

AAON INC
Form 10-Q
May 03, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended March 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____

Commission file number: 0-18953

AAON, INC.

(Exact name of registrant as specified in its charter)

Nevada 87-0448736

(State or other jurisdiction (IRS Employer
of incorporation or organization) Identification No.)

2425 South Yukon, Tulsa, Oklahoma 74107

(Address of principal executive offices)

(Zip Code)

(918) 583-2266

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No Not Applicable

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "small reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

As of April 30, 2018, registrant had outstanding a total of 52,362,231 shares of its \$.004 par value Common Stock.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.
 AAON, Inc. and Subsidiaries
 Consolidated Balance Sheets
 (Unaudited)

| | March 31, December 31, 2018 2017 | |
|---|---|------------|
| | (in thousands, except share and per share data) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$8,173 | \$ 21,457 |
| Certificates of deposit | 6,000 | 2,880 |
| Investments held to maturity at amortized cost | 8,942 | 6,077 |
| Accounts receivable, net | 54,319 | 50,338 |
| Income tax receivable | 7,316 | 1,643 |
| Note receivable | 27 | 28 |
| Inventories, net | 68,680 | 70,786 |
| Prepaid expenses and other | 1,230 | 518 |
| Total current assets | 154,687 | 153,727 |
| Property, plant and equipment: | | |
| Land | 2,233 | 2,233 |
| Buildings | 94,244 | 92,075 |
| Machinery and equipment | 190,827 | 184,316 |
| Furniture and fixtures | 14,407 | 13,714 |
| Total property, plant and equipment | 301,711 | 292,338 |
| Less: Accumulated depreciation | 153,783 | 149,963 |
| Property, plant and equipment, net | 147,928 | 142,375 |
| Goodwill | 3,677 | — |
| Note receivable | 653 | 678 |
| Total assets | \$306,945 | \$ 296,780 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Revolving credit facility | \$— | \$ — |
| Accounts payable | 22,214 | 10,967 |
| Accrued liabilities | 35,078 | 39,098 |
| Total current liabilities | 57,292 | 50,065 |
| Deferred revenue | 1,445 | 1,512 |
| Deferred tax liabilities | 8,397 | 7,977 |
| Donations | 200 | — |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.001 par value, 5,000,000 shares authorized, no shares issued | — | — |
| Common stock, \$.004 par value, 100,000,000 shares authorized, 52,394,349 and 52,422,801 issued and outstanding at March 31, 2018 and December 31, 2017, respectively | 210 | 210 |
| Additional paid-in capital | — | — |
| Retained earnings | 239,401 | 237,016 |

| | | |
|--|-----------|------------|
| Total stockholders' equity | 239,611 | 237,226 |
| Total liabilities and stockholders' equity | \$306,945 | \$ 296,780 |

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries
 Consolidated Statements of Income
 (Unaudited)

| | Three Months Ended March 31, | |
|--|---|------------|
| | 2018 | 2017 |
| | (in thousands, except share and per share data) | |
| Net sales | \$99,082 | \$ 86,078 |
| Cost of sales | 83,692 | 61,092 |
| Gross profit | 15,390 | 24,986 |
| Selling, general and administrative expenses | 10,219 | 10,530 |
| (Gain) loss on disposal of assets | (7 |) (1 |
| Income from operations | 5,178 | 14,457 |
| Interest income, net | 68 | 60 |
| Other (expense) income, net | (6 |) 11 |
| Income before taxes | 5,240 | 14,528 |
| Income tax provision | 980 | 4,311 |
| Net income | \$4,260 | \$ 10,217 |
| Earnings per share: | | |
| Basic | \$0.08 | \$ 0.19 |
| Diluted | \$0.08 | \$ 0.19 |
| Weighted average shares outstanding: | | |
| Basic | 52,433,905 | 52,622,539 |
| Diluted | 52,910,223 | 53,190,057 |

