Analyst: Carl Schemm

January 1, 2017

Utilities – Regulated Electric

WEC Energy Group Inc

Recommendation	**SELL**
Target (today's value)	$55
Current Price	$58.65
52-week range	$50.44 - $66.10

Share Data	
Ticker:	WEC
Market Cap. (Billion):	$18.5
Inside Ownership	0.2%
Inst. Ownership	70.8%
Beta	0.5
Dividend Yield	3.6%
Payout Ratio	66.8%
Cons. Long-term Growth Rate	6.6%

	'14	'15	'16E	'17E	'18E
Sales (billions)					
Year	$5.0	$5.9	$7.8	$8.1	$8.6
Gr %	10.6%	18.6%	31.3%	4.4%	6.0%
Cons	-	-	$8.5	$8.7	$8.8
EPS					
Year	$2.61	$2.36	$3.00	$3.10	$3.28
Gr %	2.8%	-9.7%	27.6%	3.3%	5.8%
Cons	-	-	$2.94	$3.11	$3.33

Ratio	'14	'15	'16E	'17E	'18E
ROE (%)	13.5	9.7	9.7	10.8	11.0
Rel Industry	1.37	1.14	1.13	1.11	1.11
NPM (%)	11.8	10.8	12.2	12.1	12.1
Rel Industry	1.28	1.19	1.20	1.17	1.11
A. T/O	0.33	0.26	0.26	0.27	0.28
ROA (%)	3.9	2.8	3.2	3.2	3.4
Rel Industry	1.36	1.14	1.55	1.22	1.24
A/E	3.43	3.39	3.36	3.31	3.27

Valuation	'15	'16E	'17E	'18E
P/E	21.0	19.7	19.9	18.9
Industry	16.5	19.3	18.1	17.7
P/S	2.9	2.4	2.2	2.1
P/B	1.8	2.0	2.1	2.0
P/CF	12.5	9.7	9.2	8.8
EV/EBIT	16.0	17.3	16.7	15.6

Performance	Stock	Industry
1 Month	4.7%	4.4%
3 Months	-1.2%	-0.4%
YTD	18.2%	18.2%
52-week	16.1%	16.8%
3-year	57.3%	50.1%

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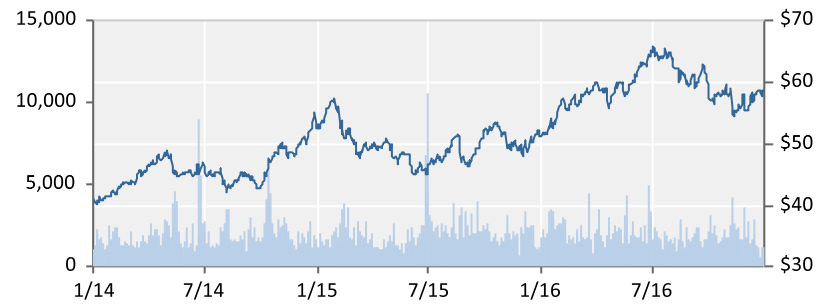


Source: FactSet Prices

Summary: I recommend a sell rating with a target of $55. Increasing interest rates and lower allowed returns will depress multiples. This will be partially offset by a growing rate base as management now expects CapEx to peak at $1.96 billion in 2018. This compares to an expected $1.48 billion of capital expenditures in 2016. WEC is overvalued based on a three-stage DCF model and relative valuation approach.

Key Drivers:

- Interest rates: WEC underperforms the S&P 500 in periods of rising interest rates. The December rate hike and 2017 expectations announcements, highlight a greater probability of declining multiples.

- Integrys acquisition: With the acquisition of Integrys, WEC has expanded operations into Illinois, Michigan, and Minnesota. Increased ownership in ATC and geographic proximity will drive earnings. Because of the acquisition, a larger portion of WEC's earnings is dependent on natural gas.

- Capital expenditures: Management has revised capital expenditure expectations upwards several times in recent months, due largely to a bonus tax depreciation and replacement of Chicago's aging natural gas pipelines. Management now expects to invest between $9 and $9.5 billion in its rate base from 2016-2020. 170MW of generating capacity will be constructed to power the Tilden Mining Company operations.

Valuation: Using a weighted average of DCF, P/E, and relative valuation approaches, WEC appears to be overvalued. This combination of approaches suggests that the stock's value is about $55 and the shares closed the day at $58.01.

Risks: Threats to the business include governmental regulation, rising interest rates, equipment failure/breakdown, pension expense, and weather.

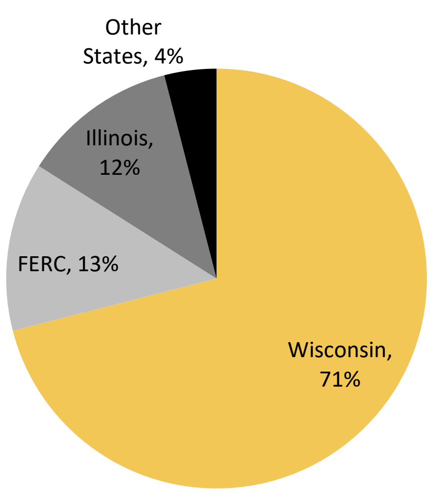
Company Overview

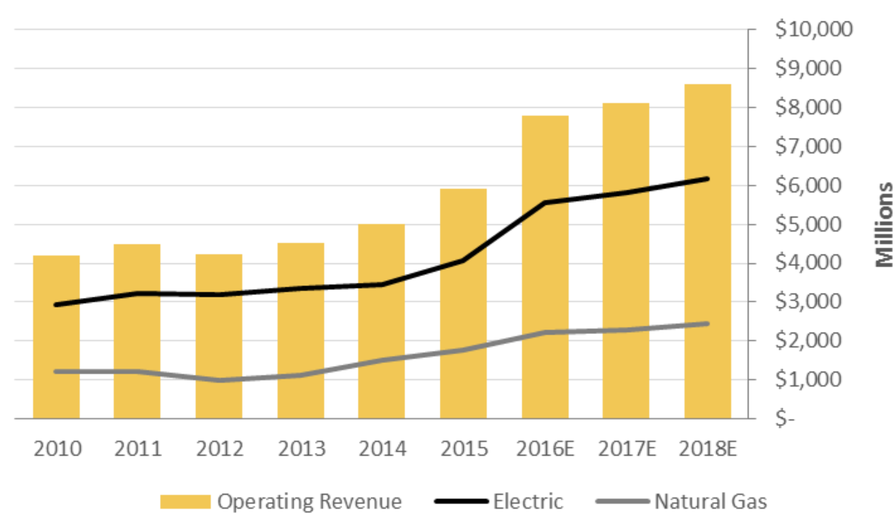
WEC Energy Group Inc. (NYSE: WEC) is a regulated energy holding company headquartered in Milwaukee, WI. WEC has provided energy services to the southeastern Wisconsin area since 1896. The company provides electric and natural gas utility services through its principal subsidiaries: We Energies, Wisconsin Public Service, Peoples Gas, North Shore Gas, Minnesota Energy Resources, and Michigan Gas Utilities. WEC Energy Group Inc. was formed on June 29, 2015, when Wisconsin Energy Group acquired Integrys Energy Group, Inc. (formerly NYSE: TEG) and its subsidiaries. Integrys provided natural gas services to Illinois, Michigan, Minnesota, and Wisconsin. WEC Energy Group operates about 70,000 miles of electric distribution lines and 44,000 miles of natural gas distribution and transmission lines. In addition to its current operations, WEC owns an approximately 60% equity interest in American Transmission Company (ATC).

As one of the nation's largest electric and natural gas utility companies, WEC Energy Group serves more than 4.4 million customers through its six reporting segments:

- Wisconsin: We Energies and Wisconsin Public Service deliver natural gas and electricity to communities throughout Wisconsin and the Michigan's Upper Peninsula.
  - Second quarter year-over-year revenue growth of 33% from 2015 to 2016, mostly due to Integrys acquisition
- Illinois: Peoples Gas and North Shore Gas deliver natural gas to customers in the city of Chicago and its nearby suburbs.
- Other states: Minnesota Energy Resources and Michigan Gas Utilities deliver natural gas to communities in Minnesota and Michigan.
- Electric transmission: ATC operates transmission systems in Wisconsin, Michigan, Illinois, and Minnesota.
  - Second quarter year-over-year equity in earnings growth of 116% from 2015 to 2016, largely due to Integrys acquisition
- We Power: We Power, LLC is a nonutility affiliate that builds power plants to lease to utility subsidiaries. WEC's recent power generation expansion, named Power the Future (PTF), has built four new facilities with an authorized ROE of 12.7 percent.
- Corporate and other: WEC Energy Group holding company, Integrys holding company, and WEC's additional operations report under the corporate and other segment.

Figures 1 and 2: 2015 Regulated earnings by jurisdiction (left) and operating revenue history since 2010 (right)





Source: Company Reports

Business/Industry Drivers

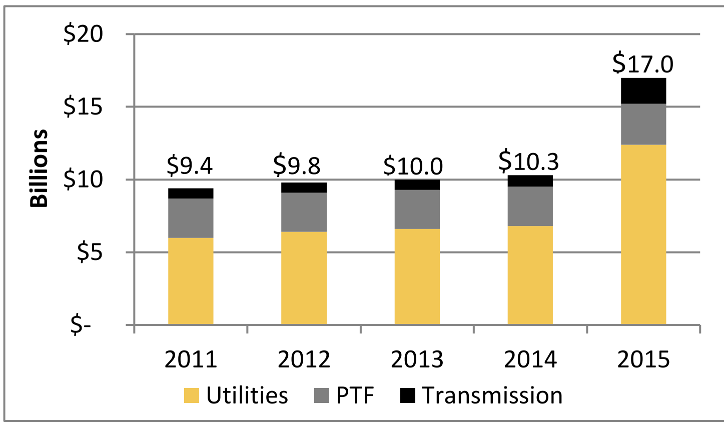
The performance of WEC will be significantly influenced by the following drivers:

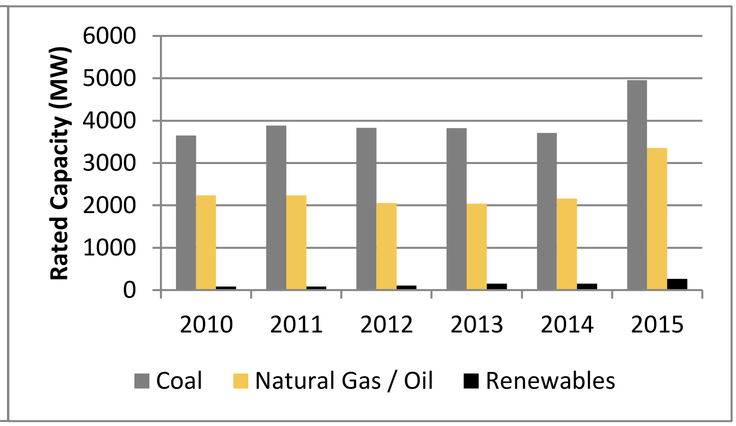
1) Integrys acquisition
2) Regulation
3) Capital expenditures
4) Management and customer developments
5) Competitive position
6) Macroeconomic trends

Integrys Acquisition

On June 23, 2014, WEC Energy Group Inc. announced an agreement to acquire Integrys Energy Group Inc. The acquisition was completed on June 29, 2015, and the joint company began reporting combined financials in the first quarter of 2016. As a result of this acquisition, WEC has expanded operations into Illinois, Michigan, and Minnesota.

