



May 5, 2017

Rating: **Neutral**
Price: (5/4/17) \$37.25
Price Targets: 12-18 month: ↑ \$38.00
5-year: \$46.00

Industry:
Construction Products

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Valuation Data

Long-Term Growth Rate (E)	15%
Total Debt/Capital (3/31/17)	0.0%
Cash per share (3/31/17)	\$0.59
Book Value per Share (3/31/17)	\$3.98
Dividend	\$0.26 (0.7%)
Return on Equity (T-T-M)	26.1%

Trading Data

Shares Outstanding (M)	53.2
Market Capitalization (\$M)	\$1,981.3
52-week range	\$25.32-\$37.75
Avg. Daily Volume (3 mos.) (K)	160.7
Float (%)	76.7%

Accelerating Growth Expected; Core Demand Plus New Product Roll-out

- **Order growth acceleration/pump line development progress.** Despite somewhat slower than expected growth this quarter, backlog of \$68.9 million (+14% YoY/+40% sequential) reflected acceleration in growth seen in the latter half of Q1; with momentum reportedly continuing into the current quarter. The water source heat pump line continues to represent a meaningful next leg of growth for AAON. The program continues to progress, albeit the impact to financials remains limited. More meaningful profit contributions await in 2018 (with potential for +/- \$50 million in contributions). Based on expectations over 12-18 months and our 5-year outlook, including core growth plus heat pump line contributions, we remain **NEUTRAL**; the growth potential appears fairly reflected at current price levels.
- **Q1 at a glance.** A variance table is attached. Q1 earnings of \$0.19 per share were slightly below \$0.20 last year (our estimate was \$0.20). Revenue of \$86.1 million (+1% YoY) was moderately below our \$89.0 million estimate. Higher than expected SG&A expense, which included certain warranty costs and advertising/promotional expenses, should decrease in the coming quarters. Gross and operating margins declined 110bp and 290bp, respectively. Overall, these results appear to be temporary with a meaningful turn in order activity continuing into Q2.
- **Estimate adjustments.** Based on the timing of incoming orders and expected ramp/contributions in pump line sales in 2H and 2018, we are modestly lowering our forecasts. As still implied, we expect AAON should experience double-digit revenue growth, accelerating to 20% in 2018 on what should be more meaningful contributions from the pump line business. Core business forecasts reflect 9% growth in 2017/11% in 2018, reflecting improving construction market activity and anticipated demand growth.
- **Valuation.** Our price target is now \$38 (previously \$34) or 15x our 2018 EBITDA estimate. Under a multi-year view, considering the significant contributions the water source pump line should add to the core business beyond the next 12-18 months, our price target represents 9x our 5-year EBITDA outlook. Our increased target reflects positive feedback regarding pump line development progress, sales channel interest and ultimately the view this product line should take notable market share over time. Beyond significant risks to the rollout of its new product line or sudden construction market weakness (neither of which we see today), we expect these shares to generally sustain premium multiples based on growth potential, although we remain on the sidelines on what we currently see as fairly valued prospects.

