



AAON, Inc. (AAON)

After Hosting Non-Deal Roadshow With Management, We Maintain Our Positive View On AAON; We Raise Our Price Target To \$37 (From \$33), But Maintain A NEUTRAL Rating On Valuation

	2017		2018		2019E		2020E	
		OLD	NEW	OLD	NEW	OLD	NEW	
Mar.	\$0.19	\$0.11		\$0.21A		\$0.36		
June	0.26	0.23		0.24		0.37		
Sep.	0.28	0.27		0.33		0.40		
Dec.	<u>0.23</u>	<u>0.24</u>		<u>0.37</u>		<u>0.40</u>		
EPS	\$0.96	\$0.84		\$1.14		\$1.53		
P/E				40.9x		30.5x		
EBITDA (mil)	\$89.9	\$73.4		\$101.6		\$128.9		
EV / EBITDA				23.9x		18.9x		

Note: 2017-2020E include stock-based compensation expense of \$0.12, \$0.14, \$0.15, and \$0.15, 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	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E
Rev.(Mil.)	\$266.2	\$303.1	\$321.1	\$356.3	\$358.6	\$384.0	\$405.2	\$430.9	\$501.2	\$550.5
GAAP EPS	\$0.25	\$0.49	\$0.68	\$0.80	\$0.84	\$0.98	\$1.03	\$0.86	\$1.14	\$1.53

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 revenue from the U.S. Headquarters are in Tulsa, OK.

- **The non-deal roadshow meetings that we hosted with President Gary Fields and CFO Scott Asbjornson last week affirmed our view AAON can return to historical gross and operating margin levels.**
- **Backlog and order trends remain strong and we continue to project robust earnings growth.**
- **In our view, the worst of the operational inefficiencies attributable to labor force turnover are past, although some effects may linger.**
- **We raise our target to \$37 (from \$33) by increasing our valuation multiple, which is reflects our higher confidence that operations are improving.**
- **Our \$37 price target is now based on 24x our 2020 EPS estimate of \$1.53; this equates to 15x our 2020 EBITDA estimate of \$129 million. (Our prior price target was based on 22x our 2020 EPS estimate of \$1.53, which equates to 13.3x our 2020 EBITDA estimate of \$129 million.)**
- **Trading at a forward EV/EBITDA multiple of 22x, compared to a five-year average of 15x and the stock on peer Lennox International (NYSE: LII, NC) which is currently at 16x, we continue to think valuation is rich.**
- **Thus, we maintain a NEUTRAL rating.**

Although the company has underperformed its peers over the past 18 months... In 2018, AAON fell behind the industry in implementing price increases to offset inflating material and component costs. In addition, operational productivity related to labor turnover was a big challenge in 2018. As a result, the company's gross margins contracted in 2018 from over 30% to 24%.

...certain key changes to operational management lead us to think much of the operational inefficiencies underlying the recent underperformance are largely past. After our recent non-deal roadshow we are more confident gross margins can return to historic levels of between 28%-32%. The cost of materials such as steel and aluminum have begun to normalize, with the lifting of specific tariffs with Canada and Mexico. Additionally, as AAON works through its backlog, the roughly 4% price increase announced in 4Q:F18

NEUTRAL

Price Target: \$37

Price: \$46.65

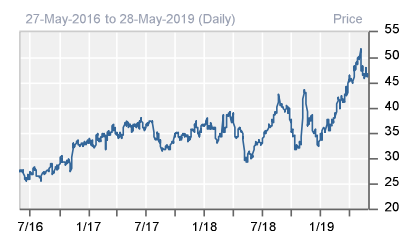
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Key Statistics

Analysts Covering	3
Market Cap (Mil)	\$2,430
Enterprise Value	\$2,436
52-Week Range (NASDAQ)	53-30
5-Year EPS CAGR	20%
Avg. Daily Trading Volume	146,000
Shares Out (Mil)	52.115
Float Shares (Mil)	40.507
Insider Ownership	25%
Institutional Holdings	60%
Annualized Dividend	\$0.32
Dividend Yield	0.7%
FCF Per Share (2020E)	\$1.47
FCF Yield (2020E)	3.2%
Net Cash Per Share (2020E)	\$1.80
Price to Book Value	9.4x
Return on Equity (2020E)	20.1%
Total Debt to Capital	Nil
Interest Coverage Ratio	N/A
Short Interest %	10.5%
Short Interest Days To Cover	22.7
Russell 2000	1,514
Russell 2000 – Last 12 Months	-1.8%
AAON – Last 12 Months	37.2%