Figures 3 and 4: Total rate base (left) and Rated generation capacity by fuel type (right)





Source: Company reports

> WEC's rate base and generation capacity increased 65% and 42% respectively

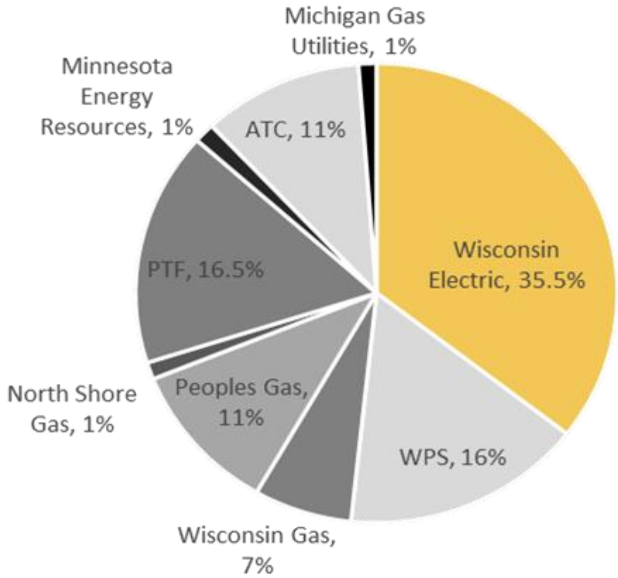
The acquisition also increased WEC's ownership of American Transmission Company (ATC) from approximately 26% to slightly more than 60%. Management lists WEC's five key cost reduction initiatives for the merger as staff level reductions, consolidating IT infrastructure, enhancing supply chain contracts, improving customer satisfaction, and operations standardization. These initiatives could save $0.03 in expenses after taxes, based on a pre-tax savings of about $16 million per year.

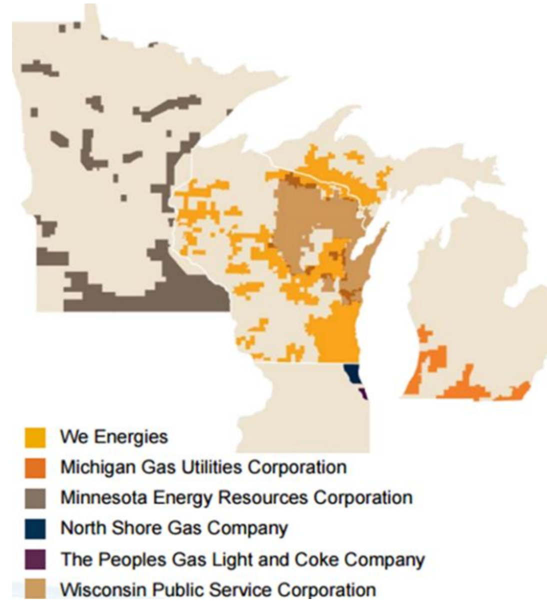
> Acquisition Rationale
> - Increased ownership in ATC
> - Location proximity
> - Increased natural gas (cleaner fuel)
> - Growth through acquisition

Thus far, the benefits of the acquisition have allowed WEC to freeze base rates of multiple subsidiaries and increase the year-over-year dividend rate by 17.2% in the first half of 2016. The geographic proximity of WEC and Integrys operations should prove advantageous for the combined utility.

Because of the Integrys acquisition, natural gas represents a larger portion of WEC's earnings base. This product shift increases the seasonality of earnings with a relatively higher portion of earnings occurring in the first and fourth quarters. Abnormally warm summers and cold winters drive customer demand for air conditioning and heating services. Last winter, the first winter of the combined WEC and Integrys operations, was the second warmest in company history. Earnings may be materially improved in the event of a colder winter in the Midwestern region.

Figures 5 and 6: 2015 Regulated earnings by business (left) and service territory (right)





Source: Company Reports

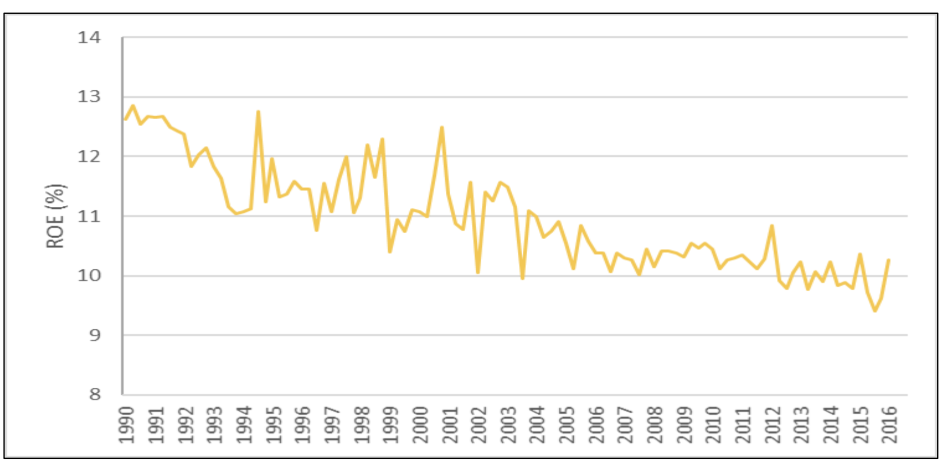
WEC financed the acquisition through the issuance of $1.2 billion of long-term debt, $300 million of commercial paper, and approximately 90.2 million shares of WEC common stock.

Benefits of the acquisition may be partially or fully offset by share dilution, unexpected transaction fees, increased per share interest expenses, goodwill impairment, or increased legal and regulatory risks. Additionally, increased ownership of ATC could negatively affect WEC's financial performance due to currently pending rate case litigation.

Regulation

Wisconsin has traditionally been a favorable regulatory environment for WEC. Including ATC and the Power the Future operations, WEC's weighted average authorized ROE (determined by rate base weights), is about 10.65%. This is slightly better than the first quarter 2016 average awarded ROE of 10.26% among investor-owned electric utilities, per the Edison Electric Institute (EEI). Average awarded ROE amongst regulated electricity utilities has been on a long downward trend, partially due to declining interest rates.

Figure 7: Industry average awarded ROE



Source: SNL Financial / Regulatory Research Assoc. & EEI Rate Department

The CPP states that generating facilities must meet compliance obligations by the year 2030.

Going forward, WEC Energy group will face a more difficult regulatory environment, largely due to a less favorable regulatory environment in Illinois. ATC is facing regulatory headwinds as Midcontinent Independent System Operator, Inc. (MISO) has issued several complaints with the Federal Energy Regulatory Commission (FERC) regarding transmission owners' ROE. In February, the Administrative Law Judge recommended ATC's base ROE be reduced from 12.2% to 9.7%. This matter is still pending. An authorized reduction of ATC's ROE could adversely impact the WEC's earnings. I expect a lower allowed ROE to decrease equity earnings in transmission affiliate by about $6 to $10 million in 2018. The current Minnesota Energy Resources rate case, initiated by MERC, aims to increase retail natural gas rates by $14.8 million. The proposed increase is related to construction, capital expenditures, and an acquisition of Alliant Energy Corporation's Minnesota natural gas operations.

Figure 8: Recent Rate Cases

Rates Case	Utility	Application	Order	Req. ($ mil)	Auth. ($ mil)	ROE	Equity
WE	Electric	May-14	Dec-14	52.30	12.70	10.2%	51.00%
	Gas	May-14	Dec-14	(10.20)	(10.20)	10.2%	51.00%
WPS	Electric	Apr-15	Dec-15	94.10	(7.90)	10.0%	51.00%
	Gas	Apr-15	Dec-15	9.40	(6.20)	10.0%	51.00%
PGL	Gas	Feb-14	Jan-15	128.90	71.10	9.05%	50.33%
NSG	Gas	Feb-14	Jan-15	7.10	3.50	9.05%	50.48%
Michigan	Gas	Jun-15	Dec-15	6.7	3.4	9.9%	52.00%
Minnesota	Gas	Sep-15	Oct-16	14.80	6.8	9.1%	50.32%

Source: Company reports

Trends in renewable energy are particularly harmful to WEC as Wisconsin is not a favorable location for solar or wind power. I believe this is why WEC has targeted natural gas as a cleaner fuel source than coal.

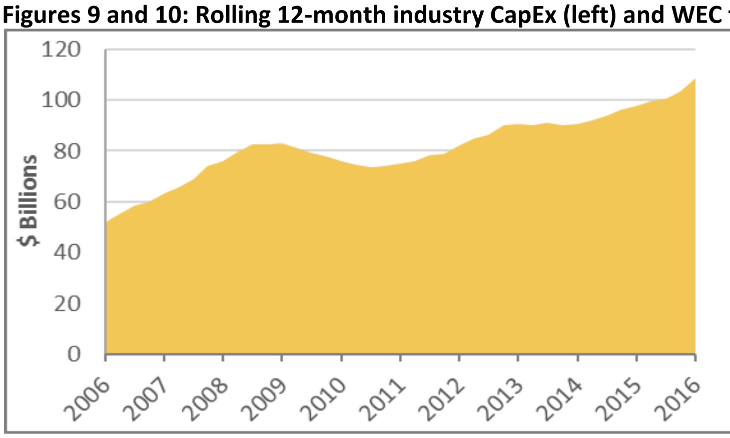
WEC is subject to significant environmental regulation. Emissions such as carbon dioxide, sulfur dioxide, nitrogen oxide and other greenhouse gasses are heavily monitored and regulated. The Clean Power Plan (CPP), initiated by the Environmental Protection Agency in 2015, imposes greenhouse gas reduction standards on current generating facilities. The CPP is currently pending judicial review at the Supreme Court. Increased costs related to the CPP may not be fully recoverable in rate cases and free cash flow could be negatively affected by this and further environmental regulation.

