



AAON, Inc. (AAON)

Reduce Target To \$35 (From \$37) Following Disappointing 2Q:17 Results; Revenue And EPS, Down From 2:16, Miss Street Expectations, But Backlog Is Up 20%; Maintain NEUTRAL Rating

	2015		2016		2017E		2018E	
		OLD	NEW	OLD	NEW	OLD	NEW	
Mar.	\$0.15	\$0.20		\$0.19A		\$0.27	\$0.26	
June	0.20	0.27		0.29	0.26A	0.38	0.36	
Sep.	0.24	0.28		0.33	0.30	0.40		
Dec.	<u>0.24</u>	<u>0.21</u>		<u>0.29</u>	<u>0.26</u>	<u>0.39</u>	<u>0.37</u>	
EPS	\$0.84	\$0.96		\$1.10	\$1.01	\$1.44	\$1.40	
P/E					33.4x		24.1x	
EBITDA (mil)	\$83.0	\$92.6		\$104.6	\$95.2	\$133.4	\$130.1	
EV / EBITDA					18.3x		13.4x	

Note: *FCF includes include stock-based compensation expense. 2015-2018E include stock-based compensation expense of \$0.05, \$0.08, \$0.08, and \$0.09, respectively. Sum of quarterly EPS may not equal full-year total due to rounding and/or change in share count. The Russell 2000 Index includes AAON. NC=Not covered by Sidoti & Company, LLC.

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017E	2018E
Rev.(Mil.)	\$245.3	\$244.6	\$266.2	\$303.1	\$321.1	\$356.3	\$358.6	\$384.0	\$408.1	\$500.8
GAAP EPS	\$0.49	\$0.38	\$0.25	\$0.49	\$0.68	\$0.80	\$0.84	\$0.96	\$1.01	\$1.40

Description: AAON, Inc. (www.aaon.com) is a leading domestic manufacturer of standard and custom heating, ventilating and air conditioning (HVAC) units, including unitary rooftops, chillers, air-handling units, make-up air units, heat recovery units, condensing units, coils and boilers. Products target the nonresidential market, specifically planned replacement (55%) and new construction (45%). AAON generates almost all of its revenue from the U.S. Headquarters are in Tulsa, OK.

- **This morning, AAON reported revenue declined 1% year over year to \$101 million and EPS, 3% to \$0.26. The results missed our respective estimates of \$118 million and \$0.29 and consensus' \$105 million and \$0.29.**
- **The weak revenue was not a complete surprise; we were cautioning that the industry slowed in April-June, although, given management's recent optimism, we thought the company's new water-source heat pump product line would contribute more.**
- **Also contributing to the weak EPS was higher-than expected-SG&A, a result of inflated warranty expenses. However, in the release, management stated this was temporary and that SG&A should revert to normal levels starting in 3Q:17. We note a lower than normal tax rate that added \$0.02 to EPS.**
- **In the release, management stated that quarter-end backlog was up 20% to \$83.5 million, which equates to orders up 4%.**
- **We lower our 2017 and 2018 EPS estimates to \$1.01 (from \$1.10) and \$1.40 (from \$1.44), respectively.**
- **All in, we temper our near-term expectations for both the core business and the new water source heat pump business, but remain optimistic on 2018 given the backlog and our confidence that the new product line will be a big benefit to the bottom line once production ramps.**
- **We lower our target to \$35 (from \$37) and remain NEUTRAL. We continue to derive our target by applying a 25x multiple to our just-reduced 2018 EPS estimate of \$1.40, which equates to 14x our 2018 EBITDA estimate. Our \$37 target reflected our prior 2018 estimate of \$1.44.**
- **Management will hold a conference call at 4:15 p.m. E.T., accessible at (888) 241-0551.**

NEUTRAL

Price Target: \$35

Price: \$33.75

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Key Statistics

Analysts Covering	3
Market Cap (Mil)	\$1,780
Enterprise Value	\$1,753
52-Week Range (NASDAQ)	38-25
5-Year EPS CAGR	20%
Avg. Daily Trading Volume	122,000
Shares Out (Mil)	52.600
Float Shares (Mil)	40.756
Insider Ownership	25%
Institutional Holdings	60%
Annualized Dividend	\$0.26
Dividend Yield	0.8%
FCF Per Share (2018E)	\$0.96
FCF Yield (2018E)	2.8%
Net Cash Per Share (2018E)	\$1.29
Price to Book Value	8.4x
Return on Equity (2018E)	17.3%
Total Debt to Capital	Nil
Interest Coverage Ratio	N/A
Short Interest %	5.2%
Short Interest Days To Cover	24.1
Russell 2000	1,413
Russell 2000 – Last 12 Months	15.8%
AAON – Last 12 Months	27.5%