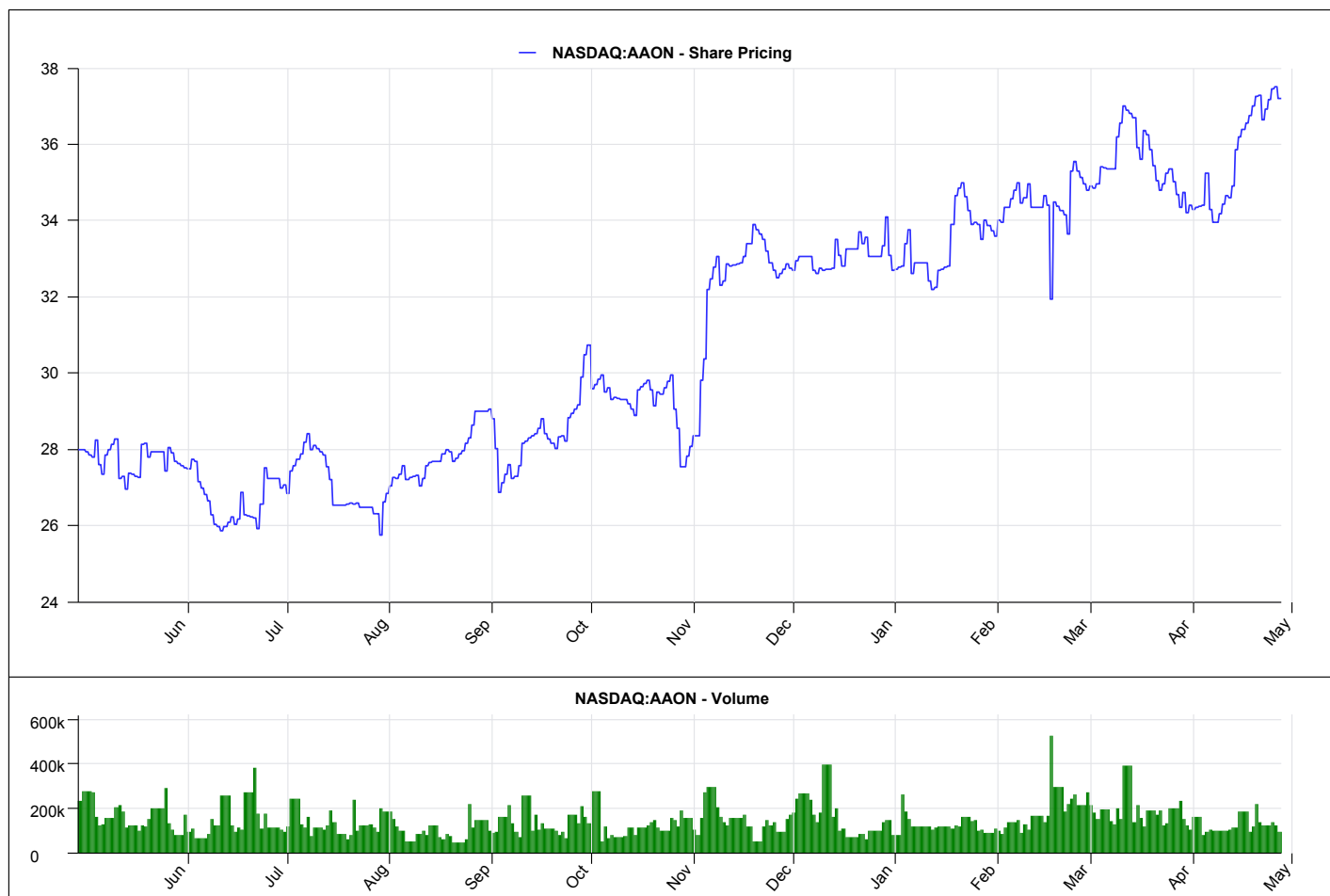
FY (Dec)		FY16A	FY17E	Previous	FY18E	Previous
EPS	Q1 (Mar)	\$0.20	\$0.19 A	\$0.20	n.a.	NC
	Q2 (Jun)	\$0.27	\$0.28 E	\$0.29	n.a.	NC
	Q3 (Sep)	\$0.29	\$0.30 E	\$0.31	n.a.	NC
	Q4 (Dec)	<u>\$0.21</u>	<u>\$0.28 E</u>	<u>\$0.31</u>	<u>n.a.</u>	<u>NC</u>
		\$0.98	\$1.05 E	\$1.10	\$1.40	\$1.45
Price/EPS		38.0x	35.5x		26.6x	
Revenue (\$M)	Q1 (Mar)	\$85.4	\$86.1 A	\$89.0	n.a.	NC
	Q2 (Jun)	\$102.3	\$109.0 E	\$114.0	n.a.	NC
	Q3 (Sep)	\$104.6	\$115.0 E	\$119.0	n.a.	NC
	Q4 (Dec)	<u>\$91.7</u>	<u>\$115.0 E</u>	<u>\$118.0</u>	<u>n.a.</u>	<u>NC</u>
		\$384.0	\$425.1 E	\$440.0	\$510.0	\$525.0
Price/Revenue		5.2x	4.7x		3.9x	
EBITDA (\$M)	Q1 (Mar)	\$20.1	\$18.1 A	\$20.3	n.a.	NC
	Q2 (Jun)	\$25.4	\$26.9 E	\$27.1	n.a.	NC
	Q3 (Sep)	\$26.0	\$28.2 E	\$28.9	n.a.	NC
	Q4 (Dec)	<u>\$21.1</u>	<u>\$26.7 E</u>	<u>\$29.1</u>	<u>n.a.</u>	<u>NC</u>
		\$92.6	\$99.9 E	\$105.4	\$130.5	\$133.8
EV/EBITDA		20.7x	19.2x		14.7x	

Please refer to pages 6 - 7 of this report for detailed disclosure and certification information.

* D. A. Davidson & Co. makes a market in this security.