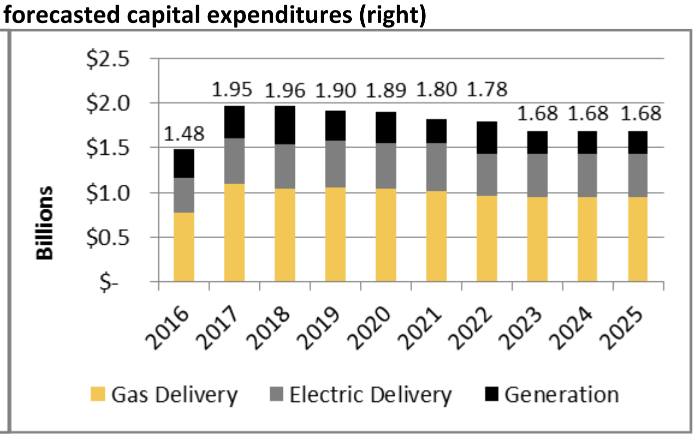
Capital expenditures

I forecast capital expenditures in 2017 of $1.95 billion to add about $0.19 to 2018 EPS.

Low interest rates and aging distribution channels have contributed to an extended building cycle amongst electric utilities. A recent EEI cash flow analysis estimated a 47.8% rise in industry capital expenditures from the third quarter of 2010 through the first quarter of 2016. The EEI has forecasted this building cycle to peak in 2016. WEC has forecasted its capital expenditure plan to peak in 2018 at $1.96 billion (about 9.8% of WECS' net property, plant, and equipment). Much of industry capital expenditure has been allocated towards gas and electric delivery as opposed to generation. Companies have sought to improve delivery reliability and replace aging delivery systems as well as move power lines underground. Completion of a building cycle can result in significantly enhanced cash flows due to lower capital expenditures but lowers rate base growth going forward.

Figures 9 and 10: Rolling 12-month industry CapEx (left) and WEC forecasted capital expenditures (right)





Source: SNL Financial, EEI Finance Department, & Company Reports

The EEI forecasts industry cap-ex to fall about 20% from peak levels over the next two years.

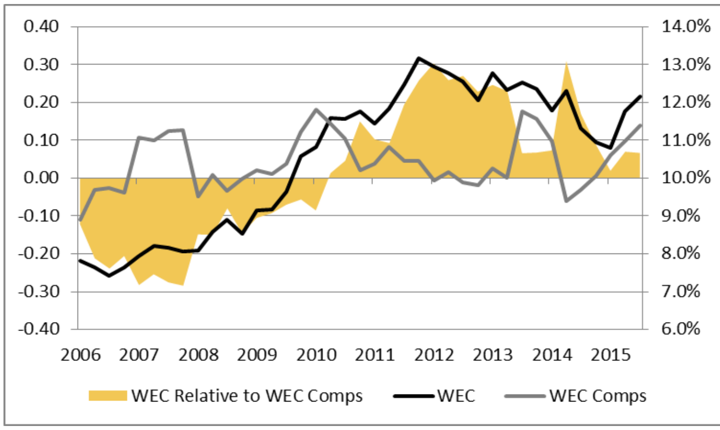
WEC plans to construct 170 MW of capacity in Michigan's Upper Peninsula by investing in $255 million in two natural gas sites. In Chicago, People's Gas is replacing approximately 2,000 miles of natural gas pipelines. Annual pipeline expenditures of $250 million to $280 million are expected through 2018. WPS is in the process of implementing a multi-pollutant control technology, at an estimated cost of approximately $345 million. An additional $100 million investment of WEC's System Modernization and Reliability Project is expected in 2019 and 2020.

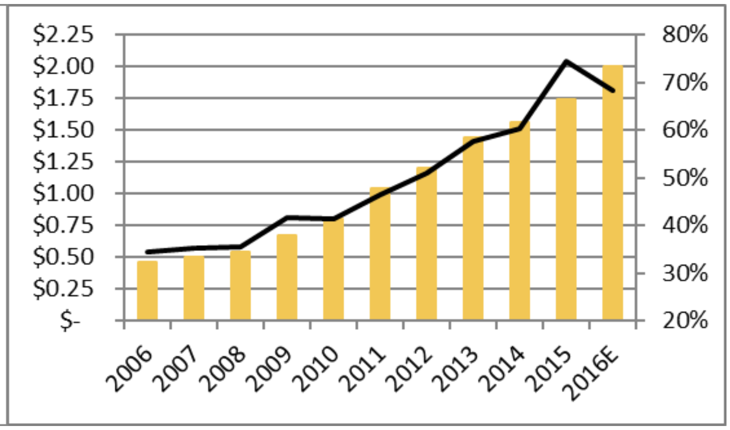
Management and customer developments

Other new roles in the management team include Scott Lauber as chief financial officer and Kevin Fletcher as president of We Energies and WPS.

Effective May 1, 2016, Allen Leverett replaced Gale Klappa as CEO of WEC Energy Group Inc. Klappa retired from the chief executive role but remained on the board as a non-executive chairperson. In addition to replacing Klappa as CEO, Allen Leverett was appointed to WEC's board of directors in January 2016. Leverett is targeting 6 to 8 percent earnings growth in 2016 and 5 to 7 percent thereafter. Dividend growth is projected to be in line with earnings growth and the annual dividend payout ratio is targeted to be between 65% and 70%. Drivers of earnings growth that WEC management must address include: working with regulators, integrating operations with Integrys, determining capital allocation opportunities, and identifying additional cost savings.

Figures 11 and 12: WEC net margin relative to comps 2006 - 2016(left) and Annual dividend per share and payout ratio (right)



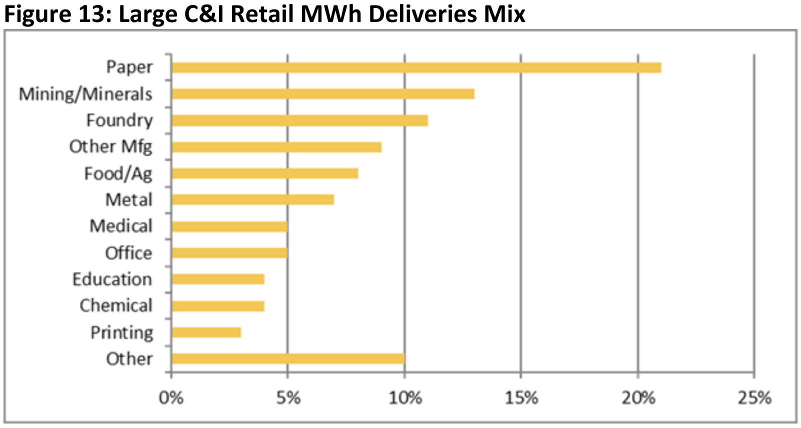


Source: Company Reports & FactSet

The EEI forecasts electric demand to increase 19.7% from 2015 to 2040.

Demand for electricity and natural gas services are significantly influenced usage per customer. Approximately 35% of its retail customer base are small commercial and industrial (C&I) businesses, 37% are large C&I businesses, and the remaining 28% include residential and farm consumers. In relation to comparable Midwestern utilities, WEC's customer base consists of a higher percentage of C&I business. This means WEC's customer demand is more cyclical and subject to economic downturns than its competition.

Figure 13: Large C&I Retail MWh Deliveries Mix



Source: Company Reports

Customer demand is significantly influenced by several factors, including population growth, weather trends, housing and business starts, wages, unemployment, natural gas prices, energy rates, and self-generation. In the state of Michigan, customers can select energy providers. If other states in which WEC operates adopt similar standards, WEC could be negatively affected by customers choosing alternative suppliers. In February 2015, WEC's largest retail customer, Tilden Mining Company, a subsidiary of Cliffs Natural Resources, returned to WEC after choosing an alternative supplier two years earlier. In 2015, Tilden announced its intention to close one of its two iron ore mines in the Upper Peninsula in 2017. In August 2016, Cliffs Natural Resources announced a 20-year agreement with WEC to supply Tilden with electrical power.

Competitive position

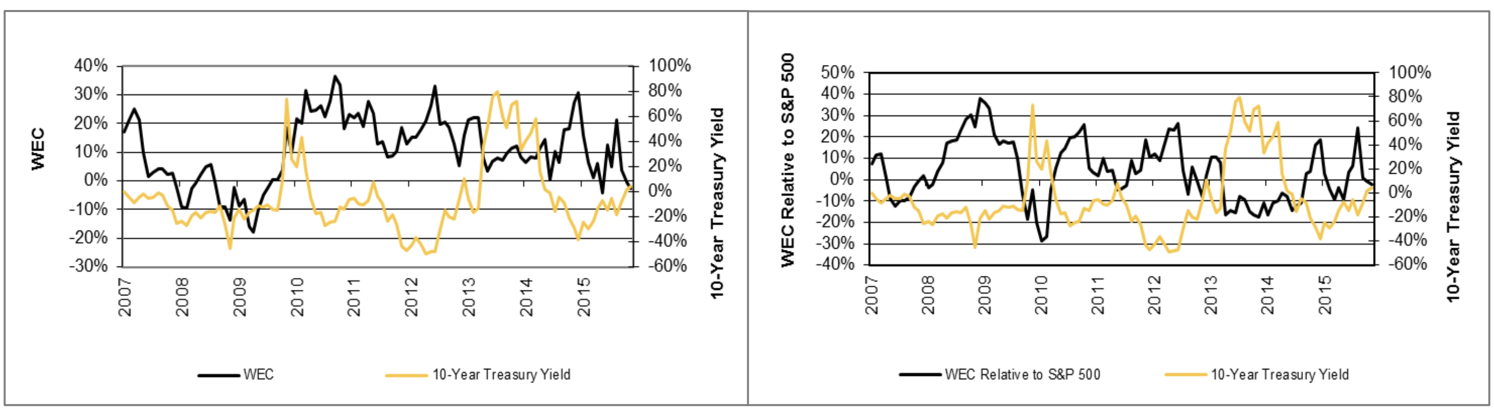
In Wisconsin, retail electric customers are not able to choose their electric supplier. WEC's competes for customers in the wholesale electric market as well as cooperatives and municipalities. WEC also faces competition from self-generation of large industrial customers. Competitive positioning and individual company growth in the industry has developed largely through acquisitions due to natural geographic monopolies. Going forward, WEC's competitive success will depend on its ability to maintain good margins, identify favorable acquisitions, and obtain favorable rate orders.

