



February 24, 2017

Rating: **Neutral**
 Price: (2/23/17) \$31.95
 Price Targets: 12-18 month: \$34.00
 5-year: ↑ \$46.00

Industry:
 Construction Products

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Soft Q4 Temporary, Product Launch Offers Multi-year Growth Potential

- **New product growth opportunity.** The water source heat pump line continues to represent a meaningful next leg of growth for AAON. The program appears to be progressing relatively well with production on initial orders, albeit impact to financials is limited. More meaningful profit contributions await in 2018 (with potential for \$50-\$100 million in sales contributions).
- **Unusual finish to an otherwise better year.** AAON reported Q4 earnings of \$0.21 per share, versus \$0.24 last year. Results compared to our estimate of \$0.24 and consensus of \$0.26. Revenue of \$91.7 million (-6% YoY) was below our \$98.0 million estimate. Lower sales follow four consecutive quarters of YoY growth; sales agent 'reshuffling' executed in 2015, coupled with favorable market demand, supported growth through most of this year. AAON noted customer hesitation around November elections and less favorable mix negatively impacted sales. Gross and operating margins declined 150bp and 80bp, respectively. Overall, these results appear to be temporary with a significant turn in order activity in the current quarter.
- **Reduced Q1, full-year 2017 unchanged; 2018 forecasts increased.** Our 2017 estimates are essentially unchanged. A slower than expected start to Q1 can/should be offset as the year develops. We are increasing our 2018 sales/earnings expectations reflecting a somewhat more optimistic outlook for contributions from the new product line; agent feedback and general progress appears very encouraging. As implied, AAON should see solid double-digit revenue growth in the next two years although we do not yet assume the company recognizes \$100 million in sales from the pump line in 2018.
- **5-year earnings scenario highlights longer-term potential.** We retain our \$34 price target (13x 2018 EBITDA). These shares continue to be rewarded with premium multiples on a historical absolute and relative (peer group) basis. Leading margins and financial returns likely continue to support the shares' relative premium. Among other factors, introduction of its new product line and associated medium-term revenue/earnings growth potential may support higher than typical absolute multiples for the shares. Within a 5-year scenario, assuming 8% CAGR in core HVAC sales, a ramp to \$300 million in heat pump line sales, and consolidated GM/OM of 30%/23%; AAON could earn in the realm of ~\$2.30 per share (by 2021). Considering this longer-term earnings growth potential, we continue to monitor opportunities amidst inevitable shorter-term share price volatility; however, at current levels we view moderate near-term upside potential. We remain **NEUTRAL**.

Valuation Data

Long-Term Growth Rate (E)	15%
Total Debt/Capital (12/31/16)	0.0%
Cash per share (12/31/16)	\$0.38
Book Value per Share (12/31/16)	\$3.88
Dividend	\$0.26 (0.8%)
Return on Equity (T-T-M)	26.7%

Trading Data

Shares Outstanding (M)	52.6
Market Capitalization (\$M)	\$1,681.9
52-week range	\$21.08-\$35.05
Avg. Daily Volume (3 mos.) (K)	137.3
Float (%)	77.2%