D.A. Davidson & Co. Member SIPC

Price Chart



Source: Bloomberg

powered by: BlueMatrix

Company Description:

Tulsa, OK – AAON, Inc. manufactures and sells air-conditioning and heating equipment in the U.S. and Canada. Products include rooftop units, chillers, air-handling units, make-up air units, heat recovery units, condensing units, self-contained units and coils. Primary markets served are the commercial and industrial new construction and replacement markets.

Potential Risks:

- **Results are susceptible to the cyclical and seasonality of construction end markets.** Demand for products within the HVAC industry is sensitive to inherently cyclical construction markets and seasonal influences on construction activity, including weather.
- **Reliance on metals in its manufacturing processes.** Steel, copper, and aluminum are the most important purchased materials. Increases in materials costs may not be recaptured immediately in pricing and could result in margin pressure.
- **Most functions performed at single site, results susceptible to major business disruptions.** Most financial and major manufacturing functions are performed from AAON's site in Tulsa, OK. While we believe this offers notable cost advantages, a major event that disrupts operations at this primary asset could be significantly disruptive to financial results and the company's ability to serve its customers.
- **Warranties.** AAON offers a variety of warranties ranging from 1-25 years. Estimated warranty expenses are accrued at the time of shipment; under-accrued warranty expenses and/or a significant product failure could result in additional accrual charges or legal liabilities.

AAON, Inc.**Historical Operating Results & Projections**

(Dollars in millions except for per share data - 5/4/17)

Fiscal Year: December	3/31/16	12/31/16	3/31/17e	3/31/17	% chg
Revenue	\$85.4	\$91.7	\$89.0	\$86.1	0.8%
Cost of Revenue	59.7	65.2	63.0	61.1	2.3
Gross Profit	25.7	26.5	26.0	25.0	
SG&A	8.9	8.6	9.0	10.5	18.1
Gain (Loss) on Disposal of Assets	(0.0)	0.0	0.0	(0.0)	
Operating Income	16.8	17.9	17.0	14.5	
Interest Expense, net	0.0	0.0	0.0	0.0	
Interest Income, net	0.1	0.1	0.0	0.1	
Other Income (Expense), net	0.1	(0.0)	0.0	0.0	
Non-Operating Income	0.2	0.1	0.0	0.1	
Pre-Tax Income	17.0	17.9	17.0	14.5	
Taxes	6.2	6.5	6.1	4.3	
Net Income	\$10.8	\$11.4	\$10.9	\$10.2	
Applicable Shares	53.4	53.4	53.4	53.2	
EPS - Diluted	\$0.20	\$0.21	\$0.20	\$0.19	
Dividends Per Share	\$0.00	\$0.13	\$0.00	\$0.00	
Depreciation & Amortization	\$3.3	\$13.0	\$3.3	\$3.6	
EBITDA	20.1	30.9	20.3	18.1	
Gross Margin	30.1%	28.9%	29.2%	29.0%	
EBITDA Margin	23.5	33.7	22.8	21.0	
Operating Margin	19.7	19.5	19.1	16.8	
Pre-tax Margin	19.9	19.6	19.1	16.9	
Net Margin	12.6	12.5	12.3	11.9	
Tax Rate	36.5%	36.3%	35.9%	29.7%	
Backlog	\$60.3	\$49.1	\$65.0	\$68.9	14.3%

Source: Company reports and D.A. Davidson & Co. estimates.

AAON, Inc.

Quarterly Financial Position

(Dollars in millions except for per share data)