First in the field policy protects WEC from potential competitors, by disallowing construction of natural gas distribution systems. Recently, regulators have begun to implement procedures in the natural gas industry to encourage competition. As well as competing with other natural gas suppliers, WEC must evaluate the likelihood of customers with dual fuel capability switching to alternate fuels. Volatile commodity prices may cause such customers to seek alternative fuel sources.

Macroeconomic Trends

The utility industry is negatively correlated to Treasury yields. Due to dividend reliability, WEC and its competitors have consistently outperformed the S&P 500 in periods of decreasing interest rates but underperformed relative to the S&P 500 during periods of rising interest rates. WEC's dividend yield and payout ratio currently lie at about 3.4% and 68% respectively. This is slightly higher than comparable companies at 3.31% and 64.3% respective average dividend yield and payout ratio.

Figures 14 and 15: 10-Year Treasury Yield compared to WEC (left) and 10-Year Treasury Yield relative to the S&P 500 index (right)



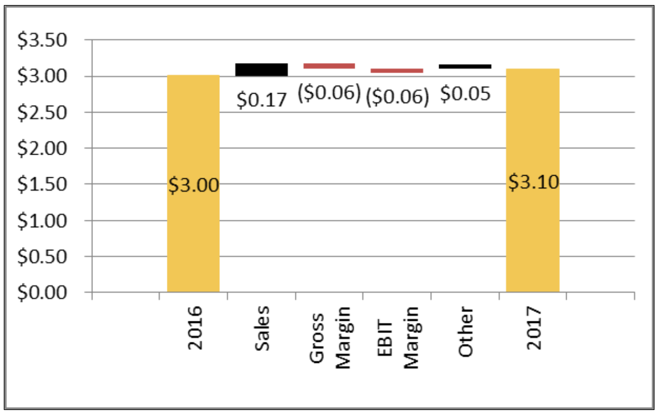
Source: Bloomberg, IMCP

In 2017, a rising yield curve and interest rate increases may cause WEC and the utility industry to underperform the S&P 500. Although the Fed hinted at a greater number of interest rate hikes in 2017, many investors have remained doubtful, and multiples have remained above historical averages. If expectations change, and the outlook for more rate hikes increases, WEC will experience above average volatility and downward pressure.

Financial Analysis

I expect GAAP EPS to grow to $3.10 in 2017. Anticipated operating revenue growth of 4.4% should increase earnings by $0.17. Gross margin and EBIT margin decline will each contribute $0.06 negatively to earnings. Gross margin is expected to decline to 53.5%; down from about 53.9% in 2016. 2016 has been an abnormally high year for gross margin and I anticipate a reversion of this trend back to normal levels. Excluding the impact of a lower gross margin, the primary reason for a lower EBIT margin in 2017 is an additional $35 million to pension expense. This will decrease WEC's equity in earnings of transmission affiliate. The $35 million pension expense will cause EPS to fall $0.11. This will be partially offset by efficiencies related to the acquisition and reduced acquisition expenses. A slightly higher interest expense should be more than offset by a lower tax rate, which would add $0.05 to EPS.

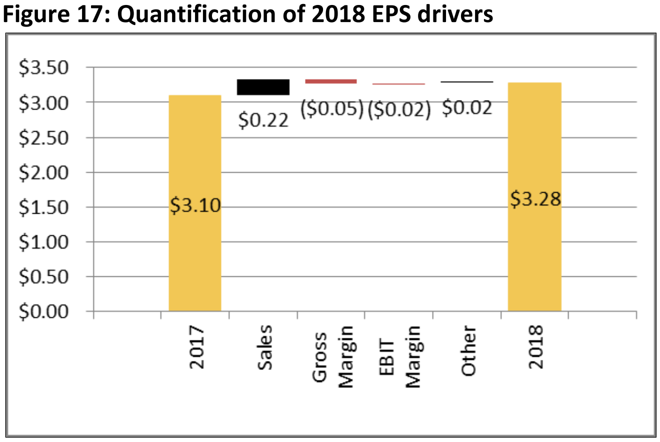
Figure 16: Quantification of 2017 EPS drivers



Source: IMCP Valuation Model

I expect 2018 EPS to increase $0.19 to $3.29. Operating revenues should increase earnings by $0.24. Gross margin (including depreciation and amortization) decline will contribute $0.05 negatively to earnings. I anticipate depreciation expense to rise in 2018 following greater capital expenditures in 2016 and 2017. I expect the increase in depreciation expense to decrease gross margin by 0.3% in 2018. Notice in Figure 17 EBIT margin decline (excluding the impact of gross margin) will contribute $0.02 negatively to earnings. I expect ATC's lower allowed ROE, following the recent FERC rate cases to decrease equity earning in transmission affiliate by about $6 to $10 million. A slightly higher interest expense should be more than offset by a lower tax rate, which would add $0.02 to EPS.

Figure 17: Quantification of 2018 EPS drivers



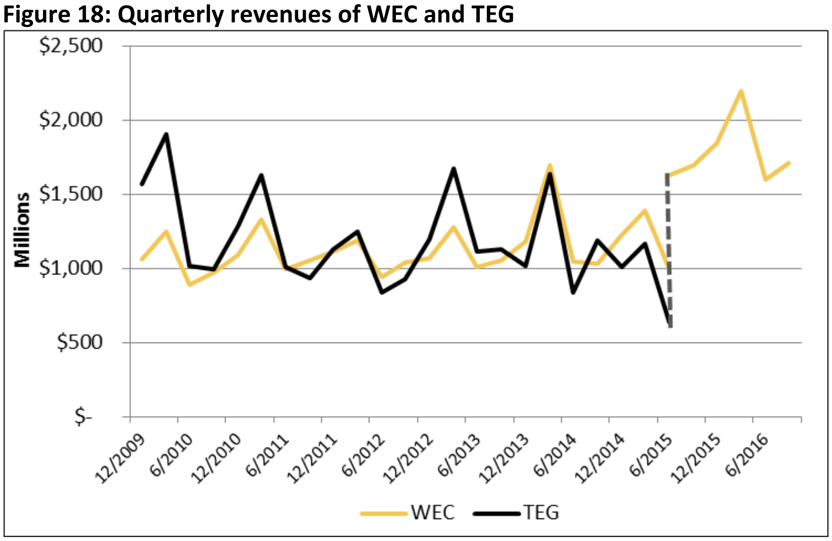
Source: IMCP Valuation Model

Revenues

Prior to the fiscal year 2014, WEC experienced mid-single-digit growth in operating revenue. In 2014 operating revenue grew 10.6%. Most this growth was from retail gas revenues resulting from a 5.3% colder winter (measured in heating degree days) than 2013. Total gas utility operating revenues grew by 33.9% in 2014.

In 2015, revenue grew by 18.6%, from $4,997 million in 2014 to $5,926 million in 2015. The two primary drivers of revenue growth in 2015 were the Integrys acquisition and the return of the two Tilden Mines in Michigan's Upper Peninsula as customers. The iron ore mines are WEC's largest retail electric customer. The mines had previously switched to another electricity supplier in 2013 before returning to WEC in February of 2015. Following the return, Cliffs Natural Resources, the owner of the mines, signed a 20-year contract with WEC to continue to power the mines. In the second quarter of 2015, WEC began reporting operating results of the combined entity, including the operations of Integrys. In the last three quarters of 2015, operating revenues totaled $5.2 billion, a 58.7% increase from the final three quarters of 2014.

Figure 18: Quarterly revenues of WEC and TEG

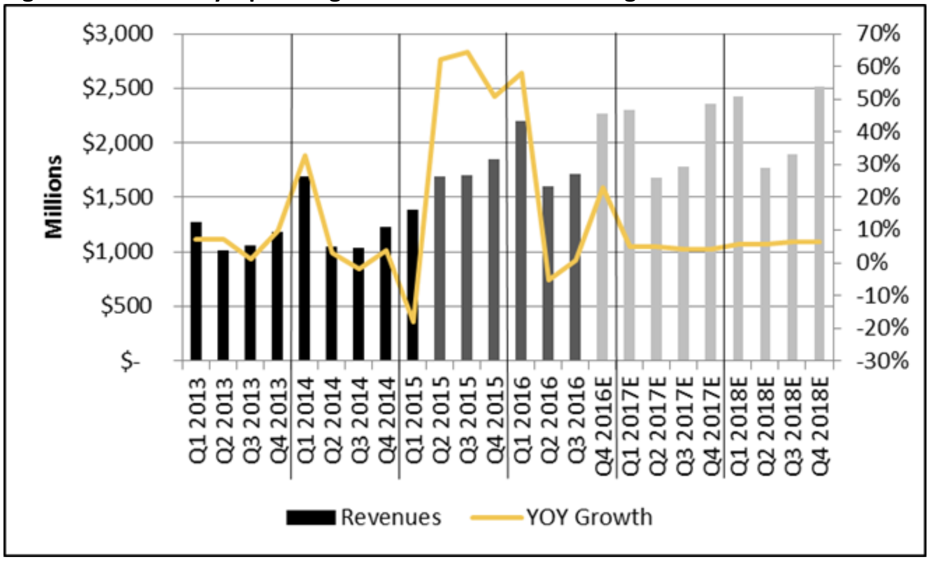


Source: Company Reports

I anticipate full year 2016 revenue to be about $7.8 billion, a 31.3% growth from 2015. 2016 will be the first full year in which the operations of Integrys are included in WEC's financial results. First quarter operating revenue was reported at $2,195 million, a 58.1% growth from the prior year. In the first 9 months of fiscal year 2016, WEC reported operating revenues of $5.5 billion. Therefore, I anticipate fourth quarter operating revenues of $2,272 million. This is 22.9% higher than 2015 fourth quarter results of $1,848.

Revenues will likely be helped by a colder winter, developments entering service and customer growth. Fourth quarter 2015 revenues were significantly hampered by the warmest winter in WEC's history. Notice the greater seasonality in revenues in Figure 19, in which more revenues occur in Q1 and Q4. I expect more normal weather conditions to increase sales volume and drive revenue by $200 million. I also expect greater customer growth and demand due partially to a more positive economic outlook for WEC's commercial and industrial customer base.

