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Integrys Energy Group Inc.

Primary Credit Analyst:

Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

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Integrys Energy Group Inc.

Major Rating Factors

Strengths:

- Stable regulatory customer base;
- Low business risk for regulated companies;
- Steady earnings and cash flow stability from regulated companies; and
- Healthy service territory economy.

Weaknesses:

- Plans to expand its energy marketing business; and
- Significant capital expenditures and dividend requirements.

Corporate Credit Rating

A-/Negative/A-2

Rationale

The ratings on Integrys Energy Group Inc. reflect the consolidated credit quality of Integrys family of companies. Integrys is a diversified energy company with regulated electric and gas utilities in Wisconsin, Minnesota, Michigan, and Illinois, and nonregulated retail and wholesale energy and gas marketing operations throughout the U.S. and Canada. The company has about \$3.1 billion of total debt.

Integrys' consolidated credit profile reflects a satisfactory business profile offset by an intermediate-to-aggressive financial profile. Integrys' business profile score is a '5'. (Utility business risk profiles are categorized from '1' (excellent) to '10' (vulnerable).) This score reflects the strength and stability of the company's regulated utilities partially offset by acquisition-related integration risk, and exposure to nonregulated wholesale and retail gas and power marketing activities at Integrys Energy Services, Inc. (ESI). 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.

Integrys' consolidated financial profile is characterized by material dividend expectations, weak cash flow protection, and moderate debt levels. The company's dividend payout ratio is expected to exceed the company's long-term payout target of 60% to 65% for the short term. Proceeds from the sale of Peoples Energy Production Co. will eliminate the need to externally finance these dividends. Although not currently expected, delays in the sale of Peoples Energy Production could stress Integrys' short-term financial profile. Until integration of the various acquisitions is complete, Standard & Poor's expects adjusted funds from operations to total debt (excluding pensions) to remain below 20%. Improvement in this cash flow measure will considerably depend on the company's ability to earn its authorized returns at its various utility subsidiaries and continued steady growth in its nonregulated marketing-related gross margins. Total debt reflects material amounts of commercial paper that the company issues to support gas held in inventory for future contracted sales. On an adjusted basis, we expect Integrys to end the year with debt to capital (post-E&P asset sale) in the mid-40% area.

The corporate credit rating on Wisconsin Public Service Corp. (WPSC) is one notch higher than on its parent due to regulatory insulation provided to Wisconsin utilities based in part on the Public Service Commission of Wisconsin's authority to determine the utility's capital structure and restrict dividends to the parent.

Liquidity

The short-term credit ratings on Integrys, WPSC, Peoples energy Corp. (PEC), and Peoples Gas Light & Coke Co. (PGL) are 'A-2'. Integrys has two \$500 million revolving credit agreements that mature in June 2010 and June 2011, respectively. WPSC, PEC, and PGL have revolving credit facilities of \$115 million, \$400 million, and \$250 million, respectively. The lines of credit are used to back the commercial-paper borrowing programs and letters of credit. ESI has a \$150 million, 364 credit agreement to finance its margin requirements, the cost of natural gas in storage, and for general corporate purposes. As of June 30, 2007, Integrys had \$866 million in short-term borrowings, which in combination with various letters of credit, reduce availability on the aforementioned credit lines.

Over the short term, consolidated liquidity is pressured by Integrys' dividend commitments, ongoing construction programs at the regulated utilities, ESI's working capital requirements, and integration-related funding needs. Annual dividend-related cash requirements are estimated at \$200 million. WPSC's annual capital requirement is estimated at \$300 million for 2008 and 2009. PGL's annual capital requirements range between \$125 million and \$135 million for 2008 and 2009. The company has modest long-term debt maturities through 2010.

Outlook

The outlook on the Integrys companies is negative. If the company fails to assimilate acquired assets or sell Peoples Energy Production in a timely fashion, the ratings could be lowered. If the company demonstrates its ability to manage its regulatory risk in its various jurisdictions and implements sound risk-management systems and policies for the combined marketing segments, the outlook could be revised to stable.

