



## AAON, Inc.

AAON - NASDAQ

## Institutional Equity Research

November 6, 2020

## Good 3Q: Uncertain NT Outlook &amp; Still A Tough Multiple to Swallow

3Q upside on much stronger revenue (+19%) though more meaningful reductions in backlog (-49%). Our 2021 estimate remains lower (Y/Y) on NT new construction demand uncertainty. Trading 28x our 2021 EBITDA estimate and 9x TBV, we still fail to see a scenario which causes earnings to substantially narrow AAON's current valuation premium NT. We remain **UNDERPERFORM**.

**Solidly stronger volume drives upside; planned backlog reductions creep (much) lower.** 3Q EPS of \$0.38/sh exceeded our \$0.30/sh estimate (consensus \$0.31/sh). GM was +620bp Y/Y to 30.3% (+30bp vs estimate) and within management's targeted range. Prior year levels were unusually low due to raw material costs and inefficient production. Sales were +18.7% Y/Y to \$134.8M (relative to our \$120M estimate); despite early quarter headwinds from a planned maintenance shutdown of the Tulsa facility (July). Water source heat pump sales declined 23% Y/Y (though up sequentially) on replacement activity; all other business was +22% Y/Y as healthy order activity and planned reduction of backlog drove improved volume. Backlog was -48.6% Y/Y to \$84.9M (-18.0% sequentially). The company does not present reported orders; on a net basis bookings were +17% Y/Y (+6% sequentially). While AAON has clearly articulated plans to lower backlog levels as it reduces production lead times, reported levels were lower than anticipated.

**We continue to project lower Y/Y earnings and EBITDA into 2021, as we anticipate new construction activity to slow.** AAON does not provide guidance. Management commentary does indicate uncertainty, particularly in new construction markets, into 2021. Replacement market (~50% of sales) does lend greater opportunities, as it has in prior cycles; we nonetheless expect 4Q and 1Q sales to face both difficult Y/Y comps and less certain NT activity levels. Our 2021 EPS estimate is now \$1.20/sh (from \$1.22/sh). We initiate a 2022 EPS of \$1.34/sh; which anticipates some later 2021 stabilization in sales. Additions through the Longview facility and de-bottlenecking opportunity in Tulsa offer meaningful additional capacity - however, the demand environment is less clear.

**Rinse Repeat: Self-funded internal growth initiatives to continue with consistent cash generation.** AAON has no debt. 3Q FCF was \$18.8M. Cash was \$78.6M (\$1.50/sh) at the end of the quarter. Cash will likely continue to be deployed internally, adding capacity and supplementing new product lines as necessary. Dividends are well-supported, share repurchases are likely to continue.

**Premium target multiple for premium company; lower share value implied.** Our \$35 PT remains 16x our 2021 EBITDA estimate (29x EPS); a premium for a premium company generating (most recently) ROE/ROC of 25%. 10-yr FY+1 avg is 16x EBITDA. EPS in 2020 looks to surpass our 'starting point' entering the year by 12%; notable credit to a team which has realigned production amidst complicated COVID impacts and potential demand headwinds. AAON remains a solid company executing on much more solid footing this year; however results (while better) have still yet to meaningfully narrow the substantial valuation premium the shares receive today.

FY (Dec)		2019A	2020E	Previous	Cons.	2021E	Previous	Cons.
EPS	Q1 (Mar)	\$0.21	<b>\$0.41A</b>	-	n.a.	<b>\$0.28E</b>	n.a.	n.a.
	Q2 (Jun)	\$0.25	<b>\$0.34A</b>	-	n.a.	<b>\$0.31E</b>	n.a.	n.a.
	Q3 (Sep)	\$0.26	<b>\$0.38A</b>	\$0.30	n.a.	<b>\$0.33E</b>	n.a.	n.a.
	Q4 (Dec)	\$0.33	<b>\$0.27E</b>	\$0.22	\$0.26	<b>\$0.29E</b>	n.a.	n.a.
		\$1.05	<b>\$1.41E</b>	\$1.27	\$1.31	<b>\$1.20E</b>	\$1.22	\$1.22
Price/EPS		58.7x	43.9x			51.3x		
Revenue (\$M)	Q1 (Mar)	\$113.8	<b>\$137.5A</b>	-	n.a.	<b>\$115.0E</b>	n.a.	n.a.
	Q2 (Jun)	\$119.4	<b>\$125.6A</b>	-	n.a.	<b>\$122.0E</b>	n.a.	n.a.
	Q3 (Sep)	\$113.5	<b>\$134.8A</b>	\$120.0	n.a.	<b>\$130.0E</b>	n.a.	n.a.
	Q4 (Dec)	\$122.6	<b>\$115.0E</b>	\$105.0	\$111.6	<b>\$115.0E</b>	n.a.	n.a.
		\$469.3	<b>\$512.9E</b>	\$488.1	\$494.5	<b>\$482.0E</b>	\$475.0	\$475.0
EV/Sales		6.7x	6.1x			6.5x		

BV Per Share uses tangible book value.