Fiscal Year: December	12/31/14	3/31/15	6/30/15	9/30/15	12/31/15	3/31/16	6/30/16	9/30/16	12/31/16	3/31/17
Cash & Equivalents	\$22.0	\$33.5	\$37.6	\$29.9	\$7.9	\$17.2	\$12.2	\$14.6	\$24.2	\$31.6
Accounts Receivable	44.1	39.9	45.5	45.8	50.0	42.0	58.5	53.3	43.0	44.4
Inventories	37.6	44.5	47.2	41.1	38.5	42.5	40.1	43.4	47.4	56.0
Deferred Taxes	6.1	6.3	5.8	6.2	4.7	0.0	0.7	0.0	6.2	3.0
Certificates of Deposit	6.1	4.2	6.2	10.8	10.1	10.8	9.8	6.2	5.5	3.1
Investments Held to Maturity	12.0	5.0	6.1	8.3	12.4	15.2	22.3	20.5	14.1	7.1
Other	3.2	3.3	4.5	3.0	0.6	2.5	1.1	3.3	0.6	1.0
Total Current Assets	131.1	136.7	152.9	144.9	124.2	130.2	144.7	141.4	141.0	146.2
Property, Plant & Equipment	91.9	92.8	95.8	96.3	101.1	105.8	111.9	115.2	114.9	118.4
Certificates of Deposit	5.3	4.6	0.5	2.1	1.9	0.0	0.2	0.0	0.0	0.0
Investments Held to Maturity	4.0	2.0	0.1	11.1	5.0	0.0	0.0	0.0	0.0	0.0
Note Receivable	0.8	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Total Assets	\$233.1	\$236.8	\$250.0	\$255.1	\$232.9	\$236.7	\$257.5	\$257.3	\$256.5	\$265.3
Current Portion of Long-term Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accounts Payable	11.4	10.1	10.5	7.8	6.2	3.6	9.4	7.2	7.1	9.9
Accrued Liabilities	31.3	28.5	30.8	34.5	37.2	34.4	38.1	36.1	31.9	31.2
Dividends Payable	0.0	0.0	6.0	0.0	0.0	0.0	5.8	0.0	0.0	0.0
Total Current Liabilities	42.7	38.6	47.3	42.2	43.4	38.0	53.3	43.3	39.0	41.1
Long-term Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred Tax Liabilities	13.7	13.4	12.8	12.7	8.7	7.7	6.9	7.2	9.5	10.3
Deferred Revenue & Other	2.7	2.6	2.5	1.8	1.8	2.3	2.4	2.0	2.1	2.1
Total Liabilities	59.1	54.6	62.6	56.7	53.9	48.0	62.5	52.5	50.6	53.5
Stockholders' Equity	174.1	182.1	187.4	198.4	178.9	188.7	195.0	204.8	205.9	211.8
Liabilities & Equity	\$233.1	\$236.8	\$250.0	\$255.1	\$232.9	\$236.7	\$257.5	\$257.3	\$256.5	\$265.3
Shares Outstanding	54.0	54.1	54.3	54.1	54.0	53.4	53.0	53.4	53.4	53.2
Per Share Items:										
Cash and Equivalents	\$0.41	\$0.62	\$0.69	\$0.55	\$0.15	\$0.32	\$0.23	\$0.27	\$0.45	\$0.59
Working Capital	1.64	1.81	1.95	1.90	1.50	1.72	1.73	1.84	1.91	1.98
Book Value	3.22	3.36	3.45	3.66	3.31	3.53	3.68	3.84	3.86	3.98
Tangible Book Value	3.22	3.36	3.45	3.66	3.31	3.53	3.68	3.84	3.86	3.98
Total Debt/Capitalization	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Note: AAON recorded a 3:2 stock split on July 16, 2014

Source: Company reports.

AAON, Inc.

Historical Operating Results & Projections

(Dollars in millions except for per share data - 5/4/17)