Source: FactSet Prices

and other price increases since then should benefit gross margins starting in 2Q:F19. As far as the operations and its labor force, the company has made several changes over the past year, including at higher-level plant management roles as well as at the entry level roles. The only remaining management role to fully undergo a transition is the Vice President of Operations. Drawing on past experiences, this should be a seamless transition as the designated successor is currently operating largely in this capacity with his predecessor. In addition, AAON continues to invest in skilled labor recruitment and training classes to reduce turnover and increase efficiency. These classes serve as a feeder program for AAON's workforce and provide a key selling point in recruiting top-tier talent. They also provide opportunities for existing employees to further their professional development and increase efficiency. In our view, although we do not expect the pre-2017 peak efficiency levels to return immediately, we think the worst is behind the company and look for continued progress throughout 2019.

The company completed a new state of the art laboratory at the Tulsa, Oklahoma manufacturing plant that will help to bolster a strong backlog. This research and development laboratory is a key differentiator from their competition and is the only one of its kind in the world. The facility can simulate temperatures as low as -20°F, 50 mph winds, and snowfall at a rate of two inches per hour. We still do not know how the facility will be monetized. However, we expect it will be a driver of new business. According to management, the new lab helped secure a majority of the HVAC equipment for the Jacob Javits Center project in New York City; we expect more project wins such as this, because of the capabilities of the lab. The company also looks to expand capacity and increase productivity. The backlog remains strong at \$167 million (up 125% year-over-year) in 1Q:F19. The new laboratory allows AAON to repurpose the old space to add additional capacity. The company also has plans for a new building at the Tulsa, Oklahoma location within three years and expansion of the Longview, Texas facility in the immediate future. These additions should provide room for growth in production and a margin of safety in the event of any unforeseen machine downtime. The unveiling of their parts store in Tulsa, Oklahoma will also serve as a prototype for AAON's sales partners across North America. By making sure every region has the required parts on hand to provide premium service on existing equipment, the company hopes to further cement its position as the premium manufacturer of standard and custom heating, ventilating and air conditioning units.

We raise our price target to \$37 (from \$33), but maintain a NEUTRAL rating. Although we maintain a positive view on the company, valuation is a hurdle for us. AAON shares currently trade at 29x our forward 12-month EPS estimate and 17x our forward 12-month EBITDA estimate. Historically, the stock traded at respective comparative multiples of 26x and 15x. On a relative peer basis, LII stock currently trades at 21x and 16x. Our new \$37 price target is based on 24x our 2020 EPS estimate of \$1.53; this equates to 15x our 2020 EBITDA estimate of \$129 million. (We derived our prior price target by applying a 22x multiple to our 2020 EPS estimate of \$1.53, which; this equates to 13.3x our 2020 EBITDA estimate of \$129 million.) We increased our valuation multiples to reflect the higher confidence we have concerning the company's ability to execute and achieve the high growth targets we project. However, we think current valuation already reflects the growth and maintain a NEUTRAL rating.

Key Risks	Construction does not improve	Steel and copper prices rise	U.S. recession
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AAON, INC.

Table 1. AAON, Inc. Income Statement
(in thousands, except where noted)

