

Peoples Gas Light and Coke Co.

Subsidiary of WEC Energy Group, Inc.
Full Rating Report

Ratings

Long-Term IDR	A-
Short-Term IDR	F1
Senior Secured	A+

IDR – Issuer Default Rating.

Rating Outlook

Long-Term IDR	Stable
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Financial Summary

Peoples Gas Light and Coke Co.		
(\$ Mil.)	2015	2014
Adjusted Revenue	1,059	1,478
Operating EBITDAR	304	206
Cash Flow from Operations	358	157
Total Adjusted Debt	973	1,015
Total Capitalization	1,935	1,889
Capex/Depreciation (%)	285.6	311.5
FFO Fixed-Charge Coverage (x)	7.4	8.6
FFO-Adjusted Leverage (x)	3.7	3.8
Total Adjusted Debt/EBITDAR (x)	3.2	4.9

Related Research

[Fitch Assigns First-Time 'BBB+' IDR to Integrys; Affirms WEC at 'BBB+' \(August 2015\)](#)

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Key Rating Drivers

Balanced Regulation: Peoples Gas Light and Coke Co. (Peoples Gas) benefits from credit-supportive regulatory mechanisms, including a purchased gas adjustment clause that allows for full and timely recovery of gas commodity costs, riders for gas pipeline replacement and bad debt expenses and a decoupling mechanism that breaks the link between sales and margins. Peoples Gas' last rate order was constructive, with the utility receiving approximately 70% of its revised rate request.

High Capex: Management projects to spend approximately \$1.09 billion over 2016–2018, compared with \$923 million over the prior three years. The primary driver of capex is the 20-year accelerated main replacement program (AMRP) to modernize natural gas infrastructure in Chicago. Peoples Gas expects to invest \$250 million–\$280 million annually over the next three years. Favorably, the utility benefits from the Qualified Infrastructure Plant (QIP) rider, which provides near-immediate cash return on capital investments.

Base Rate Freeze: Fitch Ratings does not expect the two-year base rate freeze to bear a material impact on the utility's financial profile. The rate freeze stemmed from the Illinois Commerce Commission's (ICC) merger approval of Integrys Holdings, Inc. (Integrys), Peoples Gas' parent holding company, with WEC Energy Group, Inc. (WEC) in 2015. The earnings benefit from the 2015 rate order and efficient cost control should support the utility's sound credit profile in 2016.

Adequate Credit Metrics: Fitch expects FFO-adjusted leverage and adjusted debt/EBITDAR to average 3.7x and 3.5x, respectively, over 2016–2018. The ratios of FFO fixed-charge coverage and EBITDAR/interest are projected to be strong for the rating category and average 6.5x and 7x, respectively, over the same forecast period. FFO-adjusted leverage and adjusted debt/EBITDAR were 3.7x and 3.2x, respectively, at 2015 year-end.

Good Liquidity: Peoples Gas has access to a total borrowing capacity of \$350 million under an unsecured bank credit facility that expires in December 2020. There were \$122.7 million of borrowings outstanding under the facility at year-end 2015. The company has access to further liquidity via intercompany borrowings, under which the utility can borrow up to \$150 million from Integrys and up to \$50 million from utility affiliate North Shore Gas Co. (NSG).

Rating Sensitivities

Positive Rating Action: Given high projected capex, a positive rating action is unlikely in the near term. However, FFO-adjusted leverage below 3.5x or adjusted debt/EBITDAR below 3.25x on a sustained basis could trigger positive actions.

Negative Rating Action: A deterioration of the Illinois regulatory compact illustrated by an inability to timely recover commodity costs would likely lead to negative rating actions. Negative rating actions could also be triggered by any sizeable fines associated with the ICC's ongoing AMRP investigations that require debt funding or FFO-adjusted leverage weakening to 4.5x or higher on a sustained basis.