Accounting

In conducting its credit analysis of Integrys, Standard & Poor's makes various adjustments to reported financial figures. Standard & Poor's imputes off-balance-sheet obligations, such as operating leases, unfunded pension and OPEBS, and purchase power commitments when calculating credit measures.

Integrys' regulated operations follow the accounting for regulated enterprises prescribed by SFAS 71 (accounting for effects of certain types of regulation), which allows the deferral of certain costs and obligations based on regulatory rulings that will be recovered or refunded to customers. The regulatory assets for 2007 and 2006 were about \$1.24 billion and \$418 million, respectively, and relative to total assets, the company's regulatory assets were considerably higher than the industry average at 10.9% (2007) and 6.1% (2006). Ratings could become affected if recovery of a significant level of regulatory assets were disallowed.

Table 1

Integrys Energy Group Inc.--Peer Comparison*							
Industry Sector: Multi-Utilities							
--Average of past three fiscal years--							
	Integrys Energy Group Inc.	Alliant Energy Corp.	DTE Energy Co.	Consolidated Edison Inc.	Wisconsin Energy Corp.	MidAmerican Energy Holdings Co.	FPL Group Inc.
Rating as of Sept. 6, 2007	A-/Negative/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	A/Negative/A-2	BBB+/Stable/A-2	A-/Stable/--	A/Stable/--

Table 1

Integrus Energy Group Inc.--Peer Comparison*(cont.)							
(Mil. \$)							
Revenues	6,202.3	3,199.2	8,196.5	11,169.3	3,747.7	7,989.9	12,257.2
Net income from cont. oper.	152.8	201.8	485.3	673.0	246.1	670.5	967.9
Funds from oper. (FFO)	249.7	665.2	1,123.7	1,481.7	698.0	1,616.4	2,295.8
Capital expenditures	352.8	524.4	1,124.0	1,706.5	775.1	1,688.7	1,569.0
Cash and investments	30.3	245.6	97.0	84.0	48.6	571.7	458.3
Debt	1,809.3	2,984.6	9,330.3	8,889.3	4,366.8	14,617.5	10,297.3
Preferred stock	51.1	243.8	0.0	213.0	30.4	0.0	168.2
Common equity	1,226.0	2,445.3	5,189.2	6,390.0	2,613.1	4,756.2	9,410.8
Total capital	3,086.5	5,693.4	14,608.1	15,533.0	7,010.4	19,525.8	19,876.2
Adjusted ratios							
EBIT interest coverage (x)	3.4	2.5	1.8	2.6	2.9	1.9	2.7
FFO interest coverage (x)	3.9	4.0	3.2	3.6	4.3	2.5	4.6
FFO/debt (%)	13.8	22.3	12.0	16.7	16.0	11.1	22.3
Discretionary cash flow/debt (%)	(17.5)	(3.2)	(4.2)	(10.5)	(5.9)	(0.4)	(1.2)
Net cash flow/capex (%)	45.1	103.3	68.0	56.7	76.8	95.7	112.2
Debt/total capital (%)	58.6	52.4	63.9	57.2	62.3	74.9	51.8
Return on common equity (%)	12.1	7.3	8.6	9.0	8.2	15.6	10.2
Common dividend payout ratio (un-adj.) (%)	58.5	63.1	74.1	78.3	41.8	0	55.2

*Fully adjusted (including postretirement obligations).