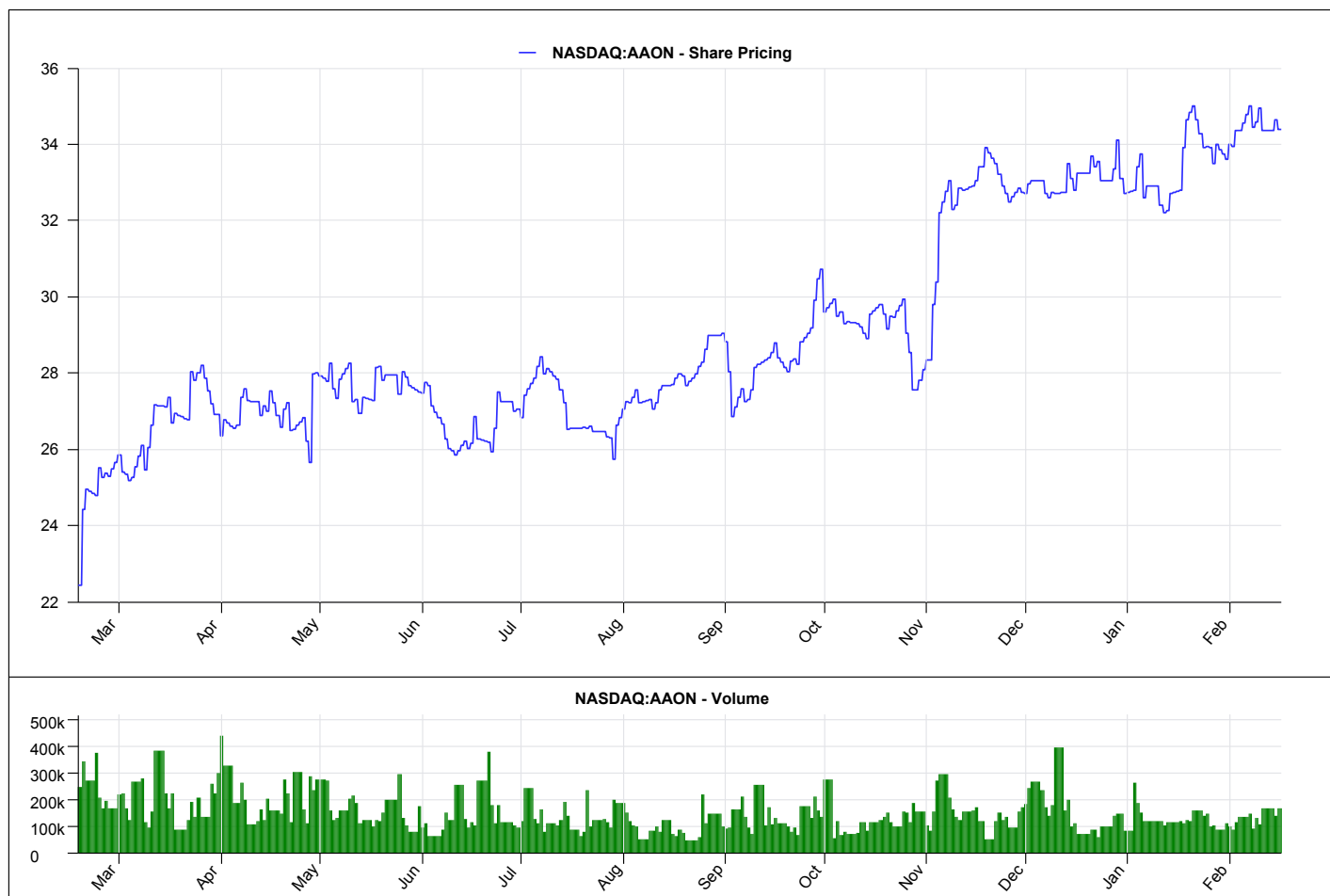
FY (Dec)		FY16A	FY17E	Previous	FY18E	Previous
EPS	Q1 (Mar)	\$0.20	\$0.20 E	\$0.22	n.a.	NC
	Q2 (Jun)	\$0.27	\$0.29 E	NC	n.a.	NC
	Q3 (Sep)	\$0.29	\$0.31 E	\$0.30	n.a.	NC
	Q4 (Dec)	<u>\$0.21</u>	<u>\$0.31 E</u>	<u>\$0.30</u>	<u>n.a.</u>	<u>NC</u>
		\$0.98	\$1.10 E	NC	\$1.45	\$1.37
Price/EPS		32.6x	29.0x		22.0x	
Revenue (\$M)	Q1 (Mar)	\$85.4	\$89.0 E	\$94.0	n.a.	NC
	Q2 (Jun)	\$102.3	\$114.0 E	NC	n.a.	NC
	Q3 (Sep)	\$104.6	\$119.0 E	\$118.0	n.a.	NC
	Q4 (Dec)	<u>\$91.7</u>	<u>\$118.0 E</u>	<u>\$117.0</u>	<u>n.a.</u>	<u>NC</u>
		\$384.0	\$440.0 E	\$443.0	\$525.0	\$500.0
Price/Revenue		4.4x	3.8x		3.2x	
EBITDA (\$M)	Q1 (Mar)	\$20.1	\$20.3 E	\$21.8	n.a.	NC
	Q2 (Jun)	\$25.4	\$27.1 E	NC	n.a.	NC
	Q3 (Sep)	\$26.0	\$28.9 E	\$28.0	n.a.	NC
	Q4 (Dec)	<u>\$30.9</u>	<u>\$29.1 E</u>	<u>\$28.2</u>	<u>n.a.</u>	<u>NC</u>
		\$102.4	\$105.4 E	\$105.1	\$133.8	\$127.5
EV/EBITDA		16.1x	15.6x		12.3x	

Please refer to pages 5 - 6 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.