Financial Overview

Liquidity and Debt Structure

Liquidity is considered to be adequate. Peoples Gas has access to a total borrowing capacity of \$350 million under an unsecured bank credit facility that expires in December 2020. There were \$122.7 million of borrowings outstanding under the facility at year-end 2015. The company has access to further liquidity via intercompany borrowings, under which the utility can borrow up to \$150 million from Integrys and up to \$50 million from affiliate NSG. Peoples Gas can lend an equivalent amount to NSG but cannot lend funds to its direct parent Integrys. Peoples Gas had no borrowings outstanding with either Integrys or NSG. Additionally, the company held a \$28.8 million short-term note receivable from NSG.

The bank credit facility includes a financial covenant that requires total debt/total capitalization to be less than 65%. The company was in compliance with the covenant at year-end 2015.

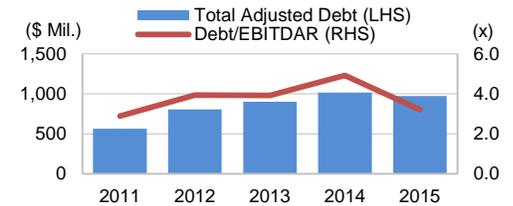
Debt Maturities and Liquidity

(\$ Mil., As of Dec. 31, 2015)

2016	50
2017	—
2018	5
2019	75
Thereafter	720
Cash and Cash Equivalents	7
Undrawn Committed Facilities	427

Source: Company data, Fitch.

Total Debt and Leverage



Source: Company data, Fitch.

Related Criteria

[Recovery Ratings and Notching Criteria for Utilities \(March 2016\)](#)

[Corporate Rating Methodology — Including Short-Term Ratings and Parent and Subsidiary Linkage \(August 2015\)](#)

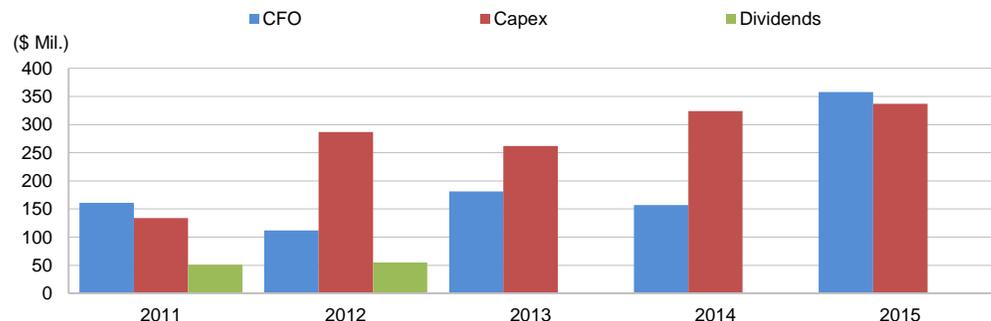
[Parent and Subsidiary Rating Linkage \(August 2015\)](#)

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

Cash Flow Analysis

CFO grew by 128% in 2015 relative to 2014, driven primarily by a refund of income taxes associated with bonus depreciation, lower operating and maintenance expenses and higher customer bill collections. Management projects to spend approximately \$1.09 billion of capex over 2016–2018, compared with \$923 million over the prior three years. The primary driver of capex is the 20-year AMRP to modernize natural gas infrastructure in Chicago. Peoples Gas expects to invest \$250 million–\$280 million annually over the next three years. Favorably, the utility benefits from the QIP rider, which provides near-immediate cash return on capital investments. Fitch expects Peoples Gas’ internally generated cash flow to support approximately 75% of capex requirements on average over 2016–2018, with the remainder funded via parent equity infusions and long-term debt.

CFO and Cash Use



Source: Company data, Fitch.

Peer Group

Issuer	Country
A	
North Shore Gas Co.	U.S.
A-	
Southwest Gas Corporation	U.S.
BBB+	
DTE Gas Co.	U.S.

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
Aug. 17, 2015	A-	Stable
Feb. 22, 2007	NR	—
May 5, 2006	A-	Negative
Feb. 17, 2006	A	Negative
Dec. 6, 2005	A	Stable

LT IDR – Long-Term Issuer Default Rating. FC – Foreign currency.
 NR – Not rated.
 Source: Fitch.

