Fitch Affirms OGE and Oklahoma Gas & Electric; Outlook Stable

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NEW YORK--(BUSINESS WIRE)--Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) of OGE Energy Corp. (OGE) at 'A-' and the Long-Term IDR of Oklahoma Gas & Electric Company (OG&E) at 'A'. The Rating Outlook for both entities is Stable.

Approximately $2.8 billion of debt is affected by these actions. A full list of rating actions follows at the end of this release.

KEY RATING DRIVERS

--Uncertainties over environmental compliance soon to be removed;

--Enable impact manageable;

--Oklahoma rate case pending;

--Stable regulated utility operations.

Uncertainties over Environmental Compliance Soon to be Removed

OGE and OG&E's ratings and Stable Outlook incorporate Fitch's expectations that either a gas conversion or a scrubber installation scenario at Sooner unit 1 and 2, credit metrics at OGE and OG&E will remain consistent with the companies' current rating categories. OG&E's latest request for approval of scrubbers at Sooner is still pending before the Oklahoma Corporation Commission (OCC). If the scrubber project is not approved by May 2, 2016, OG&E will make plans to convert the Sooner units to gas.

Conversion of the Sooner units to gas would largely mitigate the uncertainty associated with complying with the EPA deadline. Additionally, gas conversion would require substantially less capital costs ($100 million to convert vs. $400 million incremental capital to install scrubbers). OG&E would likely make the conversions in the late 2018 and early 2019 time frame. With the conversion, Fitch projects that OGE could produce an average debt-to-operating EBITDAR in the low 3x range and FFO fixed charge coverage in the low 5x range. OG&E's debt to operating EBITDAR would average near 3x and FFO fixed charge coverage near mid-5x. These credit metrics are consistent with OGE and OG&E's current ratings.

In the event that the OCC approves the scrubbers by May 2, 2016, Fitch estimates that OGE and OG&E's credit metrics would come under moderate pressure in 2016 and 2017 relative to the gas conversion before rebounding in 2018. In either scenario, Fitch believes credit ratios at OGE and OG&E will remain consistent with the companies' current rating levels. Notwithstanding the prolonged process in reviewing and rejecting the Environmental Compliance Plan (ECP), Fitch continues to view the overall regulatory compact in Oklahoma as supportive from a credit perspective.

In 2015, OG&E produced 49% of energy from coal fired generating plants, 44% from gas plants and 7% from wind. In February 2016, OG&E filed an application with the OCC requesting approval on or before May 2, 2016 to install dry scrubbers at Sooner unit 1 and 2. Subsequently, OGE indicated that it will make plans for gas conversion if OCC doesn't issue an order by May 2. Meanwhile, OG&E has suspended related construction work. On December 2, 2015, the OCC denied OG&E's ECP and its request to pre-approve the Mustang Modernization Plan. On December 23, 2015, the OCC denied OG&E's motion requesting modification of the OCC's order for the purpose of approving only the ECP.

Midstream Impact Manageable; Partner Change an Event Risk

OGE's rating and Outlook also reflect the operating risks at its commodity-sensitive midstream partnership, Enable Midstream Partners (Enable). At the end of 2015, OGE owned 50% of the general partnership (GP) and 26.3% of the limited partnership (LP) at Enable. OGE's share of Enable's EBITDA represented approximately 20% of consolidated EBITDA in 2015.

Enable's operating environment continues to be challenging. However, Fitch believes that the financial impact from Enable is manageable at this time. OGE's partner CenterPoint Energy (CNP: 'BBB' IDR/Stable Outlook) invested $363 million in Enable's preferred securities in February 2016 and Enable plans to cut capex by over 60% this year. As a result, Fitch does not expect Enable to require further external capital in 2016.

Fitch continues to believe that OGE will provide financial support to Enable, if needed. Future meaningful financial support from OGE in the form of reduced distributions from and debt financed equity contributions to Enable, are a source of concern that could result in adverse rating actions. CNP announced that it is evaluating strategic alternatives for its Enable investment including a potential sale or spinoff. CNP currently holds 50% GP and 55.4% LP.