Please refer to pages 5 - 6 of this report for detailed disclosure and certification information.

## Underperform

<b>Price Target</b>	<b>\$35.00</b>
Price (11/5/20)	\$61.68
Industry	DIVERSIFIED INDUSTRIALS

## Valuation &amp; Performance

Total Debt/Total Capital	n.a.
Cash per share (9/30/20)	\$1.50
BV Per Share (9/30/20)	\$6.54
Dividend	\$0.38 (0.6%)
Return on Equity (T-T-M)	24.8%

## Trading Data

Shares Outstanding (M)	52.3
Market Capitalization (\$M)	\$3,223.7
52-week range	\$40.48 - \$65.69
Avg. Volume (3-mth.) (K)	178.0

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## 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; with an expanding presence in water source heat pumps (WSHP). Primary markets served are the commercial and industrial new construction and replacement markets.

## Price Performance

NASDAQ: AAON



**AAON, Inc.**  
**Historical Operating Results & Projections**  
(Dollars in millions except for per share data - 11/5/20)

Fiscal Year: December	9/30/19	9/30/20e	9/30/20	% chg
Revenue	\$113.5	\$120.0	\$134.8	18.7%
Cost of Revenue	86.1	84.0	93.9	9.1
Gross Profit	27.4	36.0	40.8	
SG&A	13.0	14.9	14.7	13.3
Gain (Loss) on Disposal of Assets	0.0	0.0	0.0	
Operating Income	14.4	21.1	26.1	
Interest Expense, net	0.0	0.0	0.0	
Interest Income, net	0.0	0.0	0.0	
Other Income (Expense), net	(0.0)	0.0	0.0	
Non-Operating Income	0.0	0.0	0.0	
Pre-Tax Income	14.4	21.1	26.2	
Taxes	0.6	5.3	5.7	
Net Income	\$13.8	\$15.8	\$20.5	
Applicable Shares	52.7	52.9	53.2	
EPS - Diluted	\$0.26	\$0.30	\$0.38	
Dividends Per Share	\$0.00	\$0.00	\$0.00	
Depreciation & Amortization	\$5.9	\$6.0	\$6.6	
EBITDA	20.3	27.1	32.8	
Gross Margin	24.1%	30.0%	30.3%	
EBITDA Margin	17.9	22.6	24.3	
Operating Margin	12.7	17.6	19.4	
Pre-tax Margin	12.7	17.6	19.4	
Net Margin	12.2	13.2	15.2	
Tax Rate	3.9%	25.1%	21.8%	
Backlog	\$165.3	\$93.0	\$84.9	-48.6%