	2017	MarA	JunA	SepA	DecA	2018	MarA	JunE	SepE	DecE	2019E	MarE	JunE	SepE	DecE	2020E
Sales, net	\$405,232	\$99,082	\$109,588	\$112,937	\$112,340	\$433,947	\$113,822	\$123,834	\$131,007	\$132,561	\$501,225	\$129,757	\$137,456	\$142,798	\$140,515	\$550,526
Cost of sales	281,835	83,692	82,003	80,174	84,545	330,414	88,029	92,876	93,670	94,118	368,693	92,776	96,219	99,244	99,063	387,303
Gross profit	123,397	15,390	27,585	32,763	27,795	103,533	25,793	30,959	37,337	38,443	132,531	36,981	41,237	43,553	41,452	163,223
SG&A	49,249	10,219	13,086	13,190	11,260	47,755	11,001	14,117	14,411	12,593	52,122	11,938	14,845	15,137	13,208	55,128
Other	45	(7)	(4)	2	(3)	(12)	284	0	0	0	284	0	0	0	0	0
Operating income	74,103	5,178	14,503	19,571	16,535	55,790	14,508	16,841	22,926	25,849	80,125	25,043	26,392	28,417	28,243	108,095
Operating income (ex. one-time items)	74,103	7,078	15,003	19,571	16,535	55,790	14,508	16,841	22,926	25,849	80,125	25,043	26,392	28,417	28,243	108,095
Interest expense	(298)	(68)	(67)	(36)	(25)	(196)	0	(50)	(70)	(70)	(190)	(70)	(70)	(70)	(70)	(280)
Other (income) expense	(91)	6	(12)	(5)	58	47	17	10	10	10	47	10	10	10	10	40
Income before income taxes	74,492	5,240	14,582	19,612	16,502	55,939	14,491	16,881	22,986	25,909	80,268	25,103	26,452	28,477	28,303	108,335
Income tax provision	19,994	980	2,891	5,527	3,969	13,367	3,589	4,389	5,976	6,736	20,691	6,527	6,877	7,404	7,359	28,167
Net Income	\$54,498	\$4,260	\$11,691	\$14,085	\$12,533	\$42,572	\$10,902	\$12,492	\$17,010	\$19,173	\$59,577	\$18,576	\$19,574	\$21,073	\$20,945	\$80,168
Net Income (ex. one-time items)	\$50,748	\$5,723	\$12,092	\$14,085	\$12,533	\$44,433	\$10,902	\$12,492	\$17,010	\$19,173	\$59,577	\$18,576	\$19,574	\$21,073	\$20,945	\$80,168
GAAP Diluted EPS	\$1.03	\$0.08	\$0.22	\$0.27	\$0.24	\$0.81	\$0.21	\$0.24	\$0.33	\$0.37	\$1.14	\$0.36	\$0.37	\$0.40	\$0.40	\$1.53
Diluted EPS	\$0.96	\$0.11	\$0.23	\$0.27	\$0.24	\$0.84	\$0.21	\$0.24	\$0.33	\$0.37	\$1.14	\$0.36	\$0.37	\$0.40	\$0.40	\$1.53
Diluted shares outstanding	53,072	52,910	52,718	52,628	52,421	52,668	52,370	52,548	52,250	52,428	52,399	52,308	52,279	52,188	52,159	52,233

YOY Growth:

Revenue	5.5%	15.1%	8.2%	-0.6%	7.9%	7.1%	14.9%	13.0%	16.0%	18.0%	15.5%	14.0%	11.0%	9.0%	6.0%	9.8%
Cost of sales	6.0%	37.0%	17.7%	2.8%	15.7%	17.2%	5.2%	13.3%	16.8%	11.3%	11.6%	5.4%	3.6%	6.0%	5.3%	5.0%
SG&A	27.9%	-3.0%	9.3%	1.2%	-17.9%	-3.0%	7.7%	7.9%	9.3%	11.8%	9.1%	8.5%	5.2%	5.0%	4.9%	5.8%
Gross profit	4.5%	-38.4%	-12.9%	-8.1%	-10.6%	-16.1%	67.6%	12.2%	14.0%	38.3%	28.0%	43.4%	33.2%	16.6%	7.8%	23.2%
Operating income	-6.9%	-64.2%	-26.2%	-13.5%	-4.8%	-24.7%	180.2%	16.1%	17.1%	56.3%	43.6%	72.6%	56.7%	23.9%	9.3%	34.9%
Net income	4.3%	-58.3%	-15.2%	-4.3%	-20.5%	-16.1%	155.9%	6.9%	20.8%	53.0%	34.1%	70.4%	56.7%	23.9%	9.2%	34.6%
Diluted EPS	-2.2%	-43.7%	-11.6%	-3.6%	5.3%	-11.7%	92.5%	3.6%	21.6%	53.0%	34.7%	70.6%	57.5%	24.0%	9.8%	35.0%

Margin Analysis:

COGS/sales	69.5%	84.5%	74.8%	71.0%	75.3%	76.1%	77.3%	75.0%	71.5%	71.0%	73.6%	71.5%	70.0%	69.5%	70.5%	70.4%
SG&A/sales	12.2%	10.3%	11.9%	11.7%	10.0%	11.0%	9.7%	11.4%	11.0%	9.5%	10.4%	9.2%	10.8%	10.6%	9.4%	10.0%
Gross profit margin	30.5%	15.5%	25.2%	29.0%	24.7%	23.9%	22.7%	25.0%	28.5%	29.0%	26.4%	28.5%	30.0%	30.5%	29.5%	29.6%
Operating margin (ex. one-time items)	18.3%	5.2%	13.2%	17.3%	14.7%	12.9%	12.7%	13.6%	17.5%	19.5%	16.0%	19.3%	19.2%	19.9%	20.1%	19.6%
Pretax margin	18.4%	5.3%	13.3%	17.4%	14.7%	12.9%	12.7%	13.6%	17.5%	19.5%	16.0%	19.3%	19.2%	19.9%	20.1%	19.7%
Net margin	13.4%	4.3%	10.7%	12.5%	11.2%	9.8%	9.6%	10.1%	13.0%	14.5%	11.9%	14.3%	14.2%	14.8%	14.9%	14.6%
Tax rate	26.8%	18.7%	19.8%	28.2%	24.1%	23.9%	24.8%	26.0%	26.0%	26.0%	25.8%	26.0%	26.0%	26.0%	26.0%	26.0%

Sources: Company reports and Sidoti & Company, LLC estimates

AAON, INC.

Table 2. AAON, Inc. Cash Flow Statement

(in thousands, except where noted)

	MarA	JunA	SepA	DecA	2017	MarA	JunA	SepA	DecA	2018	MarA	2019E	2020E
Cash flows from operating activities													
Net income	\$10,217	\$13,794	\$14,717	\$15,770	\$54,498	\$4,260	\$11,691	\$14,085	\$12,536	\$42,572	\$10,902	\$59,577	\$80,168
Depreciation and amortization	3,638	3,643	3,744	3,982	15,007	4,129	4,309	4,427	4,790	17,655	5,914	21,514	20,800
Amortization of bond premiums	16	13	10	8	47	5	3	3	2	13	-	-	-
Provision for losses on account receivable	184	(43)	39	(1)	179	(11)	100	(22)	107	174	115	115	-
Provision for excess and obsolete inventories	60	200	(206)	210	264	101	198	(244)	97	152	357	357	-
(Gain)/loss on disposition of assets	(1)	48	(1)	(1)	45	(7)	(4)	2	(3)	(12)	284	284	-
Share-based compensation	1,645	1,884	1,431	1,498	6,458	1,724	1,975	1,915	1,760	7,374	2,030	7,730	7,600
Excess tax benefits from stock options exercised	-	-	-	0	-	-	-	-	0	-	-	-	-
Deferred income taxes	720	(356)	783	(2,701)	(1,554)	420	18	426	1,985	2,849	1,887	1,887	-
Other	(74)	66	(36)	7	(37)	17	20	(19)	23	41	(22)	(22)	-
Change in assets and liabilities	(6,223)	4,358	(12,366)	(2,635)	(16,866)	111	7,195	(12,624)	(10,631)	(15,949)	(6,554)	(4,081)	4,034
Net cash provided by operating activities	10,166	23,594	8,105	16,122	57,994	10,744	25,502	7,946	10,641	54,856	14,913	87,361	112,602
Cash flows from investing activities													
Other	7	7	-	56	70	(5,994)	139	16	(472)	(6,311)	-	-	-
Proceeds from sale of property, plant and equipment	-	-	-	0	0	-	-	-	0	0	52	52	-
Investment in certificates of deposit and other	9,340	(7,993)	1,883	7,361	10,591	(5,976)	5,955	5,060	3,905	8,944	17	17	-
Capital expenditures	(6,071)	(10,776)	(9,589)	(15,277)	(41,713)	(8,451)	(17,474)	(8,403)	(2,940)	(37,268)	(8,772)	(38,772)	(36,000)
Net cash provided by investing activities	3,276	(18,762)	(7,706)	(7,916)	(31,052)	(20,421)	(11,380)	(3,327)	(7,916)	(34,635)	(8,703)	(38,703)	(36,000)
Cash flows from financing activities													
Exercise of stock options	898	675	142	544	2,259	1,340	959	1,205	1,483	4,987	4,010	4,010	-
Other	(560)	(506)	(127)	(421)	(1,614)	(568)	(240)	(52)	(237)	(1,097)	(588)	(588)	-
Repurchase of common stock	(6,303)	(3,065)	(3,623)	(3,629)	(16,620)	(4,379)	(7,160)	(5,961)	(9,346)	(26,846)	(4,483)	(13,483)	(12,000)
Cash dividends paid to stockholders	-	-	(6,828)	(6,835)	(13,663)	-	-	(8,400)	(8,328)	(16,728)	-	(15,392)	0
Net cash provided by (used in) financing activities	(5,965)	(2,896)	(10,436)	(10,341)	(29,638)	(3,607)	(6,441)	(13,208)	(10,341)	(39,684)	(1,061)	(25,453)	(12,000)
Net change in cash	7,477	1,936	(10,037)	(2,135)	(2,696)	(13,284)	7,681	(8,589)	19,690	(19,463)	5,149	23,205	64,602
Cash, beginning of period	24,153	31,630	33,566	23,529	24,153	21,457	8,173	15,854	96	21,457	1,994	1,994	25,199
Cash, ending of period	\$31,630	\$33,566	\$23,529	\$21,394	\$21,457	\$8,173	\$15,854	\$96	\$972	\$1,994	\$7,143	\$25,199	\$89,801
Free cash flow	\$4,095	\$12,818	(\$1,484)	\$845	16,281	\$2,293	\$8,028	(\$457)	\$7,701	17,588	\$6,141	48,589	76,602
FCF per share	\$0.08	\$0.24	(\$0.03)	\$0.02	\$0.31	\$0.04	\$0.15	(\$0.01)	\$0.15	\$0.34	\$0.12	\$0.93	\$1.47