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries
 Consolidated Statements of Stockholders' Equity
 (Unaudited)

| | Common Stock Shares | Amount | Paid-in Capital | Retained Earnings | Total |
|--|------------------------|--------|--------------------|----------------------|-----------|
| | (in thousands) | | | | |
| Balances at December 31, 2017 | 52,422 | \$ 210 | \$ — | \$237,016 | \$237,226 |
| Net income | — | — | — | 4,260 | 4,260 |
| Stock options exercised and restricted stock awards granted | 105 | 1 | 1,339 | — | 1,340 |
| Share-based compensation | — | — | 1,724 | — | 1,724 |
| Stock repurchased and retired | (133) | (1) | (3,063 | (1,875) | (4,939) |
| Balances at March 31, 2018 | 52,394 | \$ 210 | \$ — | \$239,401 | \$239,611 |

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

| | Three Months Ended March 31, | |
|---|------------------------------------|----------|
| | 2018 | 2017 |
| | (in thousands) | |
| Operating Activities | | |
| Net income | \$4,260 | \$10,217 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 4,129 | 3,638 |
| Amortization of bond premiums | 5 | 16 |
| Provision for losses on accounts receivable, net of adjustments | (11) | 184 |
| Provision for excess and obsolete inventories | 101 | 60 |
| Share-based compensation | 1,724 | 1,645 |
| (Gain) loss on disposition of assets | (7) | (1) |
| Foreign currency transaction gain | 3 | (5) |
| Interest income on note receivable | 9 | (7) |
| Deferred income taxes | 420 | 720 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,897) | (1,560) |
| Income taxes | (5,673) | 3,230 |
| Inventories | 3,447 | (8,696) |
| Prepaid expenses and other | (712) | (313) |
| Accounts payable | 9,833 | 1,736 |
| Deferred revenue | 37 | 78 |
| Accrued liabilities and donations | (3,924) | (776) |
| Net cash provided by operating activities | 10,744 | 10,166 |
| Investing Activities | | |
| Capital expenditures | (8,451) | (6,071) |
| Cash paid in business combination | (6,000) | — |
| Proceeds from sale of property, plant and equipment | 6 | 7 |
| Investment in certificates of deposits | (4,320) | — |
| Maturities of certificates of deposits | 1,200 | 2,392 |
| Purchases of investments held to maturity | (7,495) | — |
| Maturities of investments | 4,230 | 6,928 |
| Proceeds from called investments | 395 | — |
| Principal payments from note receivable | 14 | 13 |
| Net cash (used in) provided by investing activities | (20,421) | 3,269 |
| Financing Activities | | |
| Stock options exercised | 1,340 | 898 |
| Repurchase of stock | (4,379) | (6,303) |
| Employee taxes paid by withholding shares | (568) | (560) |
| Net cash used in financing activities | (3,607) | (5,965) |
| Net (decrease) increase in cash and cash equivalents | (13,284) | 7,470 |
| Cash and cash equivalents, beginning of period | 21,457 | 24,153 |
| Cash and cash equivalents, end of period | \$8,173 | \$31,623 |

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements
(Unaudited)

1. General

Basis of Presentation

The accompanying unaudited consolidated financial statements of AAON, Inc., a Nevada corporation, and our operating subsidiaries, all of which are wholly-owned, (collectively, the “Company”) have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the rules and regulations of the Securities and Exchange Commission (“SEC”). These financial statements have not been audited by the Company's independent registered public accounting firm, except that the consolidated balance sheet at December 31, 2017 is derived from audited consolidated financial statements. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The financial statements reflect all adjustments (all of which are of a normal recurring nature) which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of the results that may be expected for a full year. Certain disclosures have been condensed in or omitted from these consolidated financial statements. The accompanying unaudited financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. All intercompany balances and transactions have been eliminated in consolidation.

We are engaged in the engineering, manufacturing, marketing and sale of air conditioning and heating equipment consisting of standard, semi-custom and custom rooftop units, chillers, packaged outdoor mechanical rooms, air handling units, makeup air units, energy recovery units, condensing units, geothermal/water-source heat pumps and coils.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because these estimates and assumptions require significant judgment, actual results could differ from those estimates and could have a significant impact on our results of operations, financial position and cash flows. We reevaluate our estimates and assumptions as needed, but at a minimum on a quarterly basis. The most significant estimates include, but are not limited to, the fair-value of acquisitions, inventory reserves, warranty accrual, worker's compensation accrual, medical insurance accrual, income taxes and share-based compensation. Actual results could differ materially from those estimates.