Fiscal Year: December	3/31/16	6/30/16	9/30/16	12/31/16	2016	3/31/17	% chg	6/30/17e	% chg	9/30/17e	% chg	12/31/17e	% chg	2017e	% chg	2018e	% chg
Revenue	\$85.4	\$102.3	\$104.6	\$91.7	\$384.0	\$86.1	0.8%	\$109.0	6.5%	\$115.0	10.0%	\$115.0	25.5%	\$425.1	10.7%	\$510.0	20.0%
Cost of Revenue	59.7	69.6	71.5	65.2	265.9	61.1	2.3	75.0	7.8	79.0	10.5	81.0	24.3	296.1	11.4	348.0	17.5
Gross Profit	25.7	32.7	33.1	26.5	118.1	25.0		34.0		36.0		34.0		129.0		162.0	
SG&A	8.9	10.6	10.4	8.6	38.5	10.5	18.1	10.7	1.1	11.4	9.5	10.9	26.6	43.5	13.0	45.9	5.5
Gain (Loss) on Disposal of Assets	(0.0)	(0.0)	0.0	0.0	(0.0)	(0.0)		0.0		0.0		0.0		(0.0)		0.0	
Operating Income	16.8	22.2	22.7	17.9	79.6	14.5		23.3		24.6		23.1		85.5		116.1	
Interest Expense, net	0.0	0.0	0.0	0.0	0.0	0.0		0.0		0.0		0.0		0.0		0.0	
Interest Income, net	0.1	0.1	0.1	0.1	0.3	0.1		0.0		0.0		0.0		0.1		0.0	
Other Income (Expense), net	0.1	0.0	(0.0)	(0.0)	0.1	0.0		0.0		0.0		0.0		0.0		0.0	
Non-Operating Income	0.2	0.1	0.1	0.1	0.4	0.1		0.0		0.0		0.0		0.1		0.0	
Pre-Tax Income	17.0	22.3	22.8	17.9	80.0	14.5		23.3		24.6		23.1		85.5		116.1	
Taxes	6.2	7.9	7.1	6.5	27.7	4.3		8.4		8.9		8.3		29.9		41.8	
Net Income	\$10.8	\$14.3	\$15.7	\$11.4	\$52.2	\$10.2		\$14.9		\$15.7		\$14.8		\$55.6		\$74.3	
Applicable Shares	53.4	53.4	53.4	53.4	53.4	53.2		53.2		53.2		53.3		53.2		53.2	
EPS - Diluted	\$0.20	\$0.27	\$0.29	\$0.21	\$0.98	\$0.19		\$0.28		\$0.30		\$0.28		\$1.05		\$1.40	
Dividends Per Share	\$0.00	\$0.11	\$0.00	\$0.13	\$0.24	\$0.00		\$0.13		\$0.00		\$0.13		\$0.26		\$0.26	
Depreciation & Amortization	\$3.3	\$3.2	\$3.3	\$3.3	\$13.0	\$3.6		\$3.6		\$3.6		\$3.6		\$14.4		\$14.4	
EBITDA	20.1	25.4	26.0	21.1	92.6	18.1		26.9		28.2		26.7		99.9		130.5	
Gross Margin	30.1%	32.0%	31.6%	28.9%	30.8%	29.0%		31.2%		31.3%		29.6%		30.3%		31.8%	
EBITDA Margin	23.5	24.8	24.8	23.1	24.1	21.0		24.7		24.5		23.2		23.5		25.6	
Operating Margin	19.7	21.7	21.7	19.5	20.7	16.8		21.4		21.4		20.1		20.1		22.8	
Pre-tax Margin	19.9	21.7	21.8	19.6	20.8	16.9		21.4		21.4		20.1		20.1		22.8	
Net Margin	12.6	14.0	15.0	12.5	13.6	11.9		13.7		13.7		12.8		13.1		14.6	
Tax Rate	36.5%	35.7%	31.1%	36.3%	34.7%	29.7%		36.0%		36.2%		36.0%		35.0%		36.0%	
Backlog	\$60.3	\$69.3	\$62.2	\$49.1	\$49.1	\$68.9	14.3%	\$75.0	8.2%	\$75.0	20.6%	\$68.0	38.5%	\$68.0	38.5%	\$85.0	25.0%

Source: Company reports and D.A. Davidson & Co. estimates.

Required Disclosures

D.A. Davidson & Co. expects to receive, or intends to seek, compensation for investment banking services from this company in the next three months.

D.A. Davidson & Co. is a full service investment firm that provides both brokerage and investment banking services. Brent Thielman, William Newby and Roresa Mojo, the research analysts principally responsible for the preparation of this report, will receive compensation that is based upon (among other factors) D.A. Davidson & Co.'s investment banking revenue. D.A. Davidson & Co.'s analysts, however, are not directly compensated for involvement in specific investment banking transactions.

We, Brent Thielman, William Newby and Roresa Mojo, attest that (i) all the views expressed in this research report accurately reflect our personal views about the common stock of the subject company, and (ii) no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

Rating Information

D.A. Davidson & Co.'s Institutional Research Rating Scale Definitions (maintained since 7/9/02):

BUY: Expected to produce a total return of over 15% on a risk adjusted basis over the next 12-18 months

NEUTRAL: Expected to produce a total return of >0-15% on a risk adjusted basis over the next 12-18 months

UNDERPERFORM: Expected to remain flat or lose value on a risk adjusted basis over the next 12-18 months

Rating Distribution (as of 3/31/17)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	IIG	Combined	IR	IIG	Combined
BUY (Buy)	55 %	78 %	57 %	10 %	3 %	9 %
NEUTRAL (Hold)	43 %	22 %	41 %	7 %	0 %	6 %
UNDERPERFORM (Sell)	2 %	0 %	2 %	0 %	0 %	0 %

IR denotes Institutional Research; IIG denotes Individual Investor Group Research whose rating scale is Buy/Add, Neutral, Sell/Reduce. Investment Banking Distribution denotes companies from whom D.A. Davidson & Co. has received compensation in the last 12 months.

AAON, Inc. Rating History as of 05/03/2017

powered by: BlueMatrix



Target prices are our Institutional Research Department's evaluation of price potential over the next 12-18 months and 5 years, based upon our assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

Other Disclosures

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