Sources: Company reports and Sidoti & Company, LLC estimates

AAON, INC.

Table 3. AAON, Inc. Balance Sheet

(in thousands, except where noted)

	MarA	JunA	SepA	2017	MarA	JunA	SepA	2018	MarA	2019E	2020E
Assets											
Current assets:											
Cash	31,630	33,566	23,529	21,457	8,173	15,854	7,265	1,994	7,143	25,199	89,801
Short-term securities	10,259	18,252	16,382	8,957	14,942	8,475	3,412	0	0	0	0
Accounts receivable	44,377	43,114	57,342	50,338	54,319	53,418	51,207	54,078	58,688	63,629	67,447
Income tax receivable	3,009	809	0	1,643	7,316	4,971	2,292	6,104	4,756	4,756	4,756
Note receivable	25	26	28	28	27	27	28	27	27	27	27
Inventories	55,988	63,075	66,117	70,786	68,680	70,467	79,182	77,612	74,577	86,546	91,092
Prepaid expenses and other	929	888	757	518	1,230	1,453	1,310	1,046	1,607	530	562
Total current assets	146,217	159,730	164,155	153,727	154,687	154,665	144,696	140,861	146,798	180,687	253,685
Property, plant and equipment, net	118,417	124,628	138,308	142,375	147,928	161,121	164,896	163,003	166,652	181,052	209,710
Goodwill					3,677	3,851	3,793	3,735	3,229	3,229	3,229
Long-term securities	656	667	689	678	653	634	639	598	2,243	2,243	2,243
Notes receivables	0	0	0	0	0	0	0	0	603	603	603
Total assets	265,290	285,025	303,152	296,780	306,945	320,271	314,024	308,197	319,525	367,814	469,470
Liabilities and stockholders' equity											
Current liabilities:											
Accounts payable	9,936	14,108	18,933	10,967	22,214	25,127	16,224	10,616	5,947	11,859	12,482
Dividend payable	0	6,849		0		8,400	0	0		0	0
Accrued liabilities	31,186	34,293	41,682	39,098	35,078	38,146	37,492	37,455	38,053	50,447	53,098
Total current liabilities	41,122	55,250	60,615	50,065	57,292	71,673	53,716	48,071	44,000	62,306	65,580
Deferred tax liabilities	10,251	9,895	10,678	7,977	8,397	8,415	8,841	10,826	12,713	12,713	12,713
Other long-term liabilities	2,115	2,119	1,547	1,512	1,645	1,746	1,838	1,801	3,442	3,442	3,442
Total stockholders' equity	211,802	217,761	230,312	237,226	239,611	238,437	249,629	247,499	259,370	289,353	387,736
Total liabilities and stockholders' equity	265,290	285,025	303,152	296,780	306,945	320,271	314,024	308,197	319,525	367,814	469,470
Key Financial Ratios:											
Long-term debt/total capital	1.0%	1.0%	0.7%	0.6%	0.7%	0.7%	0.7%	0.7%	1.3%	1.2%	0.9%
Book value/share	\$3.92	\$4.00	\$4.31	\$4.44	\$4.49	\$4.46	\$4.67	\$4.65	\$4.88	\$5.45	\$7.49
Profit Margin	14.0%	13.9%	12.5%	13.3%	11.9%	13.6%	13.3%	10.8%	12.4%	10.6%	15.9%
Asset Turnover	1.3	1.4	1.5	1.4	1.3	1.4	1.4	1.5	1.4	1.4	1.2
Leverage	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.2	1.2	1.3	1.2
Net cash	\$41,914	\$51,844	\$39,939	\$30,442	\$23,142	\$24,356	\$10,705	\$2,021	\$7,170	\$25,226	\$89,828
Net cash per share	\$0.80	\$0.98	\$0.76	\$0.58	\$0.45	\$0.47	\$0.21	\$0.05	\$0.18	\$0.53	\$1.80
Inventory turnover	5.0	5.4	5.4	5.0	5.2	4.9	4.9	3.9	4.1	4.4	4.4
Return on equity (ROE)	22.8%	26.0%	24.6%	23.4%	19.6%	25.0%	24.0%	19.7%	21.8%	19.4%	23.1%
Return on assets (ROA)	16.3%	20.3%	20.8%	16.1%	4.1%	13.4%	16.6%	18.9%	13.9%	22.7%	20.0%
Return on total capital (ROTC)	23.8%	33.0%	30.4%	21.5%	5.4%	18.8%	21.3%	23.2%	17.2%	28.9%	28.2%