Quarterly Financial Position

(Dollars in millions except for per share data)

Fiscal Year: December	Preliminary											
	3/31/14	6/30/14	9/30/14	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
Cash & Equivalents	\$19.7	\$16.5	\$18.8	\$22.0	\$33.5	\$37.6	\$29.9	\$7.9	\$17.2	\$12.2	\$14.6	\$24.2
Accounts Receivable	45.7	52.9	54.8	44.1	39.9	45.5	45.8	50.0	42.0	58.5	53.3	43.0
Inventories	34.9	36.6	37.2	37.6	44.5	47.2	41.1	38.5	42.5	40.1	43.4	47.4
Deferred Taxes	5.5	5.9	7.1	6.1	6.3	5.8	6.2	4.7	0.0	0.7		6.2
Certificates of Deposit	9.1	10.1	7.2	6.1	4.2	6.2	10.8	10.1	10.8	9.8	6.2	5.5
Investments Held to Maturity	22.8	19.1	16.1	12.0	5.0	6.1	8.3	12.4	15.2	22.3	20.5	14.1
Other	0.7	0.9	0.8	3.2	3.3	4.5	3.0	0.6	2.5	1.1	3.3	0.6
Total Current Assets	138.4	141.9	142.1	131.1	136.7	152.9	144.9	124.2	130.2	144.7	141.4	141.0
Property, Plant & Equipment	88.2	87.2	92.0	91.9	92.8	95.8	96.3	101.1	105.8	111.9	115.2	114.9
Certificates of Deposit	0.2	6.0	6.7	5.3	4.6	0.5	2.1	1.9	0.0	0.2		
Investments Held to Maturity	1.0	5.7	5.8	4.0	2.0	0.1	11.1	5.0	0.0	0.0		
Note Receivable	0.9	0.9	0.9	0.8	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Total Assets	\$228.7	\$241.7	\$247.5	\$233.1	\$236.8	\$250.0	\$255.1	\$232.9	\$236.7	\$257.5	\$257.3	\$256.5
Current Portion of Long-term Debt										0.0		
Accounts Payable	11.3	10.9	13.6	11.4	10.1	10.5	7.8	6.2	3.6	9.4	7.2	
Accrued Liabilities	30.6	33.9	39.9	31.3	28.5	30.8	34.5	37.2	34.4	38.1	36.1	
Dividends Payable		4.8				6.0			0.0	5.8		
Total Current Liabilities	42.0	49.5	53.5	42.7	38.6	47.3	42.2	43.4	38.0	53.3	43.3	39.0
Long-term Debt												
Deferred Tax Liabilities	14.0	13.6	12.4	13.7	13.4	12.8	12.7	8.7	7.7	6.9	7.2	9.5
Deferred Revenue & Other	0.7	0.8	2.6	2.7	2.6	2.5	1.8	1.8	2.3	2.4	2.0	2.1
Total Liabilities	56.7	64.0	68.5	59.1	54.6	62.6	56.7	53.9	48.0	62.5	52.5	50.6
Stockholders' Equity	172.1	177.7	179.0	174.1	182.1	187.4	198.4	178.9	188.7	195.0	204.8	205.9
Liabilities & Equity	\$228.7	\$241.7	\$247.5	\$233.1	\$236.8	\$250.0	\$255.1	\$232.9	\$236.7	\$257.5	\$257.3	\$256.5
Shares Outstanding	54.9	55.0	54.5	54.0	54.1	54.3	54.1	54.0	53.4	53.0	53.4	53.4
Per Share Items:												
Cash and Equivalents	\$0.36	\$0.30	\$0.35	\$0.41	\$0.62	\$0.69	\$0.55	\$0.15	\$0.32	\$0.23	\$0.27	\$0.45
Working Capital	1.76	1.68	1.63	1.64	1.81	1.95	1.90	1.50	1.72	1.73	1.84	1.91
Book Value	3.13	3.23	3.29	3.22	3.36	3.45	3.66	3.31	3.53	3.68	3.84	3.86
Tangible Book Value	3.13	3.23	3.29	3.22	3.36	3.45	3.66	3.31	3.53	3.68	3.84	3.86
Total Debt/Capitalization	0.0%	0.0%	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 - 2/23/17)

