S&P Global
Ratings

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Summary:

North Shore Gas Co.

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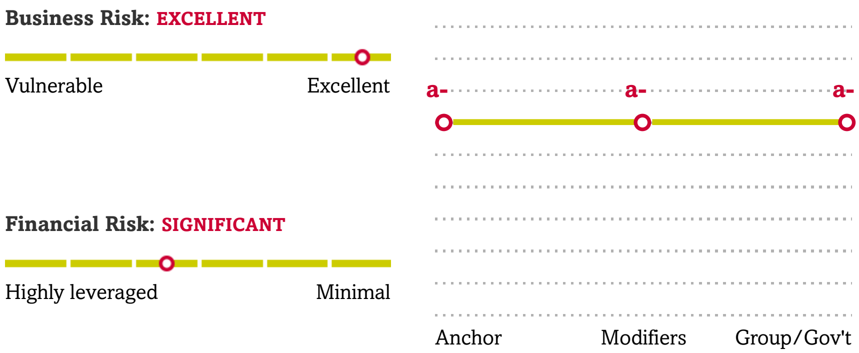

CORPORATE CREDIT RATING

A-/Stable/NR

Rationale

Business Risk: Excellent	Financial Risk: Significant
• Rate-regulated natural gas distribution utility; • Limited regulatory and geographic diversity; and • Predominately residential and commercial customers, providing higher cash flow stability.	• Modest capital spending; • Negative discretionary cash flows, resulting in external funding needs; and • Financial measures consistent with the significant financial risk profile.

Outlook: Stable

The stable outlook on North Shore Gas Co. (NSG) and parent WEC Energy Group Inc. (WEC) reflects S&P Global Ratings' expectation that management will continue to focus on its core utility operations and reach constructive regulatory outcomes to avoid any meaningful rise in business risk. The outlook also reflects our base-case forecast of annual adjusted funds from operations (FFO) to debt of 16% to 18%, in line with the current significant financial risk profile.

Downside Scenario

We could lower the ratings if the company's excellent business risk profile weakens. We could also lower the ratings if core financial measures consistently underperform our base-case forecast and remain at less credit-supportive levels, including annual adjusted FFO to total debt of less than 15%. This could occur if rate-case outcomes are consistently weaker than we expect, there is greater regulatory lag, or if capital spending grows and is largely debt financed.

Upside Scenario

We could raise the ratings if the company's business risk profile remains very low risk and financial measures improve and consistently exceed our base-case forecast, including annual adjusted FFO to total debt consistently over 20%. The company could improve financial measures through greater equity funding of capital spending or material debt reduction.

Our Base-Case Scenario

Assumptions

- Low-single-digit decline in gross margin in 2016 and 2017 for the utility;
- Continued use of supportive regulatory mechanisms, including ongoing rate recovery, resulting in gross margin increase of 5% after 2017;
- Capital spending of about $30 million on average per year; and
- Negative discretionary cash flow from greater capital spending and lower EBITDA.

Key Metrics

	2015A	2016E	2017E
FFO/total debt (%)	22.2	16.0-18.5	15.5-18.0
Debt/EBITDA (x)	3.5	3.8-4.5	3.8-4.5
FFO cash interest coverage (x)	10.9	5.5-8.5	5.5-8.5

A--Actual. E--Estimate. FFO--Funds from operations.

Business Risk: Excellent

We view NSG's stand-alone business risk profile assessment as excellent, reflecting its low-risk regulated gas distribution business. The business risk profile also reflects the company's generally supportive regulatory jurisdiction, relatively small customer base of 160,000 customers, and safe and reliable gas distribution operations. Although scale, scope, and diversity is limited with the small customer base, it is predominately residential and commercial, which limits susceptibility to economic cyclicality and provides relatively stable cash flows. Cost recovery through the regulatory process provides steady rate recovery of purchased gas costs and riders for recovery of bad debts and infrastructure improvements.

Financial Risk: Significant

Based on our medial volatility financial ratio benchmarks, our assessment of NSG's stand-alone financial risk profile is significant. We expect NSG will continue to manage its regulatory risk and fully recover capital spending and, therefore, we expect credit-protection measures to remain within the significant category range. Our base-case forecast indicates that NSG will continue to have negative discretionary cash flow, after capital spending and dividend payments to its parent, resulting in external funding needs. The significant financial risk profile factors in the core ratio of adjusted FFO to total debt, which is projected to range between 15%-18.5% through 2017.

Liquidity: Adequate

We assess NSG's stand-alone liquidity as adequate because we believe liquidity sources are likely to cover uses by more than 1.1x over the next 12 months and to meet cash outflows even with a 10% decline in EBITDA. The adequate assessment also reflects the company's generally prudent risk management, sound relationship with banks, and a generally satisfactory standing in credit market.

Principal Liquidity Sources	Principal Liquidity Uses
• An estimated $250 million of credit facility availability; and • We estimate FFO of about $40 million in 2016.	• Working capital outflows of about $20 million in 2016; and • Capital spending of approximately $35 million in 2016.

Other Credit Considerations

Our assessment of modifiers results in no further changes

Group Influence

Under our group rating methodology, we consider NSG to be a core subsidiary of WEC, reflecting our view that NSG is highly unlikely to be sold, has a strong long-term commitment from senior management, is successful at what it does, and contributes meaningfully to the group.

Ratings Score Snapshot

Corporate Credit Rating

A-/Stable/NR

Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a-

- **Group credit profile:** a-
- **Entity status within group:** Core (no impact)

Related Criteria And Research

Related Criteria

- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- Collateral Coverage And Issue Notching Rules for ‘1+’ and ‘1’ Recovery Ratings on Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use of CreditWatch And Outlooks, Sept. 14, 2009

- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	**a-**	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-