Peer and Sector Analysis

Peer Group Analysis

(\$ Mil.)	Peoples Gas Light and Coke Co.	North Shore Gas Co.	Southwest Gas Corporation	DTE Gas Co.
As of	12/31/15	12/31/15	12/31/15	12/31/15
IDR	A-	A	A-	BBB+
Outlook	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable

Fundamental Ratios (x)

Operating EBITDAR/ (Gross Interest Expense + Rents)	8.44	8.75	7.41	6.12
FFO Fixed-Charge Coverage	7.39	8.00	6.95	6.21
Total Adjusted Debt/Operating EBITDAR	3.20	3.17	2.85	3.71
FFO/Total Adjusted Debt (%)	27.3	28.8	32.9	27.3
FFO-Adjusted Leverage	3.66	3.47	3.04	3.66
Common Dividend Payout (%)	—	—	53.2	69.7
Internal Cash/Capex (%)	68.2	90.3	77.5	79.8
Capex/Depreciation (%)	285.6	258.3	180.7	266.7
Return on Equity (%)	9.1	11.7	8.7	10.9

Financial Information

Revenue	1,059	195	2,464	1,356
Revenue Growth (%)	(28.3)	(32.1)	16.1	(15.4)
EBITDA	304	35	559	355
Operating EBITDA Margin (%)	28.7	17.9	22.7	26.2
FCF	21	27	(15)	(91)
Total Adjusted Debt with Equity Credit	973	111	1,604	1,318
Readily Available Cash	7	—	36	—
Funds Flow from Operations	230	28	452	309
Capex	(337)	(31)	(488)	(272)

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

Key Rating Issues

High Capex

Management projects to spend approximately \$1.09 billion over 2016–2018, compared with \$923 million over the prior three years. The primary driver of capex is the 20-year AMRP to modernize natural gas infrastructure in Chicago. The company is replacing approximately 2,000 miles of aging natural gas pipes. Peoples Gas expects to invest \$250 million–\$280 million annually over the next three years. Favorably, the utility benefits from the QIP rider, which provides near-immediate cash return on capital investments. The rider was approved by the ICC in 2014 and is in effect through 2023.

AMRP Investigations

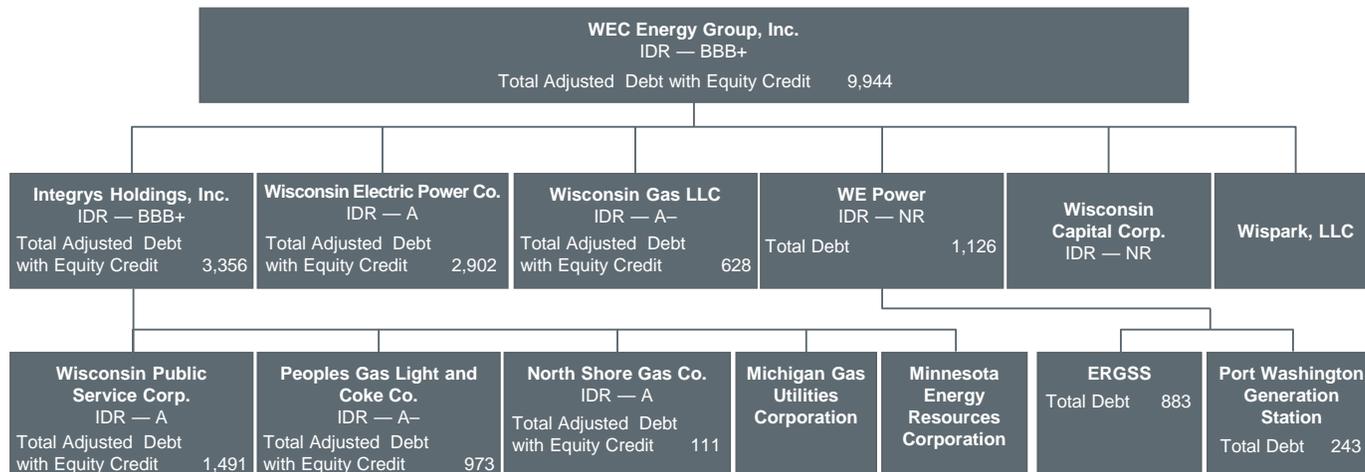
Any sizeable fines associated with the ICC and the Illinois Attorney General's (AG) ongoing AMRP investigations that lead to incremental debt funding could weaken the utility's credit profile. The investigations follow allegations from consumer groups and the AG of mismanagement and improprieties by Peoples Gas in its handling of the AMRP project, which led to material cost overruns. Fitch's rating case projections do not reflect any potential fines that could ultimately result from the investigations.