Fiscal Year: December	3/31/15	6/30/15	9/30/15	12/31/15	2015	3/31/16	6/30/16	9/30/16	12/31/16	% chg	2016	% chg	3/31/17e	% chg	6/30/17e	% chg	9/30/17e	% chg	12/31/17e	% chg	2017e	% chg	2018e	% chg
Revenue	\$76.8	\$90.3	\$94.4	\$97.2	\$358.7	\$85.4	\$102.3	\$104.6	\$91.7	-5.7%	\$384.0	7.1%	\$89.0	4.2%	\$114.0	11.4%	\$119.0	13.8%	\$118.0	28.7%	\$440.0	14.6%	\$525.0	19.3%
Cost of Revenue	55.0	63.2	64.2	67.6	250.0	59.7	69.6	71.5	65.2	(3.7)	265.9	6.4	63.0	5.5	79.0	13.6	82.0	14.7	81.0	24.3	305.0	14.7	359.0	17.7
Gross Profit	21.8	27.1	30.2	29.6	108.7	25.7	32.7	33.1	26.5		118.1		26.0		35.0		37.0		37.0		135.0		166.0	
SG&A	8.3	9.2	10.1	9.9	37.4	8.9	10.6	10.4	8.6	(12.4)	38.5	2.9	9.0	0.9	11.2	5.8	11.4	9.8	11.2	29.9	42.8	11.1	45.7	6.7
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		0.0		0.0		0.0		0.0		0.0	
Operating Income	13.5	17.9	20.1	19.7	71.3	16.8	22.2	22.7	17.9		79.6		17.0		23.8		25.6		25.8		92.2		120.3	
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		0.0		0.0		0.0		0.0		0.0	
Interest Income, net	0.0	0.0	0.0	0.1	0.2	0.1	0.1	0.1	0.1		0.3		0.0		0.0		0.0		0.0		0.0		0.0	
Other Income (Expense), net	(0.1)	0.0	(0.1)	(0.0)	(0.1)	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	(0.0)	0.1	(0.0)	0.1	0.0	0.2	0.1	0.1	0.1		0.4		0.0		0.0		0.0		0.0		0.0		0.0	
Pre-Tax Income	13.4	18.0	20.1	19.8	71.3	17.0	22.3	22.8	17.9		80.0		17.0		23.8		25.6		25.8		92.2		120.3	
Taxes	5.0	6.9	6.9	6.8	25.6	6.2	7.9	7.1	6.5		27.7		6.1		8.6		9.2		9.3		33.2		43.3	
Net Income	\$8.4	\$11.1	\$13.2	\$12.9	\$45.7	\$10.8	\$14.3	\$15.7	\$11.4		\$52.2		\$10.9		\$15.2		\$16.4		\$16.5		\$59.0		\$77.0	
Applicable Shares	54.6	54.7	54.6	54.0	54.5	53.4	53.4	53.4	53.4		53.4		53.4		53.4		53.4		53.5		53.4		53.2	
EPS - Diluted	\$0.15	\$0.20	\$0.24	\$0.24	\$0.84	\$0.20	\$0.27	\$0.29	\$0.21		\$0.98		\$0.20		\$0.29		\$0.31		\$0.31		\$1.10		\$1.45	
Dividends Per Share	\$0.00	\$0.11	\$0.00	\$0.11	\$0.22	\$0.00	\$0.11	\$0.00	\$0.13		\$0.24		\$0.00		\$0.13		\$0.00		\$0.13		\$0.26		\$0.26	
Depreciation & Amortization	\$2.9	\$2.8	\$2.9	\$3.2	\$11.7	\$3.3	\$3.2	\$3.3	\$13.0		\$22.8		\$3.3		\$3.3		\$3.3		\$3.3		\$13.2		\$13.5	
EBITDA	16.3	20.8	23.0	22.9	83.0	20.1	25.4	26.0	30.9		102.4		20.3		27.1		28.9		29.1		105.4		133.8	
Gross Margin	28.4%	30.0%	32.0%	30.4%	30.3%	30.1%	32.0%	31.6%	28.9%		30.8%		29.2%		30.7%		31.1%		31.4%		30.7%		31.6%	
EBITDA Margin	21.3	23.0	24.4	23.5	23.1	23.5	24.8	24.8	33.7		26.7		22.8		23.8		24.3		24.7		24.0		25.5	
Operating Margin	17.6	19.9	21.3	20.3	19.9	19.7	21.7	21.7	19.5		20.7		19.1		20.9		21.5		21.9		21.0		22.9	
Pre-tax Margin	17.5	19.9	21.3	20.3	19.9	19.9	21.7	21.8	19.6		20.8		19.1		20.9		21.5		21.9		21.0		22.9	
Net Margin	10.9	12.3	14.0	13.3	12.7	12.6	14.0	15.0	12.5		13.6		12.3		13.4		13.8		14.0		13.4		14.7	
Tax Rate	37.5%	38.2%	34.2%	34.5%	35.9%	36.5%	35.7%	31.1%	36.3%		34.7%		35.9%		36.1%		36.0%		36.1%		36.0%		36.0%	
Backlog	\$55.4	\$66.0	\$60.4	\$57.1	\$57.1	\$60.3	\$69.3	\$62.2	\$49.1	-14.0%	\$49.1	-14.0%	\$65.0	7.8%	\$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, the research analyst 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.