Figure 19: Quarterly Operating Revenue vs YoY revenue growth 2013 – 2016E



Source: Company Reports

I expect revenue growth to return to the mid-single digit range in 2017 and 2018 and beyond. I anticipate sales growth of 4.4% and 5.7% in 2017 and 2018 respectively. Sales growth will be significantly dependent on capital expenditures and rate cases in the coming years. In Figure 20 I calculate sales growth attributable to capital expenditures. I begin by using expected ROE and equity component adjusted for taxes to calculate EPS growth attributable to capital expenditures. I then utilize profit margin to convert EPS growth into sales growth.

- EPS Growth = (Prior Year CapEx x Equity (%) x ROE (%) X (1 – Tax Rate (%))) / Shares
- Sales Growth = (EPS Growth x Shares) / Profit Margin

Figure 20: Next 7 years' sales growth from capital expenditures

Year	Prior Yr CapEx (billions)	ROE	Equity	Tax Rate	EPS Growth	Profit Margin	SALES Growth (millions)
2017	$ 1.48	10.26%	51%	39%	$ 0.15	12.0%	$ 394
2018	$ 1.95	10.00%	51%	38%	$ 0.19	12.1%	$ 504
2019	$ 1.96	10.17%	51%	37%	$ 0.20	12.1%	$ 530
2020	$ 1.90	10.88%	51%	36%	$ 0.21	12.1%	$ 556
2021	$ 1.85	11.62%	51%	36%	$ 0.22	12.1%	$ 581
2022	$ 1.80	12.06%	51%	35%	$ 0.23	12.1%	$ 604
2023	$ 1.78	12.68%	51%	35%	$ 0.24	12.1%	$ 628

Source: Company Reports

Capital expenditures are based on management forecasts. I use the company's weighted average allowed ROE and equity component as the assumption for the first-year projection. You will notice ROE remains below 11% in the first 4 years. I base this assumption on lower approved ROE's in future rate cases. ROE then rebounds towards historical average. From 2017 to 2023, sales growth attributable to capital expenditure increases from $394 million to $628 million.

The sales growth in Figure 20 is used as a basis for my belief that total operating revenues in 2019 through 2023 should grow at about 5% per year in line with management's expectations. It is important to note that a growing ROE and lower tax rate are somewhat aggressive assumptions, justifying my belief that consensus growth is overstated.

Revenue and EPS Estimates

I am less optimistic on revenue, but more optimistic on EPS estimates for FY 2016 relative to consensus. In FY 2017 and FY 2018, my estimates for revenue are lower than consensus. My 2016 EPS is above the upper range of management's guidance and my 2017 EPS is within management's guidance range and equals consensus. Overall, my estimates of revenue and GAAP EPS are in line with consensus.

Figure 21: Revenue and EPS estimates

	2016E	2017E	2018E
Revenue Estimate*	$7,781	$8,127	$8,589
YoY Growth	31.3%	4.4%	5.7%
Revenue Concensus*	$8,527	$8,745	$8,809
YoY Growth	43.9%	2.6%	0.7%
*in millions			
EPS Estimate	$3.00	$3.10	$3.28
YoY Growth	27.6%	3.3%	5.7%
EPS Consensus	$2.94	$3.11	$3.33
YoY Growth	7.7%	5.8%	7.1%
EPS Guidance High	$2.94	$3.12	-
EPS Guidance Low	$2.88	$3.06	-

Source: FactSet

Return on Equity

WEC has historically achieved a return on equity above its comps. This is largely due to its higher net profit margins than the industry, which has more than offset a lower than average leverage ratio, thus it has a higher ROE with less risk. In 2015, the ROE results are skewed by the acquisition. Acquisition related costs caused net profit margin to drop while the spike in assets decreased the sales-to-average assets ratio. This drove down ROA to 2.9% and caused ROE to decrease from 13.6% in 2014 to 9.8% in 2015. Except for the 2015 acquisition, DuPont analysis reveals that ROE is driven primarily by profit margins.

Figure 22: ROE breakdown, 2013-2018E

3-stage DuPont	2013	2014	2015	2016E	2017E	2018E
Net income / sales	12.8%	11.8%	10.8%	12.2%	12.1%	12.1%
Sales / avg assets	0.31	0.34	0.27	0.26	0.27	0.28
ROA	4.0%	4.0%	2.9%	3.2%	3.2%	3.4%
Avg assets / avg equity	3.47	3.43	3.39	3.36	3.31	3.26
ROE	13.8%	13.6%	9.8%	10.8%	10.7%	10.9%

Source: Company Reports

Thus far, the financial results of 2016 suggest a recovery of net profit margin but not asset turnover. Therefore, I anticipate ROA to grow to 3.2% in 2016. WEC's recent rate cases have required the company to maintain its common equity components around 50% - 52%, so I expect ROE in 2016-2018 to be only modestly affected by leverage. I expect ROE to recover to 10.8% in 2016 and remain near that level in 2017 and 2018. I do not expect ROE to return to 2013 – 2014 levels due to a decline in allowed ROE in recent rate cases.

Free Cash Flow

WEC's ability to generate free cash flow has been impressive over the last several years. The electric utility industry is notoriously capital intensive, and companies constantly seek capital projects to grow earnings. Many comparable companies typically produce lower or negative free cash flows.

My analysis suggests that WEC has been able to maintain above average free cash flows because of its high profitability. The resulting output shows that NOPAT has typically been greater than growth in net fixed assets (CapEx – depreciation). Despite WEC's ability to generate positive free cash flows, these results are highly volatile on a year-to-year basis.

I expect FCFE in 2016 through 2018 to be slightly lower than previous years because the company has ramped up capital expenditures. In its December investor presentation, WEC again revised its capital plan upward to reflect greater investment in gas delivery systems. In 2017 and 2018, the company expects to invest $1.95 billion and $1.96 billion respectively. To finance these projects, I expect WEC to issue debt in 2017 and 2018.

Please notice that 2015 figures for changes in net fixed assets and debt have been adjusted for the Integrys acquisition.

Figure 23: WEC FCF analysis 2012 – 2018E

Free Cash Flow	2012	2013	2014	2015	2016E	2017E	2018E
NOPAT	$705	$737	$738	$838	$1,192	$1,234	$1,305
Growth		*4.5%*	*0.2%*	*13.5%*	*42.3%*	*3.6%*	*5.7%*
NOWC	$638	$934	$666	$751	$674	$542	$193
Net fixed assets	$13,012	$13,218	$13,612	$27,148	$27,889	$28,718	$29,824
Total net operating capital	$13,650	$14,153	$14,278	$27,899	$28,563	$29,259	$30,018
Growth		*3.7%*	*0.9%*	*95.4%*	*2.4%*	*2.4%*	*2.6%*
- Change in NOWC		$296	-$269	$85	-$76	-$132	-$348
- Change in NFA		$206	$394	$13,536	$740	$829	$1,107
+ NFA attributable to acquisition				$12,453			
FCFF		$235	$613	-$330	$528	$538	$546
Growth			*161.2%*	*-153.8%*	*-260.3%*	*1.8%*	*1.6%*
- After-tax interest expense		$158	$149	$198	$243	$254	$268
+ Net new short-term and long-term debt		-$18	-$30	$5,164	-$30	$124	$155
- Debt attributable to acquisition				$4,228			
FCFE		$59	$434	$409	$256	$408	$433
Growth			*640.0%*	*-5.6%*	*-37.5%*	*59.2%*	*6.3%*
FCFF per share		$1.03	$2.72	-$1.22	$1.67	$1.70	$1.73
Growth			*163.5%*	*-144.8%*	*-237.7%*	*1.8%*	*1.6%*
FCFE per share		$0.26	$1.92	$1.51	$0.81	$1.29	$1.37
Growth			*646.5%*	*-21.4%*	*-46.3%*	*59.2%*	*6.3%*

Source: Company reports

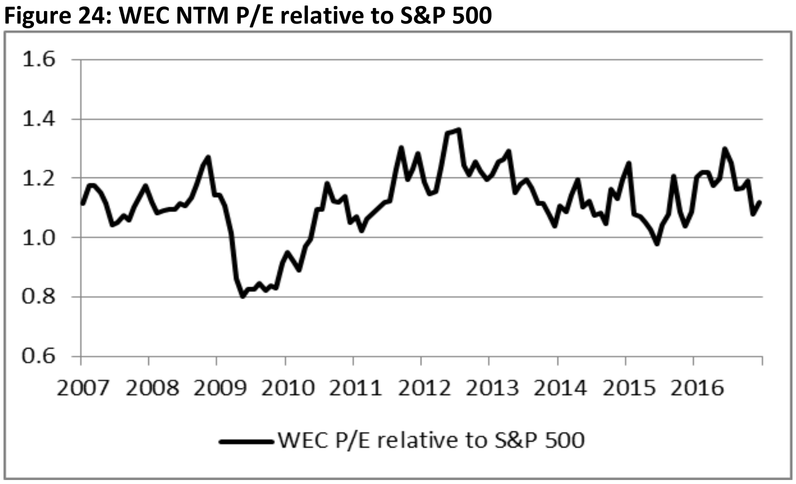
Valuation

WEC was valued using a 3-stage discounted dividend model and a relative valuation approach. Based on forecasted NTM P/E and expected 2018 EPS of $3.28, the stock is overvalued with a target price of $54.88. A P/B relative valuation regression, based on ROE, shows WEC to be slightly overvalued compared to its peers. Price-to-book valuation yielded a price of $55.79. A detailed DCF analysis values WEC slightly higher, at $55.61. Based on these valuations, I believe WEC is worth about $55.00.

Trading History

WEC is currently trading near its ten-year average NTM P/E relative to the S&P 500. Notice WEC typically trades at a P/E above the S&P 500, and trades within a range of 0.8 to 1.4 times the market. WEC's current NTM P/E is at 18.9 compared to its ten-year average of 16.0. I expect some regression towards that amount in the next year as interest rates rise and industry multiples fall.

Figure 24: WEC NTM P/E relative to S&P 500



Source: FactSet

Assuming the firm's NTM P/E falls to 18.0 by the end of 2017, it should trade at $59.04 by the end of the year based on my 2018 EPS estimate.