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	3/31/17	6/30/17	9/30/17	12/31/17	3/31/18	6/30/18	9/30/18	12/31/18	3/31/19	6/30/19	9/30/19	12/31/19	3/31/20	6/30/20	9/30/20
Cash & Equivalents	\$31.6	\$33.6	\$23.5	\$21.5	\$8.2	\$15.9	\$7.3	\$2.0	\$7.1	\$13.7	\$28.4	\$44.4	\$52.1	\$70.8	\$78.6
Accounts Receivable	44.4	43.1	57.3	50.3	54.3	53.4	51.2	54.1	58.7	68.9	56.1	67.4	69.9	56.4	62.2
Inventories	56.0	63.1	66.1	70.8	68.7	70.5	79.2	77.6	74.6	77.0	80.6	73.6	72.9	85.4	78.8
Deferred Taxes	3.0	0.8	0.0	1.6	7.3	5.0	2.3	6.1	4.8	3.2	3.9	0.8	0.0	0.0	0.0
Certificates of Deposit	3.1	5.5	5.0	2.9	6.0	5.5	2.2	0.0	0.0	4.0	0.0	0.0	0.0	0.0	0.0
Investments Held to Maturity	7.1	12.7	11.3	6.1	8.9	3.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	1.0	0.9	0.8	0.5	1.3	1.5	1.3	1.1	1.6	1.7	1.6	1.4	2.1	7.1	5.9
<b>Total Current Assets</b>	<b>146.2</b>	<b>159.7</b>	<b>164.1</b>	<b>153.7</b>	<b>154.7</b>	<b>154.7</b>	<b>144.7</b>	<b>140.9</b>	<b>146.80</b>	<b>168.6</b>	<b>170.5</b>	<b>187.5</b>	<b>197.0</b>	<b>219.8</b>	<b>225.5</b>
Property, Plant & Equipment	118.4	124.6	138.3	142.4	147.9	161.1	164.9	163.0	166.7	167.6	175.7	178.1	193.0	204.4	208.9
Certificates of Deposit	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
Investments Held to Maturity	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
Goodwill & Intangibles						3.2	3.8	3.2	3.7	3.6	3.6	3.5	3.4	3.4	3.3
Note Receivable	0.7	0.7	0.7	0.7	0.7	0.6	0.0	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.6
Other Assets	0.0	0.0	0.0	0.0	3.7	0.6	0.6	0.5	1.8	1.8	1.7	1.7	1.6	1.7	1.6
<b>Total Assets</b>	<b>\$265.3</b>	<b>\$285.0</b>	<b>\$303.1</b>	<b>\$296.8</b>	<b>\$306.9</b>	<b>\$320.3</b>	<b>\$314.0</b>	<b>\$308.2</b>	<b>\$319.5</b>	<b>\$342.3</b>	<b>\$352.2</b>	<b>\$371.4</b>	<b>\$395.6</b>	<b>\$429.8</b>	<b>\$439.9</b>
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	0.0	0.0	0.0	0.0	0.0
Accounts Payable	9.9	14.1	18.9	11.0	22.2	25.1	16.2	10.6	5.9	7.9	11.1	11.8	13.5	19.7	16.0
Accrued Liabilities	31.2	34.3	41.7	39.1	35.1	38.1	37.5	37.5	38.1	42.7	42.8	44.3	50.7	47.0	45.5
Dividends Payable	0.0	6.8	0.0	0.0	0.0	8.4	0.0	0.0	0.0	8.4		0.0	0.0	9.9	0.0
<b>Total Current Liabilities</b>	<b>41.1</b>	<b>55.3</b>	<b>60.6</b>	<b>50.1</b>	<b>57.3</b>	<b>71.7</b>	<b>53.7</b>	<b>48.1</b>	<b>44.0</b>	<b>59.0</b>	<b>53.9</b>	<b>56.0</b>	<b>64.2</b>	<b>76.6</b>	<b>61.5</b>
Long-term Debt	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
Deferred Tax Liabilities	10.3	9.9	10.7	8.0	8.4	8.4	8.8	10.8	12.7	14.9	15.0	15.3	15.1	20.4	23.0
Deferred Revenue & Other	2.1	2.1	1.5	1.5	1.6	1.7	1.6	1.7	3.4	3.8	3.7	10.0	10.0	10.1	10.5
Donations							0.2	0.1							
<b>Total Liabilities</b>	<b>53.5</b>	<b>67.3</b>	<b>72.8</b>	<b>59.6</b>	<b>67.3</b>	<b>81.8</b>	<b>64.4</b>	<b>60.7</b>	<b>60.2</b>	<b>77.7</b>	<b>72.6</b>	<b>81.3</b>	<b>89.3</b>	<b>107.1</b>	<b>95.0</b>
Stockholders' Equity	211.8	217.7	230.3	237.8	239.6	238.4	249.6	247.5	259.4	264.6	279.6	290.1	306.3	322.7	344.9
<b>Liabilities &amp; Equity</b>	<b>\$265.3</b>	<b>\$285.0</b>	<b>\$303.1</b>	<b>\$296.8</b>	<b>\$306.9</b>	<b>\$320.3</b>	<b>\$314.0</b>	<b>\$308.2</b>	<b>\$319.5</b>	<b>\$342.3</b>	<b>\$352.2</b>	<b>\$371.4</b>	<b>\$395.6</b>	<b>\$429.8</b>	<b>\$439.9</b>
Shares Outstanding	52.6	52.6	52.6	52.4	52.9	52.3	52.3	52.4	52.1	52.1	52.1	52.0	52.1	52.2	52.3
Per Share Items:															
Cash and Equivalents	\$0.60	\$0.64	\$0.45	\$0.41	\$0.15	\$0.30	\$0.14	\$0.04	\$0.14	\$0.26	\$0.54	\$0.85	\$1.00	\$1.36	\$1.50
Working Capital	2.00	1.99	1.97	1.98	1.84	1.59	1.74	1.77	1.97	2.10	2.24	2.53	2.55	2.74	3.14
Book Value	4.02	4.14	4.38	4.54	4.53	4.56	4.77	4.72	4.98	5.08	5.36	5.58	5.88	6.18	6.60
Tangible Book Value	4.02	4.14	4.38	4.54	4.53	4.50	4.70	4.66	4.91	5.01	5.30	5.51	5.82	6.11	6.54
<b>Total Debt/Capitalization</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>

