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Power & Utilities
Price Target Change
March 21, 2017
BUY

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OGE ENERGY CORP.

OCC Issues Final Order in OG&E Rate Case; Reiterate BUY

OGE (NYSE)

Company & Market Data	
Closing Price (as of 03/20/2017):	$36.49
Rating:	BUY
Price Target:	$37.00
Prior Price Target:	*$38.00*
52 Week Range:	$27.27 - $37.41
Shares Outstanding (MM):	199.7
Market Capitalization (MM):	$7,287
Avg Daily Volume (M):	925.4
Enterprise Value (MM):	$10,154
Book Value per share:	$17.23
Debt (MM):	$2,642.0
Annual Dividend/Share:	$1.21
Current Dividend Yield:	3.3%
Fiscal Year End:	Dec

Estimates			
EPS	**2016A**	**2017E**	**2018E**
1Q	$0.13	—	—
2Q	$0.35	—	—
3Q	$0.92	—	—
4Q	$0.29	—	—
Full Year	$1.69	$1.97	$2.11
Consensus EPS	NA	$1.95	$2.04
Revenue (MM)	$2,259.2	$2,439.2	$2,492.1
EBITDA (MM)	$825.9	$822.1	$850.0

Ratios			
P/E	21.6x	18.5x	17.3x
EV/EBITDA	12.3x	12.4x	11.9x

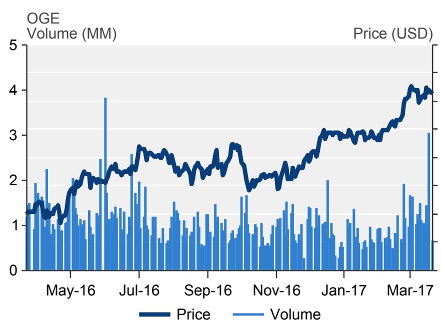

Chart data: Bloomberg

Highlights

We reiterate our BUY rating on OGE shares. Our revised price target of $37 per share (previously $38 per share) is based on our updated 2019 sum-of-the-parts analysis. Our 2017/2018/2019 EPS estimates are $1.97/$2.11/$2.25 (previously $2.00/$2.16/$2.30).

On March 20, the Oklahoma Corporation Commission (OCC) issued a final order in OG&E's ongoing rate case (Docket #: PUD 201500273), granting the company authorization to implement an $8.9 million rate increase premised upon a 9.50% allowed return on equity. The commission's finding represents a notable decrease from OG&E's current return on equity of 10.2%. The company remarked that the national average utility ROE is 9.77% and that as a premium utility OG&E deserved better than a below-average allowed ROE. In its final order filing, the OCC commented that while it accepted the ALJ's recommendation to allow the actual capital structure of OG&E at 53.31% equity, the company should evaluate adjusting its debt-to-equity ratio in order to realize the benefits of lower-cost debt financing by its next rate proceeding.

We note that the primary driver of the significantly lower revenue requirement in the OCC final order relative to OG&E's request, as well as the ALJ recommendation, is the depreciation life extension. In our opinion, in attempt to manage customer rate increases, the OCC meaningfully extended the life of net plant with total depreciation expense reduced to $265.7 million compared to OG&E proposed depreciation expense of $314.6 million. According to OGE, useful lives of new electric infrastructure equipment were extended beyond 100 years. As a result of the disappointing order, OG&E plans to evaluate discretional spending in Oklahoma. Other drivers of the lower revenue requirement are a lower allowed ROE and incentive compensation disallowance. We also view the outcome as disappointing.

In order to initiate OG&E's strategy of recovering investments made to modernize its generation and distribution infrastructure, the company expects to file rate cases with the OCC in 4Q17 and 4Q18. Many of OG&E's recent investments have been executed so that the company remains environmentally compliant according to regional and federal standards. The applications are expected to feature test years ending in June 2017 and 2018, respectively, with new rates being implemented in mid-2018 and mid-2019, respectively.

Disclosures and Analyst Certifications can be found in Appendix A.

OCC Issues Final Order in OG&E Rate Case

On March 20, the Oklahoma Corporation Commission (OCC) issued a final order in OG&E's ongoing rate case (Docket #: PUD 201500273), granting the company authorization to implement an $8.9 million rate increase premised upon a 9.50% allowed return on equity. The commission's finding represents a notable decrease from OG&E's current return on equity of 10.2%. The company remarked that the national average utility ROE is 9.77% and that as a premium utility OG&E deserved better than a below-average allowed ROE. In its final order filing, the OCC commented that while it accepted the ALJ's recommendation to allow the actual capital structure of OG&E at 53.31% equity, the company should evaluate adjusting its debt-to-equity ratio in order to realize the benefits of lower-cost debt financing by its next rate proceeding.

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The OCC's order allowed for the recovery of $1.6 billion in investments OG&E had made in new electric infrastructure subsequent to the company's previous rate case, although the company expressed disappointment in the commission's decision to extend the useful financial lives of some of OG&E's new equipment to beyond 100 years, which places future financial burden upon the Oklahoma ratepayers. Other aspects of the final order include the allowance of OG&E's request to recover Air Quality Control Systems Consumable Costs, the disallowance of a vegetation management tracker (although OG&E's vegetation management expense request was adopted), recovery of 50% of short-term incentive compensation, and denial of recovery for long-term incentive compensation, among other adjustments.