- Price = P/E x EPS = 18.0 x $3.28 = $59.04

Discounting $59.04 back to today at a 7.58% cost of equity (explained in Discounted Cash Flow section) yields a price of $54.88. Multiplying the P/E of 18.0 by 2018 consensus EPS of $3.33 results in a stock value of $55.72 today.

Relative Valuation

WEC Energy Group Inc. is currently trading at a P/E in line with its peers, with a TTM P/E of 20.2 compared to an average of 20.6. P/B is also in line with peers; however, WEC's P/S ratio is higher than its peers. This is likely due to the company's high net profit margin relative to its peers.

Figure 25: WEC comparable companies

Ticker	Name	Current Price	Market Value	Price Change 1 day	1 Mo	3 Mo	6 Mo	52 Wk	YTD	LTG	Earnings Growth NTM	2015	2016	2017	2018	Pst 5yr	Beta	LT Debt/ Equity	S&P Rating	LTM Dividend Yield	Payout
WEC	WEC ENERGY GROUP INC	$58.65	$18,511	(0.3)	4.7	(2.1)	(10.2)	12.3	14.3	6.2	9.7%	-9.7%	25.6%	5.8%	7.1%	4.2%	-0.05	102.2%	A	3.42%	66.8%
AEE	AMEREN CORP	$52.46	$12,729	(0.2)	6.8	6.7	(2.1)	19.2	21.4	5.9	0.0%	7.9%	4.6%	2.2%	7.9%	35.0%	0.29	91.9%	B	3.27%	63.4%
CMS	CMS ENERGY CORP	$41.62	$11,650	(0.4)	3.5	(0.9)	(9.2)	13.5	15.4	7.2	-1.1%	8.6%	6.3%	8.0%	8.3%	7.9%	0.06	207.4%	B+	2.98%	58.7%
DTE	DTE ENERGY CO	$98.51	$17,676	(0.4)	5.8	5.2	(0.6)	20.8	22.8	5.2	17.4%	-20.6%	26.2%	4.3%	7.7%	1.6%	0.15	103.8%	A-	3.10%	65.2%
EXC	EXELON CORP	$35.49	$32,767	(0.6)	9.2	6.6	(2.4)	28.2	27.8	4.5	92.7%	35.1%	5.5%	-3.0%	8.1%	-7.9%	0.30	126.7%	B	3.56%	95.2%
LNT	ALLIANT ENERGY CORP	$37.89	$8,620	(0.8)	5.5	(1.1)	(4.6)	19.4	21.3	7.9	35.2%	-2.9%	13.1%	5.8%	6.0%	5.3%	0.37	98.9%	B+	3.10%	76.6%
PPL	PPL CORP	$34.05	$23,141	(0.6)	1.8	(1.5)	(9.8)	(0.8)	(0.2)	2.1	-17.4%	-61.3%	148.5%	-14.3%	7.4%	1.7%	0.55	181.1%	B	4.46%	56.2%
XEL	XCEL ENERGY INC	$40.70	$20,674	(0.6)	4.3	(1.1)	(9.1)	11.8	13.3	5.5	4.7%	-4.4%	13.4%	5.0%	6.5%	3.7%	0.06	122.0%	A-	3.34%	61.8%
Average			$18,221	(0.5)	5.2	1.5	(6.0)	15.5	17.0	5.6	17.7%	-5.9%	30.4%	1.7%	7.4%	6.4%	0.21	129.2%		3.40%	68.0%
Median			$18,094	(0.5)	5.1	(1.0)	(6.9)	16.3	18.3	5.7	7.2%	-3.7%	13.2%	4.7%	7.6%	3.9%	0.22	112.9%		3.31%	64.3%
SPX	S&P 500 INDEX	$2,239		(0.5)	1.8	3.3	6.7	8.5	9.5			1.0%	0.8%	11.7%	11.6%						

Ticker	Website	2016 ROE	P/B	P/E 2014	2015	2016	TTM	NTM	2017E	2018E	2016 NPM	2016 P/S	OM	ROIC	EV/ EBIT	P/CF Current	P/CF 5-yr	Sales Growth NTM	STM	Pst 5yr	Book Equity
WEC	http://www.wecenergygroup.c	10.4%	2.08	20.4	21.9	19.9	20.2	18.4	18.9	17.6	10.9%	2.18	23.7%	4.8%	17.3	8.1	8.2	30.1%	-14.9%	7.1%	$28.17
AEE	http://www.ameren.com	9.1%	1.77	19.2	16.7	19.4	19.6	19.6	18.9	17.5	10.5%	2.03	22.8%	4.3%	14.3	6.4	5.1	6.7%	2.5%	-4.4%	$29.65
CMS	http://www.cmsenergy.com	13.2%	2.73	20.0	19.1	20.7	20.0	20.2	19.2	17.7	8.4%	1.73	20.0%	4.3%	16.5			10.6%	-2.6%	0.1%	$15.26
DTE	http://www.dteenergy.com	10.0%	1.94	16.9	19.8	19.3	21.6	18.4	18.5	17.2	8.6%	1.66	13.6%	4.2%	17.4	8.5	6.1	8.5%	-0.1%	4.2%	$50.88
EXC	http://www.exeloncorp.com	9.5%	1.26	19.7	10.9	13.2	26.9	14.0	13.7	12.6	8.1%	1.08	13.3%	4.9%	13.2	3.7	3.8	1.9%	8.4%	8.7%	$28.19
LNT	http://www.alliantenergy.com	11.2%	2.23	19.2	18.6	19.9	25.1	18.6	18.9	17.8	13.0%	2.59	18.5%	5.3%	19.5	8.6	6.3	11.4%	1.4%	-1.0%	$16.96
PPL	http://www.pplweb.com	17.1%	2.32	12.9	33.8	13.6	12.6	15.3	15.8	14.7	22.0%	2.99	39.5%	5.3%	14.7	7.0	5.9	6.5%	4.2%	11.3%	$14.68
XEL	http://www.xcelenergy.com	10.2%	1.88	17.7	18.5	18.5	18.8	17.9	17.6	16.5	9.6%	1.78	20.0%	4.4%	14.9	6.7	5.9	14.6%	-0.4%	1.4%	$21.63
Average		11.3%	2.03	18.3	19.9	18.1	20.6	17.8	17.7	16.5	11.4%	2.00	21.4%	4.7%	16.0	7.0	5.9	11.3%	-0.2%	3.4%	
Median		10.3%	2.01	19.2	18.8	19.3	20.1	18.4	18.7	17.4	10.1%	1.91	20.0%	4.6%	15.7	7.0	5.9	9.5%	0.7%	2.8%	

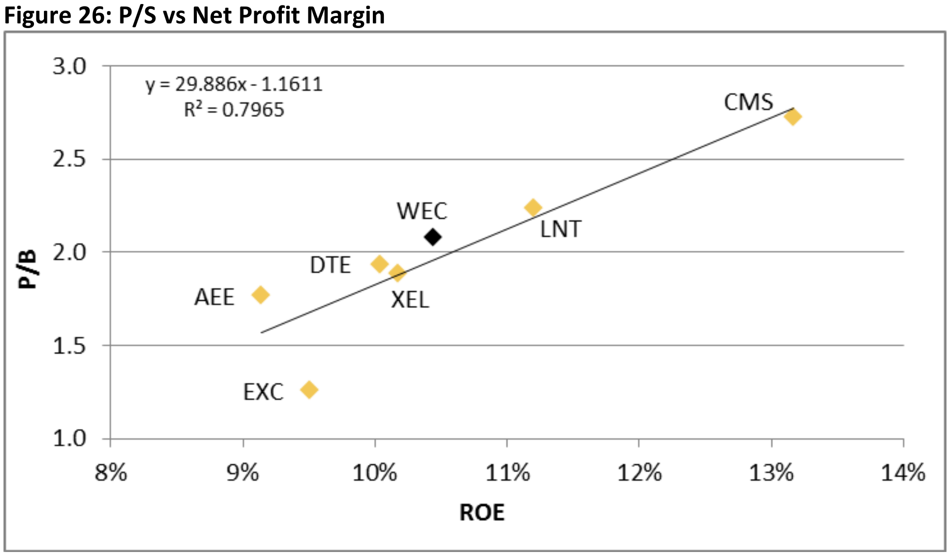
Source: FactSet

Figure 26 analyzes the relationship between P/B and ROE. The calculated R-squared of the regression indicates that ROE explains nearly 80% of a sampled firm's P/B. WEC currently has a P/B of 2.08 and appears to be overvalued.

- Estimated P/B = Estimated 2017 ROE (10.7%) x 29.886 – 1.1611 = 2.037
- Target Price = Estimated P/B (2.037) x 2017E Book per share ($29.47) = $60.02

Discounting this price of $60.02 back to the present at a 7.58% cost of equity leads to a target price of $55.79. This is 4.9% below the current price of $58.65.

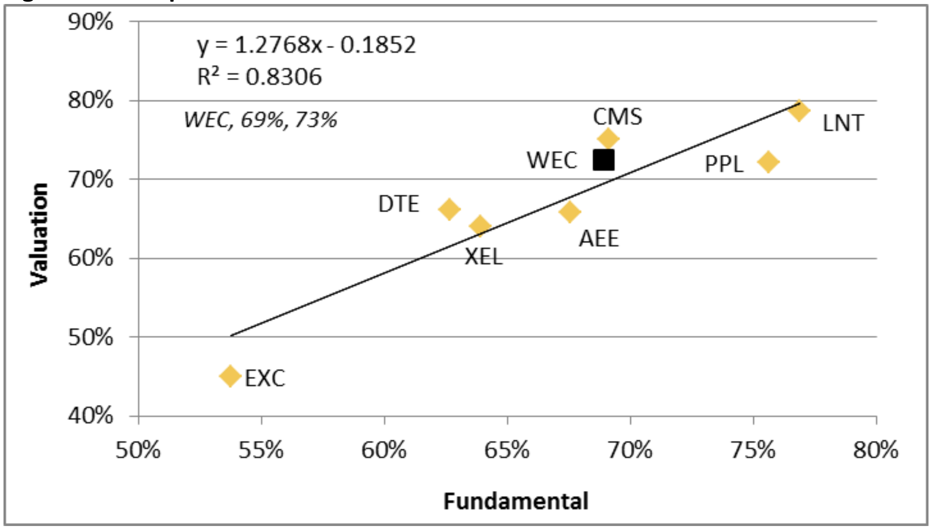
Figure 26: P/S vs Net Profit Margin



Source: FactSet

I also created a composite ranking of several fundamental and valuation metrics. The calculated R-squared of the regression indicates that the fundamental inputs explain over 83% of a sampled firm's valuation. Since the factors have different scales, each was converted to a percentile before calculating the composite score. I compared a weighted average of long-term growth rate, leverage, payout ratio, NTM ROE, and net profit margin to a weighted average composite of P/E, P/B, P/S, EV/EBIT, and yield. Based on its current fundamentals, WEC appears slightly overvalued.