Table 2

Integrus Energy Group Inc.--Financial Summary*					
Industry Sector: Multi-Utilities					
--Fiscal year ended Dec. 31--					
	2006	2005	2004	2003	2002
Rating history	A/Watch Neg/A-1	A/Watch Neg/A-1	A/Stable/A-1	A/Stable/A-1	A/Stable/A-1
(Mil. \$)					
Revenues	6,890.7	6,825.5	4,890.6	4,321.3	1,461.1
Net income from cont. oper.	151.6	150.6	156.2	110.6	118.5
Funds from oper. (FFO)	291.8	180.4	276.9	224.6	211.0
Capital expenditures	348.3	422.7	287.3	190.1	207.4

Table 2

Integrys Energy Group Inc.--Financial Summary*(cont.)					
Cash and investments	23.2	27.7	40.0	50.7	43.3
Debt	2,435.8	1,568.5	1,423.7	1,230.5	1,239.2
Preferred stock	51.1	51.1	51.1	51.1	101.1
Common equity	1,533.6	1,186.6	957.9	909.1	672.7
Total capital	4,020.5	2,806.3	2,432.7	2,190.7	2,013.0
Adjusted ratios					
EBIT interest coverage (x)	2.8	3.6	4.2	3.3	2.9
FFO interest coverage (x)	3.3	3.4	5.6	4.6	4.0
FFO/debt (%)	12.0	11.5	19.4	18.3	17.0
Discretionary cash flow/debt (%)	(14.9)	(28.7)	(9.3)	(16.5)	(7.3)
Net cash flow/capex (%)	55.3	21.7	67.0	78.8	69.5
Debt/total capital (%)	60.6	55.9	58.5	56.2	61.6
Return on common equity (%)	10.4	12.2	14.4	11.7	14.8
Common dividend payout ratio (un-adj.) (%)	64.6	57.9	53.1	66.8	58.1

*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, 2006--								
Integrys Energy Group Inc. reported amounts								
	Debt	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	Capital expenditures
Reported	2,036.5	355.9	355.9	249.8	99.2	72.9	72.9	342.0
Standard & Poor's adjustments								
Operating leases	23.3	5.4	1.4	1.4	1.4	4.0	4.0	7.1
Postretirement benefit obligations	125.2	20.3	20.3	20.3	1.7	7.6	7.6	--
Capitalized interest	--	--	--	--	0.8	(0.8)	(0.8)	(0.8)
Power purchase agreements	250.8	15.8	15.8	15.8	15.8	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	42.2	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	208.1	--
Total adjustments	399.3	41.5	37.5	79.7	19.7	10.8	218.9	6.3
Standard & Poor's adjusted amounts								
	Debt	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	2,435.8	397.4	393.4	329.5	118.9	83.7	291.8	348.3

Table 3

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

*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 September 24, 2007)***Integrys Energy Group Inc.**

Corporate Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated	
Local Currency	BBB
Senior Unsecured	
Local Currency	BBB+

Corporate Credit Ratings History

21-Feb-2007	A-/Negative/A-2
10-Jul-2006	A/Watch Neg/A-1
17-Jan-2006	A/Negative/A-1
22-Sep-2005	A/Watch Neg/A-1
26-Jan-2005	A/Negative/A-1
08-Nov-2002	A/Stable/A-1

Business Risk Profile

1 2 3 4 5 6 7 8 9 10

Financial Risk Profile

Intermediate

Debt Maturities

2008 \$0
 2009 \$150 mil.
 2010 \$50 mil.
 2011 \$475 mil.

Related Entities**North Shore Gas Co.**

Issuer Credit Rating	A-/Negative/NR
Senior Secured	
Local Currency	A-

Peoples Energy Corp.

Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured	
Local Currency	BBB+

Peoples Gas Light & Coke Co. (The)

Issuer Credit Rating	A-/Negative/A-2
Commercial Paper	
Local Currency	A-2

Ratings Detail (As Of September 24, 2007)*(cont.)

Senior Secured

Local Currency

A-

Wisconsin Public Service Corp.

Issuer Credit Rating

A/Negative/A-2

Commercial Paper

Local Currency

A-2

Preferred Stock

Local Currency

BBB+

Senior Secured

Local Currency

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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