

# KANSAS CITY CAPITAL ASSOCIATES

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## Perform

March 1, 2021

### AAON, Inc. NASDAQ - AAON - \$77.10

AAON is a niche HVAC manufacturer serving mostly the industrial and commercial markets. Despite operating in a cyclical industry, the company has compiled an excellent track record. The company's success can be partially attributed to its market leading role in the introduction of more energy efficient and environmentally friendly products.

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EPS	2021E	\$1.33
	2020A	\$1.49
	2019A	\$1.02
P/E	2021E	58.0x
	2020A	51.7x
	2019A:	75.6x
Est 3-5 yr EPS CAGR:		8%
Dividend Per Share:		\$0.38
Dividend Yield:		0.5%
Shares Outstd. (FD):		53.5m
Market Capitalization:		\$4,125m
Insider Ownership:		22%
Institutional Ownership:		72%
Avg. Daily Volume:		188,000
LT Debt/Total Capital:		0.0%
Fiscal Year End:		December

#### Fourth Quarter Results and Fiscal 2021 Forecast

After adjusting for a \$0.08 per share gain from an insurance settlement, AAON reported results modestly below expectations. In the quarter, the company posted EPS of \$0.35 inclusive of the aforementioned insurance settlement on revenues of \$116.7 million, off 4.8% from a year ago. Our forecast called for revenues of \$122.8 million and EPS of \$0.30. The weakness in the quarter reflected a generally softer business environment, inflationary pressures (more compensation related) and a deleveraging of costs on the lower revenues. Rising raw material costs had minimal impact in the quarter. However, to reflect rising raw material costs such as steel, the company announced an across the board 4% price increase effective January 11. Assuming no further escalation of costs, the company believes margins will not be pressured.

The January price increase did have a positive impact on incoming orders for AAON. Bookings were up 6% in the quarter and the backlog rose from \$74.4 million at year-end to \$103.8 million at the end of January. Although the backlog level has improved, we think it is probably more reflective of the announced price increase rather than an

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improving business environment. Indications for 2021 are for a muted commercial construction sector in 2021 . . . at least for the first half of 2021. The Architectural Billings Index has been below 50 for the past ten months. The January reading was 44.9.

With the commercial construction cycle still struggling to regain some momentum from the effects of the pandemic, we do think AAON can benefit in the long term from the pandemic. ASHRAE, American Society of Heating Refrigeration and Air-Conditioning Engineers defines and sets best practices for the industry. Because of the pandemic, ASHRAE has and will continue to recommend best practices to minimize risks of infection from airborne transmission within a building. These best practices will not only likely add incremental costs to a system, but we think it could also strengthen AAON's market position. AAON has systems that are better designed to minimize such risks and the company could further build upon that advantage.

While we look favorably upon the ASHRAE best practice directives in the long term, AAON is still facing a soft commercial construction environment. We expect the first half of the year will feel the impact of the macro environment but are looking for a strengthening in the second half. For fiscal 2021, we are looking for EPS of \$1.33 on flattish revenues of about \$509 million. Again, first half soft with a recovery in the second half. Our previous EPS estimate was \$1.40. Our earnings model is on p.3.

AAON's balance sheet remains debt-free, and we are forecasting free cash flow of over \$30 million after capital spending.

### **Valuation and Recommendation**

At current valuation levels, the shares look fairly valued. We will retain our Perform rating on AAON.

### **Risk Factors**

AAON sells into the cyclical commercial construction markets and that too can make AAON's results cyclical. Rising copper, steel and aluminum costs could reduce profitability for AAON.