Figure 27: Composite relative valuation



Source: FactSet, IMCP

Figure 28: WEC comparable companies

		Fundamental					Valuation						
	Weight	25.0%	12.5%	12.5%	25.0%	25.0%	25.0%	25.0%	25.0%	12.5%	12.5%		
Ticker	Name	LTG	Leverage	Payout	ROE	NPM	P/E	P/B	P/S	EV/EBIT	Yield	Fund	Value
WEC	WEC ENERGY GROUP INC	78%	90%	84%	61%	49%	96%	76%	73%	89%	87%	69%	73%
AEE	AMEREN CORP	75%	100%	89%	53%	48%	93%	65%	68%	73%	91%	68%	66%
CMS	CMS ENERGY CORP	91%	44%	96%	77%	38%	100%	100%	58%	85%	100%	69%	75%
DTE	DTE ENERGY CO	66%	88%	86%	59%	39%	93%	71%	55%	89%	96%	63%	66%
EXC	EXELON CORP	57%	73%	59%	56%	37%	64%	46%	36%	68%	84%	54%	45%
LNT	ALLIANT ENERGY CORP	100%	93%	73%	66%	59%	96%	82%	87%	100%	96%	77%	79%
PPL	PPL CORP	27%	51%	100%	100%	100%	66%	85%	100%	76%	67%	76%	72%
XEL	XCEL ENERGY INC	69%	75%	91%	60%	44%	89%	69%	60%	77%	89%	64%	64%

Source: FactSet, IMCP

Discounted Cash Flow Analysis

Based on a three-stage discounted cash flow model, I estimate the company's stock to be worth $55.61.

The cost of equity was calculated to be 7.58% using the CAPM with the following assumptions:

- Risk-free rate of 2.44%. This is currently the 10-year Treasury bond yield.
- A beta of 0.60. This is above the industry average, but WEC increased its risk with the recent acquisition.
- Market return of 11%. Historically, this has been about the average return of the market.

The cost of equity = 2.44% + 0.60 x (11.0% – 2.44%) = 7.58%

Stage One - The model's first stage simply discounts fiscal years 2017 and 2018 dividends per share. I forecast these per share dividends to be $2.08 and $2.24, respectively. On December 1, 2016, WEC's board of directors announced its plan to raise the quarterly dividend to $0.52 per share, indicating a full year dividend of $2.08. I anticipate WEC to raise its DPS to $2.24 in 2018, resulting in a payout ratio of about 68.4%. This aligns with WEC's target payout of 65% to 70% of earnings.

Discounting these dividends results in a value of $3.87 for the first stage of the model.

Stage Two - Stage two of the model focuses on fiscal years 2019 to 2023. Recall on page 10, I forecasted sales to grow at about 5% per year and net profit margin to remain stable. I have calculated net income for stage two based upon the same margin and growth assumptions. I expect EPS to grow from $3.10 in 2017 to $4.19 in 2023.

Figure 29: EPS estimates for 2017 – 2023

	2017	2018	2019	2020	2021	2022	2023
EPS	$ 3.10	$ 3.28	$ 3.45	$ 3.62	$ 3.80	$ 3.99	$ 4.19

During this period, DPS is calculated based on a constant growth rate of 5%. At a 5% growth rate, dividends would likely remain within management's target payout ratio of 65 – 70%. The resulting dividends are then discounted using the company's 7.58% cost of equity.

Discounting these dividends results in a value of $9.02 for the second stage of the model.

Figure 30: DPS and discounted DPS, 2017 – 2023

	2017	2018	2019	2020	2021	2022	2023
DPS	$ 2.08	$ 2.24	$ 2.35	$ 2.47	$ 2.60	$ 2.73	$ 2.86
Discounted DPS	$ 1.93	$ 1.94	$ 1.89	$ 1.85	$ 1.80	$ 1.76	$ 1.72

Stage Three - Stage three of the model requires an assumption regarding the company's terminal price-to-earnings ratio. Although industry multiples are currently elevated, I expect WEC's P/E to return to its historical average over the next 7 years. Therefore, a P/E ratio of 17 is assumed at the end of WEC's terminal year.

Given the assumed terminal earnings per share of $4.19 and a price-to-earnings ratio of 17, a terminal value of $71.23 per share is calculated. Using the 7.58% cost of equity, this number is discounted back to a present value of $42.72.

Total Present Value – given the above assumptions and utilizing a three-stage discounted cash flow model, an intrinsic value of $55.61 is calculated (3.87 + 9.02 + 42.72). Given WEC's current price of $58.65, this model indicates that the stock is slightly overvalued.

Figure 31: DCF Summary

Summary			
First stage	$3.87	Present value of first 2 year cash flow	
Second stage	$9.02	Present value of year 3-7 cash flow	
Third stage	$42.72	Present value of terminal value P/E	
Value	**$55.61**	= value at beg of fiscal yr	2017

Scenario Analysis

Adjusting my assumptions in my DCF model shows how different scenarios can affect WEC's valuation. Figure 32 displays a more positive outlook than my original model. Decreasing beta to 0.55 in my CAPM equation reduces the cost of equity to 7.15%. Increasing 2018 assumed dividends per share by $0.01 per quarter increases the second year discounted DPS to $1.99. Assuming a 1% higher second stage growth rate increases second stage present value by $0.61. Increasing terminal P/E by 1 would increase the terminal value to $81.05. Adding these assumptions together results in a present value of WEC of $63.43. This is about 8.2% greater than the current stock price of $58.65. This scenario is bullish considering falling industry allowed ROE and increased cyclicality and seasonality following the Integrys acquisition. As interest rates normalize, I expect industry P/E ratios to return to normal levels. Historically WEC has traded at an average P/E of 17; however, P/E's of the market are elevated so it is still optimistic.

Figure 32: Bull scenario

Summary			
First stage	$3.93	Present value of first 2 year cash flow	
Second stage	$9.63	Present value of year 3-7 cash flow	
Third stage	$49.99	Present value of terminal value P/E	
Value	**$63.54**	= value at beg of fiscal yr	2017

Figure 33 displays a more pessimistic outlook than my original model. Increasing beta in my CAPM equation to 0.65 decreases cost of equity to 8.00%. Decreasing 2018 assumed dividends per share by $2.12 for the year decreases the second year discounted DPS to $1.82. Assuming a 1% lower second stage growth rate decreases the second stage present value by $0.89. Decreasing terminal P/E by 1 would decrease the terminal value to $62.47. Adding these assumptions together results in a present value of WEC of $48.32. This is about 17.6% less than the current stock price of $58.65. This scenario is very bearish. As a large utility company, WEC's competitive advantage, high profit margins, and stable dividends make this scenario a strong price floor.

Figure 33: Bear scenario

Summary			
First stage	$3.74	Present value of first 2 year cash flow	
Second stage	$8.13	Present value of year 3-7 cash flow	
Third stage	$36.44	Present value of terminal value P/E	
Value	**$48.32**	= value at beg of fiscal yr	2017

Risks

Regulation:

A long-term industry downtrend in approved returns and the ATC rate case may be harmful to WEC's bottom line going forward. Environmental regulation is another regulatory threat to WEC's capital budget needs.

Weather:

Above average temperatures in winter months can negatively impact earnings. WEC's increased reliance on natural gas revenues and another abnormally warm winter may hamper revenues.

Interest rates:

Rising interest rates are likely to depress shareholder returns in the short-run. Market expectations may not have fully incorporated the likelihood of additional rate hikes in 2017 and 2018.

Pension expense:

The current interest rate environment has had a negative effect on WEC's pension plan assumptions. Management recently indicated the potential for a 100-basis-point reduction in the current discount rate. WEC expects an increase to 2017 pension expense by about $35 million.

Appendix 1: Income Statement

Income Statement (in millions)							
Items	2012	2013	2014	2015	2016E	2017E	2018E
Operating Revenue	$4,246	$4,519	$4,997	$5,926	$7,781	$8,127	$8,589
Direct costs (inc. Dep & Amort)	$2,009	$2,167	$2,651	$2,802	$3,587	$3,779	$4,020
Gross Profit	$2,238	$2,352	$2,346	$3,124	$4,194	$4,348	$4,570
Operating expenses	$1,137	$1,184	$1,155	$1,719	$2,194	$2,324	$2,465
Earnings before interest & tax	$1,101	$1,167	$1,192	$1,406	$2,000	$2,024	$2,104
Interest expense	$248	$251	$240	$331	$407	$416	$432
Earnings before tax	$853	$917	$951	$1,074	$1,593	$1,607	$1,672
Taxes	$306	$338	$362	$434	$643	$627	$635
Net income	$546	$579	$590	$640	$949	$980	$1,037
Preferred dividends	$0	$1	$1	$2	$1	$1	$1
Net income attributable to common	$546	$577	$588	$639	$948	$979	$1,035
Dividends	$276	$329	$352	$455	$625	$656	$707
Basic Shares	230	228	226	271	316	316	316
Earnings per share	$2.37	$2.54	$2.61	$2.36	$3.00	$3.10	$3.28
Dividends per share	$1.20	$1.45	$1.56	$1.74	$1.98	$2.08	$2.24

Appendix 2: Balance Sheet

Balance Sheet (in millions)							
Items	2012	2013	2014	2015	2016E	2017E	2018E
Assets							
Cash	$36	$26	$62	$50	$52	$54	$22
Operating assets ex cash	$1,237	$1,525	$1,231	$2,157	$1,945	$1,951	$1,890
Operating assets	$1,273	$1,551	$1,293	$2,207	$1,997	$2,005	$1,911
Operating liabilities	$635	$617	$627	$1,456	$1,323	$1,463	$1,718
Net operating working capital	$638	$934	$666	$751	$674	$542	$193
Net working capital	$602	$908	$604	$701	$622	$488	$172
Net fixed assets	$13,012	$13,218	$13,612	$27,148	$27,889	$28,718	$29,824
Invested capital	$13,650	$14,153	$14,278	$27,899	$28,563	$29,259	$30,018
Total assets	$14,285	$14,769	$14,905	$29,355	$29,885	$30,722	$31,736
Liabilities & Equity							
Short-term and long-term debt	$5,261	$5,243	$5,212	$10,377	$10,347	$10,471	$10,626
Other liabilities	$4,224	$4,646	$4,616	$8,837	$9,207	$9,457	$9,732
Preferred Stock	$30	$30	$30	$30	$30	$30	$30
Equity	$4,135	$4,233	$4,420	$8,655	$8,978	$9,301	$9,629
Total supplied capital	$13,650	$14,153	$14,278	$27,899	$28,563	$29,259	$30,018
Total liabilities and equity	$14,285	$14,769	$14,905	$29,355	$29,885	$30,722	$31,736