OG&E's rate case application, filed in December 2015, incorporated a request to increase base rates by $92.5 million, premised upon a return on equity of 10.25%. The company cited the termination of a wholesale contract and necessary recovery of costs for plants and infrastructure placed into service as justification for the request. In July 2016, OG&E implemented a $69 million interim rate increase, in accordance with statutory law in Oklahoma. In December 2016, an Administrative Law Judge (ALJ) issued its report, recommending a rate increase of $43.6 million premised upon an ROE of 9.87%. The OCC's final order outlines the methodology through which a refund of excessive interim rates will be accomplished, with OG&E refunding customers for the difference, plus reasonable interest, through adjusted tariff rates through December 2017.

In order to initiate OG&E's strategy of recovering investments made to modernize its generation and distribution infrastructure, the company expects to file rate cases with the OCC in 4Q17 and 4Q18. Many of OG&E's recent investments have been executed so that the company remains environmentally compliant according to regional and federal standards. The applications are expected to feature test years ending in June 2017 and 2018, respectively, with new rates being implemented in mid-2018 and mid-2019, respectively.

Risks

The firm's profitability is largely dependent upon the ability to fully regain its costs from its customers, which may be hindered by regulatory action at the local, state, or national level.
Environmental laws, rules, and regulations could adversely impact the costs and timing of major projects, posing a threat to the profitability of the firm.

Any changes to the federal corporate tax laws could have financial implications.

OGE may be unable to recover expenditures and costs related to planned investment in capital improvement.

The OK general rate case (and pending OCC order) has inherent risks and the outcome is uncertain.

OGE operates within a regional power market that features changing transmission regulatory structures, which may affect revenues and expenses related to that aspect of the business.

Unforeseeable events, such as acts or threats of terrorism, cyber-attacks, security breaches, or any other disruptions in OGE's operations may negatively impact the firm's financial condition and results of operations.

There are inherent operating risks to OGE's business, such as incidents, shutdowns, or errors that may adversely affect the financial condition of the business. Firm performance may also be negatively impacted by economic conditions.

Extreme weather events, including tornadoes, thunderstorms, ice storms, wind storms, and droughts, as well as those associated with climate change, could adversely affect the firm's results of operations and financial condition.

Adverse performance regarding pension and postretirement benefit plan investments could impact the operating results and financial condition of the firm.

Factors pertaining to the workforce of the firm may increase costs and adversely affect OGE's financial condition. Performance could be significantly altered if the firm were unable to hire, train, and compensate dependable labor.

A downgrade in the firm's credit rating may affect OGE's ability to access capital. Restricted access to capital markets or volatility within those markets may adversely affect the financial condition and operating results of the firm. The firm may be unable to incur additional indebtedness which may increase the risks created by its indebtedness. Debt levels may limit OGE's flexibility in obtaining additional financing.

OGE is exposed to the credit risk of its key customers and counterparties, and nonperformance by these groups may adversely affect the firm's financial position.

OGE does not control Enable, and therefore is unable to cause or prevent certain actions by Enable. OGE is reliant upon Enable for a portion of its earnings and operating cash flows.

Enable's ownership structure may change following a strategic review by a partner with the outcome uncertain.

Enable's contracts are vulnerable to renewal risk. Enable relies upon a small amount of customers for a significant portion of its transportation and storage revenues. Enable provides certain transportation and storage services under long-term, fixed-price "negotiated rate" contracts that are not subject to adjustment.

Enable's operations are dependent upon the drilling and production decisions of others. Enable operates within a highly competitive industry.

Enable relies upon the performance of subsidiaries in order to reach its performance standards. Enable may be unable to recover expenditures and costs related to planned investment in capital improvement.

Natural gas, NGL, and crude oil prices are volatile, and significant price changes could adversely affect Enable's ability to make cash distributions.

Enable depends on the availability of third-party pipelines and other facilities interconnected to Enable's gathering.

Enable conducts a portion of its business through joint-ventures, which subjects them to additional risks that could affect financial performance.

Changes in midstream market conditions could impact Enable distributable cash flows and the distributable cash flows OGE receives from its ownership interest.

APPENDIX A: IMPORTANT RESEARCH DISCLOSURES

ANALYST CERTIFICATION

I, Brian J. Russo, attest that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. Furthermore, no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report, provided, however, that:

The research analyst primarily responsible for the preparation of this research report has or will receive compensation based upon various factors, including the volume of trading at the firm in the subject security, as well as the firm's total revenues, a portion of which is generated by investment banking activities.

Additional information regarding the contents of this publication will be furnished upon request. Please contact Ladenburg Thalmann, Compliance Department, 570 Lexington Avenue, 11th floor, New York, New York 10022 (or call 212-409-2000) for any information regarding current disclosures, and where applicable, relevant price charts, in regard to companies that are the subject of this research report.