Source: FactSet Prices

Key Risks

Construction does not improve

Steel and copper prices rise

U.S. recession

Exhibit 1: AAON, Inc. 2Q:17 Variance Analysis

	<u>1Q:17 Actual</u>	<u>2Q:17 Estimate</u>	<u>Variance</u>	<u>% Variance</u>	<u>2Q:16 Actual</u>	<u>YoY Change</u>
Revenue (thou.)	\$101,326	\$117,528	(\$16,202)	-13.8%	\$102,319	-1.0%
Gross profit	31,678	36,743	(5,065)	-13.8%	32,747	-3.3%
<i>Profit margin</i>	<i>31.3%</i>	<i>31.3%</i>			<i>32.0%</i>	
Operating income	19,659	24,021	(4,362)	-18.2%	22,198	-11.4%
<i>Profit margin</i>	<i>19.4%</i>	<i>20.4%</i>			<i>21.7%</i>	
Adjusted net income	\$13,794	\$15,398	(1,604)	-10.4%	\$14,341	-3.8%
<i>Profit margin</i>	<i>13.6%</i>	<i>13.1%</i>			<i>14.0%</i>	
Adjusted EPS	\$0.26	\$0.29	(\$0.03)	-10.6%	\$0.27	-3.4%

Source: Sidoti & Co., and Company reports

AAON, INC.

Table I. AAON, Inc. Income Statement

(in thousands, except where noted)

	2015	Mar	Jun	Sep	Dec	2016	MarA	JunA	SepE	DecE	2017E	MarE	JunE	SepE	DecE	2018E
Sales, net	\$358,632	\$85,422	\$102,319	\$104,568	\$91,668	\$383,977	\$86,078	\$101,326	\$114,796	\$105,918	\$408,119	\$104,686	\$128,512	\$136,678	\$130,912	\$500,787
Cost of sales	249,951	59,691	69,572	71,476	65,158	265,897	61,092	69,648	78,222	74,743	283,705	72,928	86,522	91,606	89,667	340,723
Gross profit	108,681	25,731	32,747	33,092	26,510	118,080	24,986	31,678	36,574	31,175	124,413	31,758	41,990	45,072	41,244	160,064
SG&A	37,438	8,913	10,561	10,400	8,632	38,506	10,530	11,971	11,620	9,792	43,913	9,979	12,331	12,424	10,754	45,489
Other	(59)	(8)	(12)			(20)	(1)	48			47					0
Operating income	71,302	16,826	22,198	22,692	17,878	79,594	14,457	19,659	24,954	21,383	80,453	21,779	29,659	32,648	30,490	114,576
Operating income (ex. one-time items)	71,302	16,826	22,198	22,692	17,878	79,594	14,457	19,659	24,954	21,383	80,453	21,779	29,659	32,648	30,490	114,576
Interest expense	(161)	(74)	(67)	(82)	(69)	(292)	(60)	(71)	(21)	(50)	(202)	(45)	(48)	(21)	(50)	(164)
Other (income) expense	124	(117)	(10)	12	10	(105)	(11)	(34)	10	10	(25)	10	10	10	10	40
Income before income taxes	71,339	17,017	22,275	22,762	17,937	79,991	14,528	19,764	24,965	21,423	80,680	21,814	29,697	32,659	30,530	114,700
Income tax provision	25,611	6,211	7,934	8,180	6,517	28,842	4,311	5,970	8,987	7,712	26,981	7,853	10,691	11,757	10,991	41,292
Net Income	\$45,728	\$10,806	\$14,341	\$14,582	\$11,420	\$51,149	\$10,217	\$13,794	\$15,978	\$13,711	\$53,699	\$13,961	\$19,006	\$20,902	\$19,539	\$73,408
Net Income (ex. one-time items)	\$45,728	\$10,806	\$14,341	\$14,082	\$11,420	\$51,149	\$10,217	\$13,794	\$15,978	\$13,711	\$53,699	\$13,961	\$19,006	\$20,902	\$19,539	\$73,408
GAAP Diluted EPS	\$0.84	\$0.20	\$0.27	\$0.27	\$0.21	\$0.96	\$0.19	\$0.26	\$0.30	\$0.26	\$1.01	\$0.26	\$0.36	\$0.40	\$0.37	\$1.40
Diluted EPS	\$0.84	\$0.20	\$0.27	\$0.26	\$0.21	\$0.96	\$0.19	\$0.26	\$0.30	\$0.26	\$1.01	\$0.26	\$0.36	\$0.40	\$0.37	\$1.40
Diluted shares outstanding	54,481	53,430	53,401	53,394	53,420	53,411	53,190	53,151	53,031	52,911	53,071	52,791	52,671	52,551	52,431	52,611
YOY Growth:																
Revenue	0.6%	11.3%	13.3%	10.8%	-5.7%	7.1%	0.8%	-1.0%	9.8%	15.5%	6.3%	21.6%	26.8%	19.1%	23.6%	22.7%
Cost of sales	0.8%	8.6%	10.2%	11.4%	-3.7%	6.4%	2.3%	0.1%	9.4%	14.7%	6.7%	19.4%	24.2%	17.1%	20.0%	20.1%
SG&A	-7.7%	7.2%	14.8%	3.4%	-12.4%	2.9%	18.1%	13.4%	11.7%	13.4%	14.0%	-5.2%	3.0%	6.9%	9.8%	3.6%
Gross profit	0.4%	18.0%	20.8%	9.6%	-10.4%	8.6%	-2.9%	-3.3%	10.5%	17.6%	5.4%	27.1%	32.6%	23.2%	32.3%	28.7%
Operating income	4.8%	24.9%	23.7%	12.6%	-9.3%	11.6%	-14.1%	-11.4%	10.0%	19.6%	1.1%	50.6%	50.9%	30.8%	42.6%	42.4%
Net income	-0.3%	28.7%	28.8%	10.0%	-11.8%	11.9%	-5.5%	-3.8%	9.6%	20.1%	5.0%	36.6%	37.8%	30.8%	42.5%	36.7%
Diluted EPS	0.9%	31.6%	31.9%	8.6%	-10.8%	14.1%	-5.0%	-3.4%	14.2%	21.2%	5.7%	37.7%	39.0%	32.0%	43.8%	37.9%
Margin Analysis:																
COGS/sales	69.7%	69.9%	68.0%	68.4%	71.1%	69.2%	71.0%	68.7%	68.1%	70.6%	69.5%	69.7%	67.3%	67.0%	68.5%	68.0%
SG&A/sales	10.4%	10.4%	10.3%	9.9%	9.4%	10.0%	12.2%	11.8%	10.1%	9.2%	10.8%	9.5%	9.6%	9.1%	8.2%	9.1%
Gross profit margin	30.3%	30.1%	32.0%	31.6%	28.9%	30.8%	29.0%	31.3%	31.9%	29.4%	30.5%	30.3%	32.7%	33.0%	31.5%	32.0%
Operating margin (ex. one-time items)	19.9%	19.7%	21.7%	21.7%	19.5%	20.7%	16.8%	19.4%	21.7%	20.2%	19.7%	20.8%	23.1%	23.9%	23.3%	22.9%
Pretax margin	19.9%	19.9%	21.8%	21.8%	19.6%	20.8%	16.9%	19.5%	21.7%	20.2%	19.8%	20.8%	23.1%	23.9%	23.3%	22.9%
Net margin	12.8%	12.7%	14.0%	13.9%	12.5%	13.3%	11.9%	13.6%	13.9%	12.9%	13.2%	13.3%	14.8%	15.3%	14.9%	14.7%
Tax rate	35.9%	36.5%	35.6%	35.9%	36.3%	36.1%	29.7%	30.2%	36.0%	36.0%	33.4%	36.0%	36.0%	36.0%	36.0%	36.0%