Appendix 3: Ratios

Ratios	2012	2013	2014	2015	2016E	2017E	2018E
Profitability							
Gross margin	52.7%	52.0%	47.0%	52.7%	53.9%	53.5%	53.2%
Operating (EBIT) margin	25.9%	25.8%	23.8%	23.7%	25.7%	24.9%	24.5%
Net profit margin	12.9%	12.8%	11.8%	10.8%	12.2%	12.0%	12.1%
Activity							
NFA (gross) turnover		0.34	0.37	0.29	0.28	0.29	0.29
Total asset turnover		0.31	0.34	0.27	0.26	0.27	0.28
Liquidity							
Op asset / op liab	2.01	2.51	2.06	1.52	1.51	1.37	1.11
NOWC Percent of sales		17.4%	16.0%	11.9%	9.2%	7.5%	4.3%
Solvency							
Debt to assets	36.8%	35.5%	35.0%	35.3%	34.6%	34.1%	33.5%
Debt to equity	127.2%	123.9%	117.9%	119.9%	115.2%	112.6%	110.4%
Other liab to assets	29.6%	31.5%	31.0%	30.1%	30.8%	30.8%	30.7%
Total debt to assets	66.4%	67.0%	65.9%	65.5%	65.4%	64.9%	64.1%
Total liabilities to assets	70.8%	71.1%	70.1%	70.4%	69.9%	69.6%	69.6%
Debt to EBIT	4.78	4.49	4.37	7.38	5.17	5.17	5.05
EBIT/interest	4.44	4.65	4.96	4.24	4.91	4.86	4.87
Debt to total net op capital	38.5%	37.0%	36.5%	37.2%	36.2%	35.8%	35.4%
ROIC							
NOPAT to sales		16.3%	14.8%	14.1%	15.3%	15.2%	15.2%
Sales to IC		0.33	0.35	0.28	0.28	0.28	0.29
Total		5.3%	5.2%	4.0%	4.2%	4.3%	4.4%
Total using EOY IC	5.2%	5.2%	5.2%	3.0%	4.2%	4.2%	4.3%
ROE							
5-stage							
EBIT / sales		25.8%	23.8%	23.7%	25.7%	24.9%	24.5%
Sales / avg assets		0.31	0.34	0.27	0.26	0.27	0.28
EBT / EBIT		78.5%	79.8%	76.4%	79.6%	79.4%	79.4%
Net income /EBT		63.0%	61.8%	59.4%	59.5%	60.9%	61.9%
ROA		4.0%	4.0%	2.9%	3.2%	3.2%	3.3%
Avg assets / avg equity		3.47	3.43	3.39	3.36	3.32	3.30
ROE		13.8%	13.6%	9.8%	10.8%	10.7%	10.9%
3-stage							
Net income / sales		12.8%	11.8%	10.8%	12.2%	12.0%	12.1%
Sales / avg assets		0.31	0.34	0.27	0.26	0.27	0.28
ROA		4.0%	4.0%	2.9%	3.2%	3.2%	3.3%
Avg assets / avg equity		3.47	3.43	3.39	3.36	3.32	3.30
ROE		13.8%	13.6%	9.8%	10.8%	10.7%	10.9%
Payout Ratio		57.0%	59.8%	71.3%	65.9%	67.0%	68.3%
Retention Ratio		43.0%	40.2%	28.7%	34.1%	33.0%	31.7%
Sustainable Growth Rate		5.9%	5.5%	2.8%	3.7%	3.5%	3.5%

Appendix 4: 3-stage DCF Model

	Year						
	1	2	3	4	5	6	7
First Stage			**Second Stage**				
Cash flows	2017	2018	2019	2020	2021	2022	2023
Sales Growth	*4.4%*	*5.7%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
NOPAT / S	*15.2%*	*15.2%*	*15.2%*	*15.2%*	*15.2%*	*15.2%*	*15.2%*
S / NWC	*16.67*	*50.00*	*42.50*	*35.00*	*27.50*	*20.00*	*12.50*
S / NFA (EOY)	*0.28*	*0.29*	*0.29*	*0.29*	*0.30*	*0.30*	*0.30*
S / IC (EOY)	*0.28*	*0.29*	*0.29*	*0.29*	*0.29*	*0.29*	*0.29*
ROIC (EOY)	*4.2%*	*4.3%*	*4.4%*	*4.4%*	*4.4%*	*4.5%*	*4.5%*
ROIC (BOY)		*4.5%*	*4.6%*	*4.6%*	*4.6%*	*4.7%*	*4.7%*
Share Growth		*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Sales	$8,127	$8,589	$9,019	$9,470	$9,943	$10,441	$10,963
NOPAT	$1,234	$1,305	$1,370	$1,438	$1,510	$1,586	$1,665
Growth		*5.7%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
- Change in NWC	-135	-316	40	58	91	160	355
NWC	*488*	*172*	*212*	*271*	*362*	*522*	*877*
Growth NWC		*-64.8%*	*23.5%*	*27.5%*	*33.6%*	*44.4%*	*68.0%*
- Chg NFA	829	1107	1232	1286	1341	1399	1459
NFA EOY	*28,718*	*29,824*	*31,057*	*32,342*	*33,683*	*35,082*	*36,542*
Growth NFA		*3.9%*	*4.1%*	*4.1%*	*4.1%*	*4.2%*	*4.2%*
Total inv in op cap	694	791	1273	1344	1432	1559	1814
Total net op cap	29205	29996	31269	32613	34045	35604	37419
FCFF	$540	$514	$97	$95	$78	$27	($149)
% of sales	*6.6%*	*6.0%*	*1.1%*	*1.0%*	*0.8%*	*0.3%*	*-1.4%*
Growth		*-4.8%*	*-81.1%*	*-2.6%*	*-17.1%*	*-66.2%*	*-662.7%*
- Interest (1-tax rate)	254	268	282	296	310	326	342
Growth		*5.6%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
FCFE w/o debt	$286	$246	($184)	($201)	($232)	($299)	($491)
% of sales	*3.5%*	*2.9%*	*-2.0%*	*-2.1%*	*-2.3%*	*-2.9%*	*-4.5%*
Growth		*-14.1%*	*-175.0%*	*9.0%*	*15.4%*	*29.0%*	*64.1%*
/ No Shares	315.6	315.6	315.6	315.6	315.6	315.6	315.6
FCFE	$0.91	$0.78	($0.58)	($0.64)	($0.74)	($0.95)	($1.56)
Growth		*-14.1%*	*-175.0%*	*-9.0%*	*-15.4%*	*-29.0%*	*-64.1%*
Dividends	$656	$707	$743	$780	$819	$860	$903
Payout ratio (DPS/EPS)	67%	68%	68%	68%	68%	68%	68%
Dividend Per share	$2.08	$2.24	$2.35	$2.47	$2.60	$2.73	$2.86
* Discount factor	0.93	0.86	0.80	0.75	0.69	0.65	0.60
Discounted FCFE	$1.93	$1.94	$1.89	$1.85	$1.80	$1.76	$1.72
Third Stage							
Terminal value P/E							
Net income	$979	$1,035	$1,088	$1,143	$1,200	$1,260	$1,323
% of sales	*12.0%*	*12.1%*	*12.1%*	*12.1%*	*12.1%*	*12.1%*	*12.1%*
EPS	$3.10	$3.28	$3.45	$3.62	$3.80	$3.99	$4.19
Growth		*5.7%*	*5.1%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Terminal P/E							17.00
* Terminal EPS							$4.19
Terminal value							$71.23
* Discount factor							0.60
Discounted terminal value							$42.72

Summary

First stage	$3.87	Present value of first 2 year cash flow
Second stage	$9.02	Present value of year 3-7 cash flow
Third stage	$42.72	Present value of terminal value P/E
Value (P/E)	**$55.61**	= value at beg of fiscal yr 2017

Appendix 5: Porter's 5 Forces

Threat of New Entrants – Very Low

Significant barriers to entry continue to exist in the industry. As a natural monopoly, WEC benefits from the substantial capital and regulatory requirements necessary for aspiring competitors. Additionally, marginal costs of supplying power to one more customer are minimal. Geographic restraints vary by state but remain favorable for the majority of WEC operations.

Threat of Substitutes - Low

Technology shifts and government subsidies have decreased price points for solar panels and other renewable generation sources. Self-generation is a growing threat to reduce WEC's customer base. Other self-generation techniques, such as microturbines and fuel cells, provide a long-term threat to WEC's demand but remain nonviable options in short-term demand.

Supplier Power - Medium

Companies such as Siemens and General Electric dominate the power systems supply market. Little competition exists amongst these suppliers and the utility industry necessitates high building and development capital expenditures. Heightened needs for capacity and delivery shift power to suppliers of WEC. Natural gas and electric power inputs are highly commoditized and prices are determined by market forces. WEC faces relatively low switching costs with natural gas suppliers and acts to hedge natural gas market price movements.

Buyer Power – Medium to Low

Residential and small commercial and industrial customers have very limited ability to switch suppliers. Customers rarely shift demand for power unless external factors necessitate such actions. As prices rise customers may attempt to reduce energy usage with various conservation efforts. In exchange for low customer buying power, rates and allowed returns are heavily regulated. Retail choice and wholesale rate agreements have shifted power to electric and natural gas buyers, but this represents a small portion of WEC's revenue base.

Intensity of Competition – Low

Industry competition is low due to geographic and regulatory limitations. Independent power producers and retail choice have increased competition, but generally, these are a minimal threat to the industry.

Appendix 6: SWOT Analysis

Strengths	Weaknesses
High net margins	High emissions
Economies of scale	Limited ROE
Growing rate base	Reliance on C&I customers
Opportunities	**Threats**
Integrys integration	Rising interest rates
Customer growth	Regulation
Improving reliability	Weather