COMPANY BACKGROUND

Incorporated in 1995 and headquartered in Oklahoma City, Oklahoma, OGE Energy Corp. (NYSE: OGE) is an energy and energy services provider that delivers both electricity and natural gas throughout the south central United States. OGE is the parent company of Oklahoma Gas and Electric Company (OG&E), a regulated electric utility that serves more than 765,000 retail customers in Oklahoma and western Arkansas, and Enogex LLC, a midstream natural gas pipeline business engaged in natural gas gathering, processing, transportation and storage.

VALUATION METHODOLOGY

We value equities utilizing a multi-faceted approach which includes; sum-of-the-parts, net asset value, discounted cash flow, leading P/E, and EV/EBITDA.

RISKS

The primary risks of an investment in OGE shares include (but are not limited to): regulatory risk, changes in the regional economy and impact on utility sales, legislation/regulation changes, EPA Regional Haze compliance risks, environmental expenditures execution risks, midstream volume risk, midstream execution risk, utility access to capital markets, litigation, pension requirements, execution risk, and increased employee related costs.

STOCK RATING DEFINITIONS

Buy: The stock's return is expected to exceed 12.5% over the next twelve months.

Neutral: The stock's return is expected to be plus or minus 12.5% over the next twelve months.

Sell: The stock's return is expected to be negative 12.5% or more over the next twelve months.

Investment Ratings are determined by the ranges described above at the time of initiation of coverage, a change in risk, or a change in target price. At other times, the expected returns may fall outside of these ranges because of price movement and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review.

RATINGS DISPERSION AND BANKING RELATIONSHIPS AS OF (March 21, 2017)

Rating	%	IB %
BUY	68.5	48.4
NEUTRAL	28.2	33.3
SELL	3.3	0.0

COMPANIES UNDER BRIAN'S COVERAGE

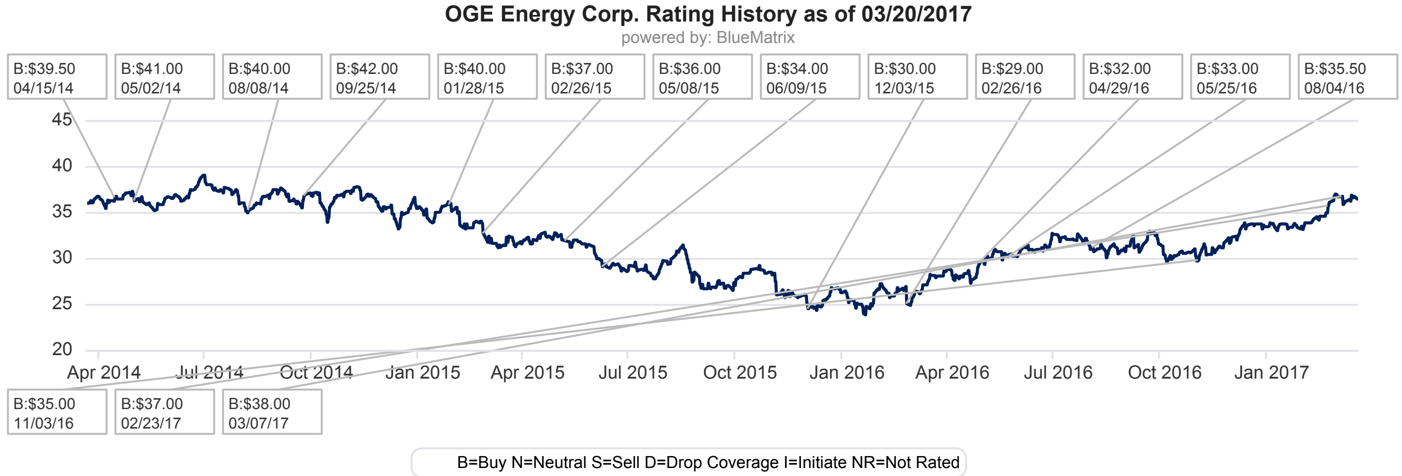
Ameren Corporation (AEE)
Allete Inc. (ALE)
Avista Corporation (AVA)
CenterPoint Energy, Inc. (CNP)
El Paso Electric Company (EE)
IdaCorp, Inc. (IDA)
New Jersey Resources Corporation (NJR)
Northwestern Energy (NWE)
ONE Gas, Inc. (OGS)
AES Corporation (AES)
Atmos Energy Corporation (ATO)
CMS Energy Corp. (CMS)
Dynegy Inc. (DYN)
Great Plains Energy Inc. (GXP)
Alliant Energy Corporation (LNT)
NRG Energy, Inc. (NRG)
OGE Energy Corp. (OGE)
PNM Resources, Inc. (PNM)

Pinnacle West Capital Corporation (PNW)
PPL Corporation (PPL)
WEC Energy Group Inc. (WEC)
Portland General Electric Co. (POR)
Spire Inc. (SR)
Westar Energy, Inc. (WR)

COMPANIES UNDER TANNER'S COVERAGE

Chesapeake Utilities Corporation (CPK)
Spark Energy, Inc. (SPKE)

INVESTMENT RATING AND PRICE TARGET HISTORY



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