Accounting Policies

A comprehensive discussion of our critical accounting policies and management estimates is included in Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2017.

Business Combinations

We record the assets acquired and liabilities assumed in a business combination at their acquisition date fair values. Pursuant to U. S. GAAP, an entity is allowed a reasonable period of time (not to exceed one year) to obtain the information necessary to identify and measure the fair value of the assets acquired and liabilities assumed in a business combination. As discussed in Note 3, our acquisition is still within this measurement period, and as a result, the acquisition date fair values we have recorded for the assets acquired and liabilities assumed are subject to change.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value is based upon assumptions that market participants would use when pricing an asset or liability. We use the following fair value hierarchy, which prioritizes valuation technique inputs used to measure fair value into three broad levels:

Level 1: Quoted prices in active markets for identical assets and liabilities that we have the ability to access at the measurement date.

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Level 2: Inputs (other than quoted prices included within Level 1) that are either directly or indirectly observable for the asset or liability, including (i) quoted prices for similar assets or liabilities in active markets, (ii) quoted prices for identical or similar assets or liabilities in inactive markets, (iii) inputs other than quoted prices that are observable for the asset or liability, and (iv) inputs that are derived from observable market data by correlation or other means.

Level 3: Unobservable inputs for the asset or liability including situations where there is little, if any, market activity for the asset or liability. Items categorized in Level 3 include the estimated business combination fair values of property, plant and equipment and goodwill.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall into different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to a fair value measurement requires judgment, considering factors specific to the asset or liability.

Goodwill

Goodwill represents the excess of the consideration paid for the acquired businesses over the fair value of the individual assets acquired, net of liabilities assumed. The estimated goodwill of \$3.7 million is subject to change and such changes could be material. We expect that all of our goodwill at March 31, 2018 is deductible for income tax purposes.

Goodwill is not amortized, but instead is evaluated for impairment at least annually. We perform our annual assessment of impairment during the fourth quarter of our fiscal year, and more frequently if circumstances warrant.

To perform this assessment, we first consider qualitative factors to determine whether it is more likely than not that the fair value of each reporting unit exceeds its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit does not exceed its carrying amount, we calculate the fair value for the reporting unit and compare the amount to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired. If the carrying amount of a reporting unit exceeds its fair value, goodwill is considered to be impaired and the goodwill balance is reduced by the difference between the fair value and carrying amount of the reporting unit.

Estimates and assumptions used to perform the impairment evaluation are inherently uncertain and can significantly affect the outcome of the analysis. The estimates and assumptions we use in the annual goodwill impairment assessment included market participant considerations and future forecasted operating results. Changes in operating results and other assumptions could materially affect these estimates.

Recent Accounting Pronouncements

Changes to U.S. GAAP are established by the Financial Accounting Standards Board ("FASB") in the form of Accounting Standards Updates ("ASUs") to the FASB's Accounting Standards Codification ("ASC").

We consider the applicability and impact of all ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial statements and notes thereto.

In February 2016, the FASB issued ASU 2016-02, Leases. The ASU will replace previous lease accounting guidance in U.S. GAAP. The ASU requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. The ASU retains a distinction between finance leases and operating leases. The ASU is effective for the Company beginning January 1, 2019, and requires a modified retrospective method of adoption. We are currently in the process of assessing the impact under this ASU on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other. The ASU simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. We will be required to perform our annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. In the event the carrying amount exceeds the reporting unit's fair value, a goodwill impairment charge for the excess will be recorded (not exceeding the recorded amount of the reporting unit's goodwill). The ASU is effective for the Company beginning April 1, 2020, and requires a prospective method of adoption, although early adoption is permitted for annual goodwill impairment tests performed on testing dates on or after January 1, 2017. We adopted this ASU effective January 1, 2018.

2. Revenue Recognition

On January 1, 2018, we adopted the new accounting standard FASB ASC 606, Revenue from Contracts with Customers, and all the related amendments (“new revenue standard”) to all contracts using the retrospective method. The impact at adoption was not material to the consolidated financial statements. The new accounting policy provides results substantially consistent with prior revenue recognition policies.