Balanced Regulation

Peoples Gas benefits from credit-supportive regulatory mechanisms, including a purchased gas adjustment clause that allows for full and timely recovery of gas commodity costs, riders for gas pipeline replacement and bad debt expenses, and a decoupling mechanism that breaks the link between sales and margins. Peoples Gas' last rate order was constructive, with the utility receiving approximately 70% of its revised rate request.

Organizational Structure

Organizational and Debt Structure — Peoples Gas Light and Coke Co.
(\$ Mil., As of Dec. 31, 2015)



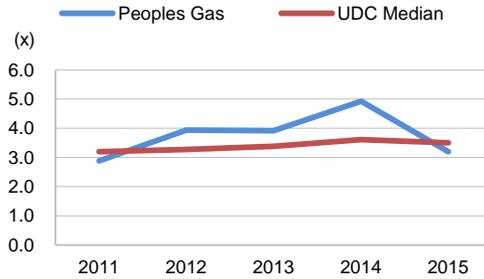
IDR — Issuer Default Rating. NR — Not rated.
Source: Company filings, Fitch.

Key Metrics

Definitions

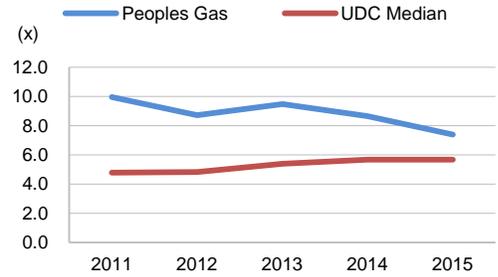
- Total Adjusted Debt/Op. EBITDAR: Total balance sheet adjusted for equity credit and off-balance sheet debt divided by operating EBITDAR.
- FFO Fixed-Charge Coverage: FFO plus gross interest minus interest received plus preferred dividends plus rental payments divided by gross interest plus preferred 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



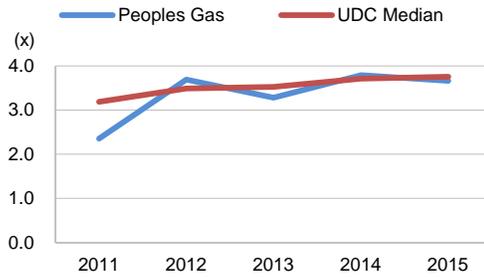
UDC – Utility distribution company.
Source: Company data, Fitch.

FFO Fixed-Charge Coverage



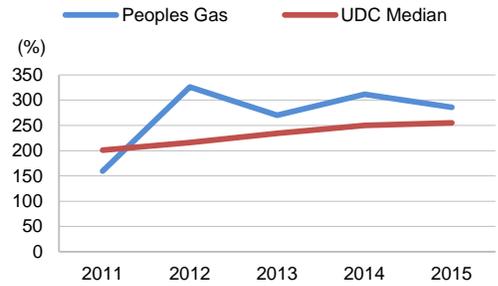
UDC – Utility distribution company.
Source: Company data, Fitch.

FFO-Adjusted Leverage



UDC – Utility distribution company.
Source: Company data, Fitch.

Capex/Depreciation



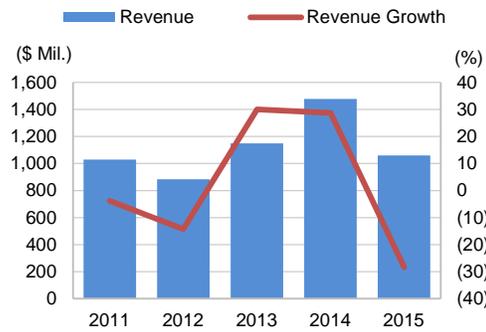
UDC – Utility distribution company.
Source: Company data, Fitch.