Source: Sidoti & Company, LLC and company reports

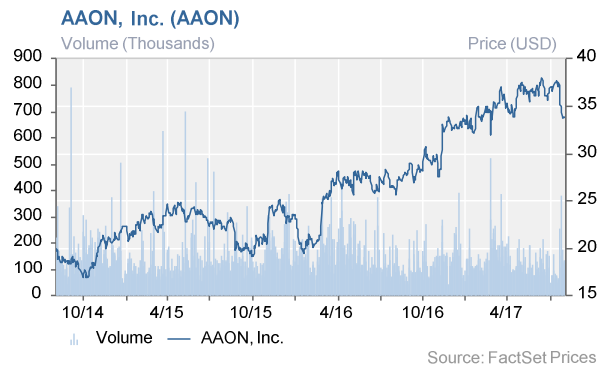
Appendix Required Disclosures

Required Disclosures

AAON, Inc. (AAON-\$33.75) NEUTRAL Price Target: \$35 August 3, 2017

Rating and Price Target History Table

Action	Date	Px	Rating	PT
Rating	2/6/15	23.7	Neutral	25
PT	8/6/15	21.6		22
PT	10/19/15	21		20
PT	12/17/15	23.4		23
PT	2/25/16	22.4		25
PT	9/16/16	27.6		28
PT	12/16/16	32.6		34
PT	5/4/17	37.2		37



Key Risks	Construction does not improve	Steel and copper prices rise	U.S. recession
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Valuation:

- **We lower our target to \$35 (from \$37) and remain NEUTRAL. We continue to derive our target by applying a 25x multiple to our just-reduced 2018 EPS estimate of \$1.40, which equates to 14x our 2018 EBITDA estimate. Our \$37 target reflected our prior 2018 estimate of \$1.44.**

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APPENDIX CONTINUED

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