Disaggregated net sales by major source:

| | Three Months Ended March 31, 2018 2017 (in thousands) | |
|--------------------------|---|----------|
| Rooftop Units | \$74,815 | \$66,872 |
| Condensing Units | 4,281 | 4,215 |
| Air Handlers | 5,240 | 5,133 |
| Outdoor Mechanical Rooms | 973 | 1,204 |
| Water Source Heat Pumps | 4,387 | 1,854 |
| Other | 9,386 | 6,800 |
| Net Sales | \$99,082 | \$86,078 |

Disaggregated units sold by major source:

| | Three Months Ended March 31, 2018 2017 | |
|--------------------------|--|-------|
| Rooftop Units | 3,468 | 3,474 |
| Condensing Units | 411 | 532 |
| Air Handlers | 536 | 613 |
| Outdoor Mechanical Rooms | 14 | 24 |
| Water Source Heat Pumps | 1,614 | 378 |
| Total Units | 6,043 | 5,021 |

The Company recognizes revenue when it satisfies the performance obligation in its contracts. Most of the Company's products are highly customized, cannot be resold to other customers and the cost of rework to be resold is not economical. The Company has a formal cancellation policy and generally does not accept returns on these units. As a result, many of the Company's products do not have an alternative use and therefore, for these products we recognize revenue over the time it takes to produce the unit. For all other products that are part sales or standardized units, we satisfy the performance obligation when the title and risk of ownership pass to the customer, generally at time of shipment. Final sales prices are fixed based on purchase orders. Sales allowances and customer incentives are treated as reductions to sales and are provided for based on historical experiences and current estimates. Sales of our products are moderately seasonal with the peak period being July - November of each year.

In addition, the Company presents revenues net of sales tax and net of certain payments to our independent manufacturer representatives (“Representatives”). Representatives are national companies that are in the business of providing HVAC units and other related products and services to customers. The end user customer orders a bundled

group of products and services from the Representative and expects the Representative to fulfill the order. Only after the specifications are agreed to by the Representative and the customer, and the decision is made to use an AAON HVAC unit, will we receive notice of the order. We establish the amount we must receive for our HVAC unit (“minimum sales price”), but do not control the total order price that is negotiated by the Representative with the end user customer.

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We are responsible for billings and collections resulting from all sales transactions, including those initiated by our Representatives. The Representatives submit the total order price to us for invoicing and collection. The total order price includes our minimum sales price and an additional amount which may include both the Representatives' fee and amounts due for additional products and services required by the customer. These additional products and services may include controls purchased from another manufacturer to operate the unit, start-up services, and curbs for supporting the unit ("Third Party Products"). All are associated with the purchase of a HVAC unit but may be provided by the Representative or another third party. The Company is under no obligation related to Third Party Products.

The Representatives' fee and Third Party Products amounts ("Due to Representatives") are paid only after all amounts associated with the order are collected from the customer. The amount of payments to our Representatives were \$11.6 million and \$11.9 million for the three months ended March 31, 2018 and 2017, respectively.

The Company also sells extended warranties on parts for various lengths of time ranging from 6 months to 10 years. Revenue for these separately priced warranties is deferred and recognized on a straight-line basis over the separately priced warranty period.

3. Acquisition

On February 28, 2018, we closed on the purchase of substantially all of the assets of WattMaster Controls, Inc., (collectively, "WattMaster"). The assets acquired consisted primarily of intellectual property, receivables, inventory and fixed assets. The Company also hired substantially all of the WattMaster employees. These assets and workforce will allow us to accelerate the development of our own electronic controllers for air distribution systems. We funded the business combination with available cash of \$6.0 million. We have included the results of WattMaster's operations in our consolidated financial statements beginning March 1, 2018.

We have not completed the accounting for the business combination. We are in the process of completing an independent appraisal of the fair value of the assets acquired. The estimates of fair value reflected as of February 28, 2018 are subject to change and such changes could be material. We expect to complete this process prior to our quarter end of June 30, 2018. We have preliminarily estimated the fair value of the assets acquired and liabilities assumed as follows (in thousands):

| | |
|-------------------------------|---------|
| Accounts receivable | \$1,073 |
| Inventories | 1,442 |
| Property, plant and equipment | 133 |
| Goodwill | 3,677 |
| Assumed current liabilities | (325) |
| Consideration paid | \$6,000 |

Goodwill represents the excess of the consideration paid for the acquired businesses over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill represents a premium paid to acquire the skilled workforce of the business acquired. We expect that all of the goodwill will be deductible for federal income tax purposes.

