the relatively favorable rate decisions Wisconsin Utilities received in their most recent rate cases. Notably, ROEs of 10.2%, 10.3%, and 10.2% were authorized to WEPCO, WI Gas, and Wisconsin Public Service, respectively, which were above national medians. Constructive regulatory mechanisms include forward-looking test years, pre-approval of large projects, a partial cash return on construction work in progress for infrastructure investments, and annual fuel adjustments. The merger provisions, which include an earnings cap at WEPCO and WI Gas, should not have a material impact on the utilities' credit profiles, in Fitch's view.

In IL, the gas utilities benefit from constructive tariff mechanisms, including a purchased gas adjustment, decoupling, and riders for bad debt expense and manufactured gas plant remediation costs. Importantly, Peoples Gas can timely recover, via a rider, costs associated with its accelerated main replacement program in Chicago. The rider is in effect from 2014 through 2023 with annual review by the ICC. On the negative side, authorized ROEs in recent cases have been materially below national median ROEs, which can make the process of raising external capital more challenging.

High Parent Leverage: Combined parent-level debt represents 30% of WEC consolidated debt. About 20% of parent debt is related to WEC. Management has indicated they intend to reduce parent debt over time but has not established specific targets. Fitch would view efforts of active deleveraging over the forecast period as supportive of credit quality.

Manageable Capex: Management plans on spending approximately $1.3 billion to $1.4 billion annually. Capex is expected to be split evenly between WEC and Integrys. Capital investments associated with WEC's 60% ownership of ATC are projected to total $818 million over 2015-2017, further supporting rate base growth. Utility capital investments will primarily be earmarked towards environmental upgrades and enhancement of distribution networks and gas pipeline replacements. Fitch expects the utilities to finance capex in a conservative manner using a target mix that is consistent with their respective authorized regulatory capital structures.

Credit Metrics: Fitch projects consolidated FFO-adjusted leverage to approximate 5x in 2016 and improve to about 4.4x by 2018. FFO fixed charge coverage is projected to range between 4.3x and 4.6x over 2016-2019. The credit metrics include the negative effect on cash flows of the expiration of bonus depreciation.

Fitch forecasts WEPCO's credit metrics to modestly decline over the forecast period, but remain adequate for the current rating level. Fitch forecasts debt/EBITDAR to range between 3.4x and 3.7x over 2015-2019, while FFO-adjusted leverage is expected to range between 4.3x and 3.8x. Debt/EBITDAR and FFO-adjusted leverage stood at 3.5x and 4.1x, respectively, for the LTM ended June 30, 2015.

Fitch projects WI Gas' debt/EBITDAR to range between 3.4x and 3.6x over 2015-2018, while FFO-adjusted leverage is expected to hover in the low-4x range. Forecasted credit metrics remain adequate for the current ratings levels. The year 2015 represents the weakest year, as the utility incurs incremental capex associated with the gas lateral project. The step rate increase in 2016 allows timely recovery of capex associated with the project.

ERGSS

The ratings of ERGSS reflect the credit quality of WEPCO. ERGSS services its debt obligations with the rental payments it receives from WEPCO related to the lease of the Power the Future (PTF) generating plants.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case are as follows:

Wisconsin Public Service

--Base rate increase per the last rate order effective Jan. 1, 2015
--Wisconsin base rate increase of approximately $60 million effective Jan. 1, 2016
--Retail sales growth of 0.5% annually
--$1.4 million capex 2015-2019

Peoples Gas

--Base rate increase per the last rate order effective Jan. 1, 2015
--Two-year base rate freeze from date of merger closing
--QIP rider increases effective Jan.1, 2015 and onwards
--No fines from AMRP investigation
--$1.8 million capex including average of $250 million annually related to AMRP

North Shore Gas

--Base rate increase per the last rate order effective Jan. 1, 2015

--$100 million capex

WEPCO

--Base rate increases in 2015 and 2016 per the last rate order
--Retail sales growth of 0.5% annually
--$2.6 million capex 2015-2019
--No financial impact from merger concessions

WI Gas

--Base rate increases per the last rate order
--Retail sales growth of 0.5% annually
--$900 million capex 2015-2019
--No financial impact from merger concessions

RATING SENSITIVITIES FOR INTEGRYS

Positive: Future developments that may, individually or collectively, lead to a positive action include:
--Given comparable credit profiles, a positive action at WEC could carry over to Integrys and lead to a positive action;
--Deleveraging efforts that result in a material reduction in parent-level debt and lead to FFO -adjusted leverage ratio to sustain below 4x;
--Successful integration of Integrys into the WEC group, including through the generation of material merger synergies.

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--Unfavorable regulatory developments in WI or IL that lead to a deterioration of utilities' financial profiles;
--FFO -adjusted leverage ratio between 5x-5.25x on a sustained basis;
--A more aggressive financial management policy from WEC that creates added financial pressure on Integrys to upstream dividends.

RATING SENSITIVITIES FOR WISCONSIN PUBLIC SERVICE

Positive: Future developments that may, individually or collectively, lead to a positive action include:
Given current rating levels and elevated capex over the forecast period, positive rating actions are unlikely in the near term.

Negative: Future developments that may, individually or collectively, lead to a negative action include:

-- A deterioration of the regulatory compact in WI;
--Debt/EBITDAR at or over 4x on a sustained basis.

RATING SENSITIVITIES FOR PEOPLES GAS

Positive: Future developments that may, individually or collectively, lead to a positive action include: Given high projected capex, a positive rating action is unlikely in the near-term. However, FFO -adjusted leverage below 3.5x on a sustained basis or adjusted debt/EBITDAR below 3.25x on a sustained basis could trigger positive actions.