Oklahoma Rate Case Pending

Fitch expects the outcome of OG&E's pending general rate case (GRC) to be reasonably supportive. On December 18, 2015, OG&E filed a GRC with the OCC requesting a net rate increase of $92.5 million and a 10.25% ROE on 53% equity based on a June 30, 2015 test year. The rate case seeks to recover $1.6 billion of electric infrastructure investments and rate impact on the termination of certain wholesale contracts since the last GRC in 2012. The GRC includes recovery of Activated Carbon Injection projects and all but two low NOx projects that were in service in December 2015. Several riders are requested to be moved into base rates such as smart grid rider and SPP transmission system additions. OG&E also requested to increase residential customer fixed charge. The commission staff in March recommended a net increase of approximately $82 million based on a ROE of 9.25%. The OCC is expected to issue an order by June 2016.

Stable Utility Operations

OGE's rating and Outlook reflect the stable cash flows and earnings provided by its regulated utility OG&E. In 2015, OG&E's EBITDA represented approximately 80% of OGE's total EBITDA. In Fitch's view, Oklahoma, which represents nearly 80% of OG&E's total rate base, is a relatively supportive regulatory jurisdiction.

Capex pre-approval, and riders for storm, smart grid and demand programs give the utility a reasonable opportunity to earn its 10.2% authorized return on equity (ROE). Oklahoma legislation allows utilities to recover environmental compliance costs to meet state and federal mandates. Federal Energy Regulatory Commission (FERC) regulations allow for recovery with minimal lag. Although authorized ROEs granted by FERC have trended downward in recent years they remain attractive relative to the low operating risks. Fitch considers Arkansas regulation to be relatively restrictive. However, the enactment of the formula rate plan legislation in 2015 shows a sign of improvement.

KEY ASSUMPTIONS

--OG&E customer growth 0.8% to 1% from 2016 to 2020;

--In the case of gas conversion at Sooner, approximately $250 million total capex for environmental compliance projects is assumed;

--In the case of installing scrubbers at Sooner, approximately $500 million total capex for environmental compliance projects is assumed;

--60% of Oklahoma GRC rate increase request is assumed to be granted.

RATING SENSITIVITIES

OGE

Future developments, individually or collectively, that could lead to a future upgrade include:

--While an upgrade appears unlikely in the foreseeable future, better than expected regulatory outcome, meaningful improvement in its midstream business or other factors leading to sustained debt-to-operating EBITDAR and FFO adjusted leverage below 2.8x and 3.0x, respectively could result in rating upgrades.

Future developments, individually or collectively, that could lead to a future downgrade include:

--A significant increase in leverage at OGE due to deteriorating business conditions or future restructuring activity at Enable could trigger adverse rating actions;

--A downgrade at OG&E would likely trigger a downgrade at OGE;

--Weakening credit metrics such that debt-to-operating EBITDAR increases to 3.8x and FFO adjusted leverage increases to 4.0x on a sustained basis.

OG&E

Future developments, individually or collectively, that could lead to a future upgrade include:

--While an upgrade appears unlikely in the foreseeable future, better than expected regulatory outcomes at OG&E or other factors leading to sustained debt-to-operating EBITDAR and FFO adjusted leverage below 2.5x and 2.8x, respectively could result in future rating upgrades.

Future developments, individually or collectively, that could lead to a rating downgrade include:

--Material environmental capex cost overruns;

--Significant deterioration in the Oklahoma regulatory compact; --A materially negative outcome in OG&E's pending Oklahoma GRC;

--If debt-to-operating EBITDAR increases to 3.5x and FFO adjusted leverage increases to 3.8x on a sustained basis.

--Adverse rating actions at OG&E's corporate parent, OGE, could also result in rating downgrades at OG&E.

Fitch affirms the following ratings with a Stable Outlook:

OGE Energy Corp.

--Long-term IDR at 'A-';

--Senior unsecured debt at 'A-';

--Short-term IDR/commercial paper (CP) at 'F2'.

Oklahoma Gas & Electric Company

--Long-term IDR at 'A';

--Senior unsecured debt at 'A+';

--Short-term IDR and CP at 'F1'.

Summary of Financial Statement Adjustments:

Consolidation at OGE - Fitch adjusts OGE's consolidated financials to reflect its ownership interest in Enable.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1002686

Solicitation Status

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