4. Investments

Certificates of Deposit – We held approximately \$6.0 million and \$2.9 million in certificates of deposit at March 31, 2018 and December 31, 2017, respectively. At March 31, 2018, the certificates of deposit bear interest ranging from 1.00% to 1.60% per annum and have various maturities ranging from less than one month to approximately 4 months.

Investments Held to Maturity – Our investments held to maturity are comprised of \$8.9 million of corporate notes and bonds with original maturities ranging from less than one month to approximately 4 months. The investments have moderate risk with S&P ratings ranging from AAA to BBB-.

We record the amortized cost basis and accrued interest of the corporate notes and bonds in the Consolidated Balance Sheets. We record the interest and amortization of bond premium to interest income in the Consolidated Statements of Income.

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The following summarizes the amortized cost and estimated fair value of our investments held to maturity as of March 31, 2018 and December 31, 2017:

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized (Loss) | Fair Value (Level 1) |
|------------------------------|-------------------|-----------------------------|-------------------------------|-------------------------------|
| March 31, 2018: | (in thousands) | | | |
| Current assets: | | | | |
| Investments held to maturity | \$8,942 | \$ | —\$ (11) | \$8,931 |
| Non current assets: | | | | |
| Investments held to maturity | — | — | — | — |
| Total | \$8,942 | \$ | —\$ (11) | \$8,931 |
| December 31, 2017: | | | | |
| Current assets: | | | | |
| Investments held to maturity | \$6,077 | \$ | —\$ (6) | \$6,071 |
| Non current assets: | | | | |
| Investments held to maturity | — | — | — | — |
| Total | \$6,077 | \$ | —\$ (6) | \$6,071 |

5. Accounts Receivable

Accounts receivable and the related allowance for doubtful accounts are as follows:

| | March 31, 2018 | December 31, 2017 | Three months ended March 31, 2018 | March 31, 2017 |
|--|-------------------|----------------------|--|-------------------|
| | (in thousands) | | | |
| Accounts receivable | \$54,427 | \$ 50,457 | | |
| Less: Allowance for doubtful accounts | (108) | (119) | (11) | 184 |
| Total, net | \$54,319 | \$ 50,338 | \$108 | \$ 274 |
| Allowance for doubtful accounts: | | | | |
| Balance, beginning of period | | | \$119 | \$ 90 |
| Provisions for losses on accounts receivables, net of recoveries | | | (11) | 184 |
| Balance, end of period | | | \$108 | \$ 274 |

6. Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (“FIFO”) method. We establish an allowance for excess and obsolete inventories based on product line changes, the feasibility of substituting parts and the need for supply and replacement parts.

| | March 31, December 31, | |
|---|------------------------|-----------|
| | 2018 | 2017 |
| | (in thousands) | |
| Raw materials | \$61,214 | \$ 57,784 |
| Work in process | 3,284 | 5,957 |
| Finished goods | 5,391 | 8,163 |
| | 69,889 | 71,904 |
| Less: Allowance for excess and obsolete inventories | (1,209) | (1,118) |
| Total, net | \$68,680 | \$ 70,786 |

The related changes in the allowance for excess and obsolete inventories account are as follows:

| | Three months ended | |
|--|--------------------|----------------|
| | March 31, 2018 | March 31, 2017 |
| | (in thousands) | |
| Allowance for excess and obsolete inventories: | | |
| Balance, beginning of period | \$1,118 | \$ 1,382 |
| Provisions for excess and obsolete inventories | 101 | 60 |
| Inventories written off | (10) | — |
| Balance, end of period | \$1,209 | \$ 1,442 |

7. Supplemental Cash Flow Information

| | Three months ended | |
|--|--------------------|----------------|
| | March 31, 2018 | March 31, 2017 |
| | (in thousands) | |
| Supplemental disclosures: | | |
| Interest paid | \$5 | \$ — |
| Income taxes paid | \$6,232 | \$ 361 |
| Non-cash investing and financing activities: | | |
| Non-cash capital expenditures | \$733 | \$ 1,098 |
| Dividends declared | — | — |

8. Warranties

The Company has warranties with various terms ranging from 18 months for parts to 25 years for certain heat exchangers. The Company has an obligation to replace parts or service its products if conditions under the warranty are met. A provision is made for estimated warranty costs at the time the related products are sold based upon the warranty period, historical trends, new products and any known identifiable warranty issues.