Source: Company reports.

AON, Inc.  
 Historical Operating Results & Projections  
 (Dollars in millions except for per share data - 11/5/20)

Fiscal Year: December	3/31/19	6/30/19	9/30/19	12/31/19	2019	3/31/20	6/30/20	9/30/20	% chg	12/31/20e	% chg	2020e	% chg	3/31/21e	% chg	6/30/21e	% chg	9/30/21e	% chg	12/31/21e	% chg	2021e	% chg	2022e	% chg
Revenue	\$113.8	\$119.4	\$113.5	\$122.6	\$469.3	\$137.5	\$125.6	\$134.8	18.7%	\$115.0	-6.2%	\$512.9	9.3%	\$115.0	-16.4%	\$122.0	-2.9%	\$130.0	-3.5%	\$115.0	0.0%	\$482.0	-6.0%	\$510.0	5.8%
Cost of Revenue	88.0	89.3	86.1	86.2	349.6	94.5	87.5	93.9	9.1	81.5	(5.4)	357.4	2.2	81.0	(14.3)	85.5	(2.2)	91.5	(2.6)	81.0	(0.6)	339.0	(5.2)	355.5	4.9
Gross Profit	25.8	30.2	27.4	36.4	119.7	42.9	38.1	40.8		33.5		155.4		34.0		36.5		38.5		34.0		143.0		154.5	
SG&A	11.0	13.5	13.0	13.1	50.6	15.2	15.9	14.7	13.3	14.3	9.0	60.2	18.9	14.4	(5.5)	14.6	(8.1)	14.6	(1.1)	13.6	(5.1)	57.1	(5.0)	58.0	1.5
Gain (Loss) on Disposal of Assets	(0.3)	0.0	0.0	(0.0)	0.0	0.1	0.0	0.0		0.0		0.1		0.0		0.0		0.0		0.0		0.0		0.0	
Operating Income	14.5	16.7	14.4	23.2	69.1	27.8	22.2	26.1		19.2		95.3		19.6		21.9		23.9		20.4		85.9		96.5	
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	0.0	0.1	0.1	0.0	0.0		0.0		0.1		0.0		0.0		0.0		0.0		0.0		0.0	
Other Income (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	
Non-Operating Income	(0.0)	0.0	0.0	(0.0)	0.0	0.0	0.1	0.0		0.0		0.1		0.0		0.0		0.0		0.0		0.0		0.0	
Pre-Tax Income	14.5	16.7	14.4	23.2	69.2	27.8	22.2	26.2		19.2		95.4		19.6		21.9		23.9		20.4		85.9		96.5	
Taxes	3.6	3.8	0.6	5.9	13.9	6.0	4.4	5.7		4.8		20.9		4.9		5.5		6.0		5.1		21.5		24.1	
Net Income	\$10.9	\$13.0	\$13.8	\$17.3	\$55.3	\$21.9	\$17.8	\$20.5		\$14.4		\$74.5		\$14.7		\$16.4		\$17.9		\$15.3		\$64.4		\$72.4	
Applicable Shares	52.4	52.7	52.7	52.7	52.6	52.9	52.8	53.2		53.3		53.0		53.4		53.5		53.6		53.7		53.6		54.0	
EPS - Diluted	\$0.21	\$0.25	\$0.26	\$0.33	\$1.05	\$0.41	\$0.34	\$0.38		\$0.27		\$1.41		\$0.28		\$0.31		\$0.33		\$0.29		\$1.20		\$1.34	
Dividends Per Share	\$0.00	\$0.16	\$0.00	\$0.16	\$0.32	\$0.00	\$0.19	\$0.00		\$0.19		\$0.38		\$0.00		\$0.19		\$0.00		\$0.19		\$0.38		\$0.38	
Depreciation & Amortization	\$5.9	\$5.8	\$5.9	\$5.1	\$22.8	\$6.0	\$6.3	\$6.6		\$6.6		\$25.6		\$6.6		\$6.6		\$6.6		\$6.6		\$26.4		\$26.5	
EBITDA	20.4	22.5	20.3	28.4	91.9	33.8	28.5	32.8		25.8		120.9		26.2		28.5		30.5		27.0		112.3		123.0	
Gross Margin	22.7%	25.3%	24.1%	29.7%	25.5%	31.2%	30.4%	30.3%		29.1%		30.3%		29.6%		29.9%		29.6%		29.6%		29.7%		30.3%	
EBITDA Margin	17.9	18.9	17.9	23.1	19.6	24.6	22.7	24.3		22.4		23.6		22.8		23.3		23.5		23.5		23.3		24.1	
Operating Margin	12.7	14.0	12.7	18.9	14.7	20.2	17.7	19.4		16.7		18.6		17.1		17.9		18.4		17.8		17.8		18.9	
Pre-tax Margin	12.7	14.0	12.7	18.9	14.7	20.2	17.7	19.4		16.7		18.6		17.1		17.9		18.4		17.8		17.8		18.9	
Net Margin	9.6	10.9	12.2	14.1	11.8	15.9	14.2	15.2		12.5		14.5		12.8		13.4		13.8		13.3		13.4		14.2	
Tax Rate	24.8%	22.5%	3.9%	25.6%	20.0%	21.5%	20.0%	21.8%		25.0%		21.9%		25.0%		25.2%		25.1%		25.0%		25.0%		25.0%	
Backlog	\$166.6	\$179.6	\$165.3	\$142.7	\$142.7	\$119.6	\$103.5	\$84.9	-48.6%	\$79.0	-44.7%	\$79.0	-44.7%	\$79.0	-34.0%	\$80.0	-22.7%	\$82.0	-3.4%	\$84.0	6.3%	\$84.0	6.3%	\$90.0	7.1%