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--A deterioration of the IL regulatory compact;
--Any sizeable fines associated with the AMRP investigations that require debt funding.
--FFO-adjusted leverage over 4.5x on a sustained basis.

RATING SENSITIVITIES FOR NORTH SHORE GAS

Positive: Future developments that may, individually or collectively, lead to a positive action include: Given current rating levels, no positive rating action is likely in the near term.

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--Deterioration of the regulatory compact.
--Inability to receive short-term funding from Integrys or Peoples Gas in the event of a liquidity crisis.
--FFO -adjusted leverage at or over 4x on a sustained basis.

RATING SENSITIVITIES FOR WEC

Positive: Future developments that may, individually or collectively, lead to a positive action include:
--Deleveraging efforts that result in the FFO -adjusted leverage ratio to improve to near 4x;
--Successful integration of Integrys into the WEC group, including through the generation of material merger synergies.

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--A more aggressive financial management policy that results in incremental parent leverage;
--Unfavorable regulatory developments that lead to a deterioration of utilities' financial profiles;
--FFO-adjusted leverage ratio between 5x-5.25x on a sustained basis.

RATING SENSITIVITIES FOR WEPCO

Positive: Future developments that may, individually or collectively, lead to a positive action include:

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

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--Although not anticipated by Fitch, a deterioration of the regulatory compact could lead to negative rating actions;
--Debt/EBITDAR at or over 4.0x on a sustained basis.

RATING SENSITIVITIES FOR WI GAS

Positive: Future developments that may, individually or collectively, lead to a positive action include:
Given current rating levels and elevated capex over the forecast period, positive rating actions are unlikely in the near term.

Negative: Future developments that may, individually or collectively, lead to a negative action include:
--Although not anticipated by Fitch, a deterioration of the WI regulatory compact could lead to a negative rating action.
--Debt/EBITDAR at or over 4x on a sustained basis.

LIQUIDITY

At June 30, 2015, WEC and its subsidiaries had approximately $214.4 million of cash and cash equivalents and approximately $2.3 billion of unused committed credit arrangements with banks. The unused credit capacity is allocated to provide liquidity support to the group's CP programs. Approximately $826.3 million of CP borrowings were outstanding at June 30, 2015.

Each entity within the combined group has access to their own unsecured credit facility except smaller entities North Shore Gas, Michigan Gas Utilities (MGU), and Minnesota Energy Resources (MER), who meet their short-term liquidity needs through intercompany borrowings with the parent company. North Shore Gas can borrow up to $50 million with Integrys and up to $50 million with sister affiliate Peoples Gas. In addition, Peoples Gas can borrow up to $150 million from Integrys and up to $50 million from North Shore Gas.

Financial covenants include maintaining a debt-to-total capitalization ratio no greater than 65% for WEPCO, WI Gas, Integrys, Wisconsin Public Service, and Peoples Gas. WEC must maintain a debt-to-total capitalization ratio that is no greater than 70%. At June 30, 2015, all entities were in compliance with the covenants. In addition, Wisconsin Public Service cannot pay a common dividend that is more than 103% of the prior year's dividend. All subsidiaries, with the exception of MGU, are prohibited from lending funds to WEC or Integrys.

FULL LIST OF RATING ACTIONS

Fitch assigns the following ratings with a Stable Outlook:

Integrys Holding
--Long-term IDR at 'BBB+';
--Short-term IDR at 'F2';
--Commercial paper at 'F2';
--Senior unsecured debt at 'BBB+';
--Junior subordinated notes at 'BBB-'.

Wisconsin Public Service
--Long-term IDR at 'A';
--Short-term IDR at 'F1';
--Commercial paper at 'F1';
--Senior secured debt at 'AA-';
--Preferred stock at 'A-'.

Peoples Gas
--Long-term IDR at 'A-';
--Short-term IDR at 'F1';
--Commercial paper at 'F1';
--Senior secured debt at 'A+'.

North Shore Gas
--Long-term IDR at 'A';
--Senior secured debt at 'AA-'.

Fitch affirms the following ratings with a Stable Outlook:

WEC
--Long-term IDR at 'BBB+';
--Short-term IDR at 'F2';
--Commercial paper at 'F2';
--Senior unsecured debt at 'BBB+';
--Junior subordinated notes at 'BBB-'.

WEPCO
--Long-term IDR at 'A';
--Short-term IDR at 'F1';

--Commercial paper at 'F1';
--Senior unsecured debt at 'A+';
--Preferred stock at 'A-'.

WI Gas
--Long-term IDR at 'A-';
--Short-term IDR at 'F1';
--Commercial paper at 'F1';
--Senior unsecured debt at 'A'.

ERGSS
--Long-term IDR at 'A';
--Senior unsecured debt at 'A+'.

Wisconsin Energy Capital Corp.
--Senior unsecured debt at 'BBB+'.

Contact:

Primary Analyst
Philippe Beard
Director
+1-212-908-0242
Fitch Ratings, Inc.
33 Whitehall St.
New York, NY, 10004

Secondary Analyst
Shalini Mahajan
Managing Director
+1-212-908-0351

Committee Chairperson
Philip W. Smyth, CFA
Senior Director
+1-212-908-0531

Media Relations: Alyssa Castelli, New York, Tel: +1 (212) 908 0540, Email: alyssa.castelli@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362)
Recovery Ratings and Notching Criteria for Utilities (pub. 05 Mar 2015) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863298)
Treatment and Notching of Hybrids in Non-Financial Corporate and REIT Credit Analysis (pub. 25 Nov 2014) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=821568)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=989564)
Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=989564)
Endorsement Policy (https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31)

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.