AAON, Inc. - AAON (000's) except per share data	FY 2019A		Q1 2020A		Q2 2020A		Q3 2020A		Q4 2020A		FY 2020A		Q1 2021E		Q2 2021E		Q3 2021E		Q4 2021E		FY 2021E			
			Mar	June	Sept.	Dec.			Mar	June	Sept.	Dec.			Mar	June	Sept.	Dec.			Mar	June	Sept.	Dec.
Revenue	469,333	137,483	125,596	134,772	116,700	514,551	120,675	142,287	130,139	115,635	120,675	142,287	130,139	115,635	120,675	142,287	130,139	115,635	120,675	142,287	130,139	115,635	120,675	142,287
% Increase	8.2%	20.8%	5.2%	18.7%	-4.8%	9.6%	-3.9%	5.6%	11.5%	-10.0%	-3.9%	5.6%	11.5%	-10.0%	-3.9%	5.6%	11.5%	-10.0%	-3.9%	5.6%	11.5%	-10.0%	-3.9%	5.6%
CGS - \$	349,933	94,536	87,465	93,924	82,777	358,702	84,593	99,316	90,446	81,291	84,593	99,316	90,446	81,291	84,593	99,316	90,446	81,291	84,593	99,316	90,446	81,291	84,593	99,316
CGS - %	74.6%	68.8%	69.6%	69.7%	70.9%	69.7%	70.1%	69.8%	69.5%	70.3%	70.1%	69.8%	69.5%	70.3%	70.1%	69.8%	69.5%	70.3%	70.1%	69.8%	69.5%	70.3%	70.1%	69.8%
Gr. Profit	119,425	42,947	38,131	40,848	33,923	155,849	36,082	42,971	39,692	34,344	36,082	42,971	39,692	34,344	36,082	42,971	39,692	34,344	36,082	42,971	39,692	34,344	36,082	42,971
Gr. Margin	25.4%	31.2%	30.4%	30.3%	29.1%	30.3%	29.9%	30.2%	30.5%	29.7%	29.9%	30.2%	30.5%	29.7%	29.9%	30.2%	30.5%	29.7%	29.9%	30.2%	30.5%	29.7%	29.9%	30.2%
SG&A - \$	52,077	15,214	15,939	14,716	14,622	60,491	14,481	16,221	16,658	13,414	14,481	16,221	16,658	13,414	14,481	16,221	16,658	13,414	14,481	16,221	16,658	13,414	14,481	16,221
SG&A - %	11.1%	11.1%	12.7%	10.9%	12.5%	11.8%	12.0%	11.4%	12.8%	11.6%	12.0%	11.4%	12.8%	11.6%	12.0%	11.4%	12.8%	11.6%	12.0%	11.4%	12.8%	11.6%	12.0%	11.4%
Loss on Equip. Sale	337	(62)	-	1	(6,417)	(6,476)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Op. Inc.	67,011	27,795	22,192	26,131	25,718	101,836	21,601	26,750	23,035	20,930	21,601	26,750	23,035	20,930	21,601	26,750	23,035	20,930	21,601	26,750	23,035	20,930	21,601	26,750
Op. Margin	14.3%	20.2%	17.7%	19.4%	22.0%	19.8%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%
Interest Expense																								
Interest Income	66	61	19	10	(2)	88	30	30	30	30	30	30	30	30	30	30	30	30	30	30	30	30	30	30
Other Income	(46)	(27)	32	15	31	51	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pretax Income	67,031	27,829	22,243	26,156	25,747	101,975	21,631	26,780	23,065	20,960	21,631	26,780	23,065	20,960	21,631	26,780	23,065	20,960	21,631	26,780	23,065	20,960	21,631	26,780
Pretax Margin	14.3%	20.2%	17.7%	19.4%	22.1%	19.8%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%	17.7%	18.1%	17.9%	18.8%
Inc. Taxes	13,320	5,976	4,439	5,696	6,855	22,966	4,975	6,159	5,305	4,821	4,975	6,159	5,305	4,821	4,975	6,159	5,305	4,821	4,975	6,159	5,305	4,821	4,975	6,159
Tax Rate	19.9%	21.5%	20.0%	21.8%	26.6%	22.5%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%
Net Income	53,711	21,853	17,804	20,460	18,892	79,009	16,656	20,620	17,760	16,139	16,656	20,620	17,760	16,139	16,656	20,620	17,760	16,139	16,656	20,620	17,760	16,139	16,656	20,620
Net Margin	11.4%	15.9%	14.2%	15.2%	16.2%	15.4%	13.8%	14.5%	13.6%	14.0%	13.8%	14.5%	13.6%	14.0%	13.8%	14.5%	13.6%	14.0%	13.8%	14.5%	13.6%	14.0%	13.8%	14.5%
EPS	1.02	0.41	0.34	0.38	0.35	1.49	0.31	0.39	0.33	0.30	0.31	0.39	0.33	0.30	0.31	0.39	0.33	0.30	0.31	0.39	0.33	0.30	0.31	0.39
Shares Out.	52,635	52,871	52,750	53,151	53,470	53,061	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500	53,500
EBITDA	93,086	34,770	29,149	34,190	33,412	131,521	29,601	34,750	31,035	28,930	29,601	34,750	31,035	28,930	29,601	34,750	31,035	28,930	29,601	34,750	31,035	28,930	29,601	34,750
TTM EBITDA	93,086	109,499	114,499	127,444	131,521	131,521	126,693	124,315	124,315	125,681	126,133	126,693	124,315	125,681	126,133	126,693	124,315	125,681	126,133	126,693	124,315	125,681	126,133	126,693

Source: Company documents and KCCA estimates

## Investment Thesis

Stock price fairly reflects outlook, we believe. Maintain Perform rating.

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Rating	IB Serv/Past 12 Mos.			
	Count	Percent	Count	Percent
OUTPERFORM [O]	420	67.96	214	50.95
PERFORM [P]	197	31.88	66	33.50
UNDERPERFORM [U]	1	0.16	0	0.00

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