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

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**Potential Risks**

- **Results are susceptible to the cyclicality 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.

**Required Disclosures**

D.A. Davidson & Co. makes a market in AAON, Inc..

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We, Brent Thielman, Zane Karimi and Will Jellison, 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 October 10, 2017); information regarding our previous definitions is available upon request:

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

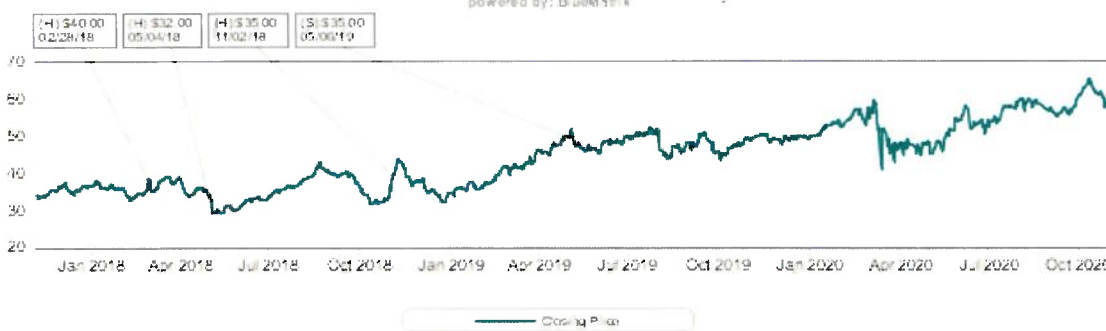
**NEUTRAL:** Expected to produce a total return of -15% to +15% on a risk adjusted basis over the next 12-18 months

**UNDERPERFORM:** Expected to lose value of over 15% on a risk adjusted basis over the next 12-18 months

Rating Distribution (as of 9/30/20)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	WMR	Combined	IR	WMR	Combined
<b>BUY (Buy)</b>	57%	89%	59%	15%	0%	14%
<b>NEUTRAL (Hold)</b>	42%	11%	40%	6%	0%	6%
<b>UNDERPERFORM (Sell)</b>	1%	0%	1%	0%	0%	0%

*IR denotes Institutional Research; WMR denotes Wealth Management 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 11/05/2020**



Target prices are our Institutional Research Department's evaluation of price potential over the next 12 months, 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.

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**Other Companies Mentioned in this Report**

<b>Company Name</b>	<b>Ticker</b>	<b>Rating</b>	<b>Price</b>
AAON, Inc.	AAON	UNDERPERFORM	\$61.68