Sources: Company reports and Sidoti & Company, LLC estimates

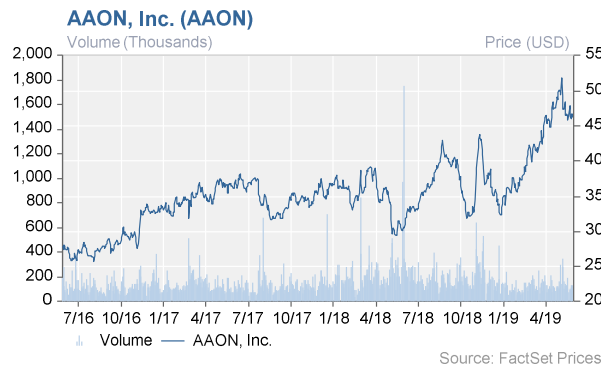
Appendix Required Disclosures

Required Disclosures

AAON, Inc. (AAON-\$46.65) NEUTRAL Price Target: \$37 May 30, 2019

Rating and Price Target History Table

Action	Date	Px	Rating	PT
PT	9/16/16	27.6		28
PT	12/16/16	32.6		34
PT	5/4/17	37.2		37
PT	8/3/17	33.8		35
PT	4/3/18	37.2		33



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

Valuation:

We raise our price target to \$37 (from \$33), but maintain a NEUTRAL rating. Although we maintain a positive view on the company, valuation is a hurdle for us. AAON shares currently trade at 29x our forward 12-month EPS estimate and 17x our forward 12-month EBITDA estimate. Historically, the stock traded at respective comparative multiples of 26x and 15x. On a relative peer basis, LII stock currently trades at 21x and 16x. Our new \$37 price target is based on 24x our 2020 EPS estimate of \$1.53; this equates to 15x our 2020 EBITDA estimate of \$129 million. (We derived our prior price target by applying a 22x multiple to our 2020 EPS estimate of \$1.53, which; this equates to 13.3x our 2020 EBITDA estimate of \$129 million.) We increased our valuation multiples to reflect the higher confidence we have concerning the company's ability to execute and achieve the high growth targets we project. However, we think current valuation already reflects the growth and maintain a NEUTRAL rating.

Required Disclosures

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APPENDIX CONTINUED

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