Changes in the warranty accrual are as follows:

| | Three months ended | |
|------------------------------|--------------------|----------------|
| | March 31, 2018 | March 31, 2017 |
| | (in thousands) | |
| Warranty accrual: | | |
| Balance, beginning of period | \$ 10,483 | \$ 7,936 |
| Payments made | (1,222) | (1,342) |
| Provisions | 1,527 | 1,218 |
| Balance, end of period | \$ 10,788 | \$ 7,812 |
| Warranty expense: | \$ 1,527 | \$ 1,218 |

9. Accrued Liabilities

Accrued liabilities are as follows:

| | March 31, 2018 | December 31, 2017 |
|------------------------|----------------|-------------------|
| | (in thousands) | |
| Warranty | \$ 10,788 | \$ 10,483 |
| Due to representatives | 12,029 | 13,086 |
| Payroll | 3,258 | 4,456 |
| Profit sharing | 674 | 2,034 |
| Worker's compensation | 605 | 593 |
| Medical self-insurance | 716 | 725 |
| Customer prepayments | 1,395 | 2,838 |
| Donations | 742 | 588 |
| Employee vacation time | 2,913 | 2,688 |
| Other | 1,958 | 1,607 |
| Total | \$ 35,078 | \$ 39,098 |

10. Revolving Credit Facility

Our revolving credit facility, which is provided by BOKF, NA dba Bank of Oklahoma, formerly known as Bank of Oklahoma, N.A. ("Bank of Oklahoma"), provides for maximum borrowings of \$30.0 million. Under the line of credit, there is one standby letter of credit totaling \$0.8 million. Borrowings available under the revolving credit facility at March 31, 2018 were \$29.2 million. Interest on borrowings is payable monthly at LIBOR plus 2.5%. No fees are associated with the unused portion of the committed amount. We had no outstanding balance under the revolving credit facility at March 31, 2018 and December 31, 2017. The termination date of the revolving credit facility is July 27, 2018. The Company expects to renew the facility with similar terms.

As of March 31, 2018, we were in compliance with our financial covenants. These covenants require that we meet certain parameters related to our tangible net worth and total liabilities to tangible net worth ratio. At March 31, 2018, our tangible net worth was \$239.6 million and met the requirement of being at or above \$125.0 million. Our total liabilities to tangible net worth ratio was 0.28 to 1, and met the requirement of not being above 2 to 1.

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11. Income Taxes

The provision (benefit) for income taxes consists of the following:

| | Three months ended | |
|----------|-----------------------|-------------------|
| | March 31, 2018 | March 31, 2017 |
| | (in thousands) | |
| Current | \$560 | \$ 3,591 |
| Deferred | 420 | 720 |
| | \$980 | \$ 4,311 |

The reconciliation of the Federal statutory income tax rate to the effective income tax rate is as follows:

| | Three months ended | |
|--|-----------------------|-------------------|
| | March 31, 2018 | March 31, 2017 |
| Federal statutory rate | 21.0 % | 35.0 % |
| State income taxes, net of Federal benefit | 6.8 | 3.4 |
| Domestic manufacturing deduction | — | (2.9) |
| Excess tax benefits | (8.9) | (7.1) |
| Other | (0.2) | 1.3 |
| Effective tax rate | 18.7 % | 29.7 % |

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. Major changes under the Act include the following:

- Reducing the corporate rate to 21 percent
- Doubling bonus depreciation to 100 percent for five years
- Further limitations on executive compensation deductions
- Eliminating the domestic manufacturing deduction

As a result of these changes, the Company adjusted its deferred tax assets and liabilities in the fourth quarter of 2017 using the newly enacted rates for the periods when they are expected to be realized.