Company Profile

Peoples Gas is a local gas distribution company that provides natural gas service to approximately 833,000 residential, commercial, industrial and transportation customers in Chicago. The company owns approximately 4,400 miles of natural gas distribution mains and approximately 270 miles of natural gas transmission mains. The company is a direct subsidiary of Integrys and an indirect subsidiary of WEC, following WEC's acquisition of Integrys in 2015. Fitch forecasts Peoples Gas to represent 15%–20% of WEC's consolidated EBITDA over the forecast period.

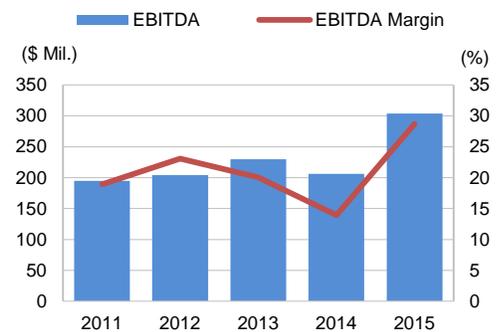
Business Trends

Revenue Dynamics



Source: Company data, Fitch.

EBITDA Dynamics



Source: Company data, Fitch.

Financial Summary — Peoples Gas Light and Coke Co.

(\$ Mil., As of Dec. 31, 2015, IDR — A-/Rating Outlook Stable)	2012	2013	2014	2015
Fundamental Ratios				
Operating EBITDAR/(Gross Interest Expense + Rents) (x)	8.2	7.9	6.6	8.4
FFO Fixed-Charge Coverage (x)	8.7	9.5	8.6	7.4
Total Adjusted Debt/Operating EBITDAR (x)	3.9	3.9	4.9	3.2
FFO/Total Adjusted Debt (%)	27.1	30.5	26.4	27.3
FFO-Adjusted Leverage (x)	3.7	3.3	3.8	3.7
Common Dividend Payout (%)	101.9	—	—	—
Internal Cash/Capex (%)	48.1	93.9	73.1	68.2
Capex/Depreciation (%)	326.1	270.1	311.5	285.6
Return on Equity (%)	7.7	8.5	4.9	9.1
Profitability				
Revenues	883	1,148	1,478	1,059
Revenue Growth (%)	(14.3)	30.0	28.7	(28.3)
Net Revenues	550	662	709	721
Operating and Maintenance Expense	(329)	(413)	(482)	(404)
Operating EBITDA	204	230	206	304
Operating EBITDAR	204	230	206	304
Depreciation and Amortization Expense	(88)	(97)	(104)	(118)
Operating EBIT	116	133	102	186
Gross Interest Expense	(25)	(29)	(31)	(36)
Net Income for Common	54	65	43	88
Operating Maintenance Expense % of Net Revenues	(59.8)	(62.4)	(68.0)	(56.0)
Operating EBIT % of Net Revenues	21.1	20.1	14.4	25.8
Cash Flow				
Cash Flow from Operations	112	181	157	358
Change in Working Capital	(81)	(65)	(80)	128
Funds from Operations	193	246	237	230
Dividends	(55)	—	—	—
Capex	(287)	(262)	(324)	(337)
FCF	(230)	(81)	(167)	21
Net Other Investment Cash Flow	(13)	(21)	(12)	26
Net Change in Debt	242	99	113	(43)
Net Equity Proceeds	—	—	65	—
Capital Structure				
Short-Term Debt	179	177	165	123
Total Long-Term Debt	625	725	850	850
Total Debt with Equity Credit	804	902	1,015	973
Total Adjusted Debt with Equity Credit	804	902	1,015	973
Total Common Shareholder's Equity	699	765	874	962
Total Capital	1,503	1,667	1,889	1,935
Total Debt/Total Capital (%)	53	54	54	50
Common Equity/Total Capital (%)	47	46	46	50

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

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