I, Brent Thielman, attest that (i) all the views expressed in this research report accurately reflect my personal views about the common stock of the subject company, and (ii) no part of my 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

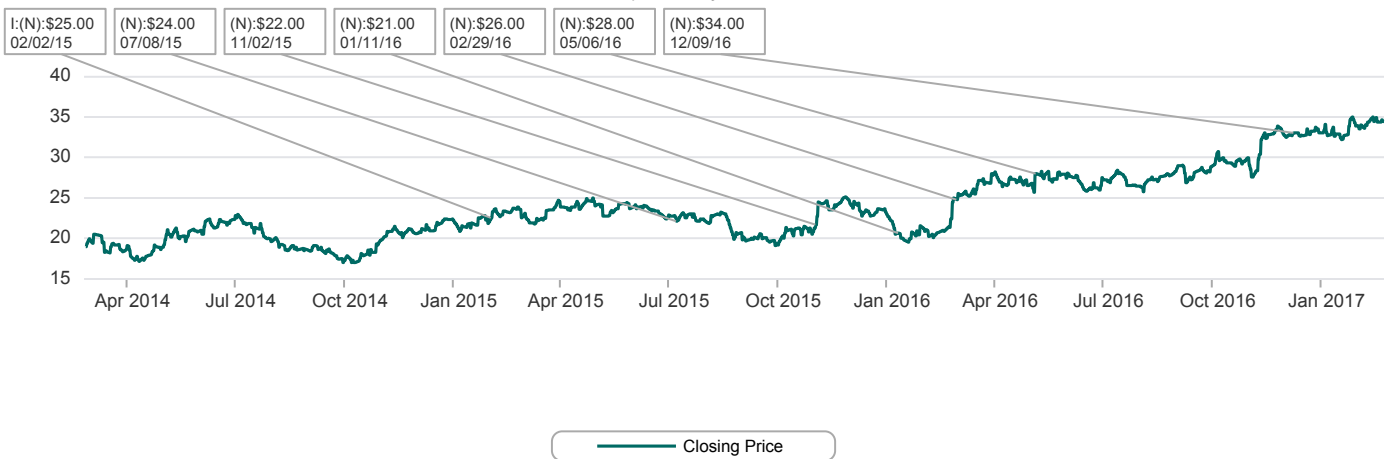
UNDERPERFORM: Expected to remain flat or lose value on a risk adjusted basis over the next 12-18 months

Rating Distribution (as of 12/31/16)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	IIG	Combined	IR	IIG	Combined
BUY (Buy)	58 %	81 %	61 %	9 %	3 %	8 %
NEUTRAL (Hold)	38 %	19 %	36 %	7 %	0 %	7 %
UNDERPERFORM (Sell)	4 %	0 %	3 %	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 02/22/2017

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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