The Company's estimated annual 2018 effective tax rate, excluding discrete events, is approximately 28%. We file income tax returns in the U.S., state and foreign income tax returns jurisdictions. We are subject to U.S. examinations for tax years 2014 to present, and to non-U.S. income tax examinations for the tax years of 2013 to present. In addition, we are subject to state and local income tax examinations for the tax years 2013 to present. The Company continues to evaluate its need to file returns in various state jurisdictions. Any interest or penalties would be recognized as a component of income tax expense.

12. Share-Based Compensation

On May 22, 2007, our stockholders adopted a Long-Term Incentive Plan ("LTIP") which provided an additional 3.3 million shares that could be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance units and performance awards. Since inception of the LTIP, non-qualified stock options and restricted stock awards were granted with the same vesting schedule as the previous plan. Under the LTIP, the exercise price of

shares granted could not be less than 100% of the fair market value at the date of the grant.

On May 24, 2016, our stockholders adopted the 2016 Long-Term Incentive Plan ("2016 Plan") which provides for approximately 3.8 million shares, comprised of 3.4 million new shares provided for under the 2016 Plan and approximately 0.4 million shares that were available for issuance under the previous LTIP, that are now authorized for issuance under the 2016 Plan, that can be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance awards, dividend equivalent rights, and other awards. Under the 2016 Plan, the exercise price of shares granted may not be less than 100% of the fair market value at the date of the grant. The 2016 Plan will be administered by the Compensation Committee of the Board of Directors or such other committee of the Board of Directors as is designated by the Board of Directors (the "Committee"). Membership on the Committee shall be limited to independent directors. The Committee may delegate certain duties to one or more officers of the Company as provided in the 2016 Plan. The Committee will determine the persons to whom awards are to be made, determine

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the type, size and terms of awards, interpret the 2016 Plan, establish and revise rules and regulations relating to the 2016 Plan and make any other determinations that it believes necessary for the administration of the 2016 Plan.

Options - The compensation cost related to unvested stock options not yet recognized as of March 31, 2018 is \$19.0 million and is expected to be recognized over a weighted average period of 2.60 years.

The following weighted average assumptions were used to determine the fair value of the stock options granted on the original grant date for expense recognition purposes for options granted during the three months ended March 31, 2018 and 2017 using a Black Scholes Model:

| | Three months ended | |
|--------------------------|-----------------------|-------------------|
| | March 31, 2018 | March 31, 2017 |
| Directors and Officers: | | |
| Expected dividend rate | \$0.26 | \$ 0.26 |
| Expected volatility | 29.73 % | 30.81 % |
| Risk-free interest rate | 2.20 % | 1.90 % |
| Expected life (in years) | 5.0 | 5.0 |

Employees:

| | | |
|--------------------------|---------|---------|
| Expected dividend rate | \$0.26 | \$ 0.26 |
| Expected volatility | 29.82 % | 30.86 % |
| Risk-free interest rate | 2.48 % | 1.91 % |
| Expected life (in years) | 5.0 | 5.0 |

The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. Volatility is based on historical volatility of our stock over time periods equal to the expected life at grant date.

The following is a summary of stock options vested and exercisable as of March 31, 2018:

| Range of Exercise Prices | Number of Shares | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Intrinsic Value (in thousands) |
|--------------------------------|------------------------|--|--|---|
| \$4.54 - \$32.80 | 486,601 | 5.19 | \$ 16.32 | \$ 11,036 |
| \$32.85 - \$34.10 | 65,054 | 5.64 | 34.06 | 322 |
| \$34.15 - \$39.00 | 9,193 | 8.90 | 34.45 | 42 |
| Total | 560,848 | 5.30 | \$ 18.67 | \$ 11,400 |

The following is a summary of stock options vested and exercisable as of March 31, 2017:

| Range of Exercise Prices | Number of Shares | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Intrinsic Value (in thousands) |
|--------------------------------|------------------------|--|--|---|
|--------------------------------|------------------------|--|--|---|

| | | Contractual Life (in years) | | |
|-------------------|---------|-----------------------------------|----------|----------|
| \$4.54 - \$22.76 | 341,654 | 5.41 | \$ 11.31 | \$ 8,213 |
| \$23.57 - \$32.80 | 18,002 | 7.52 | 24.19 | 201 |
| \$32.85 - \$36.70 | — | — | — | — |
| Total | 359,656 | 5.52 | \$ 11.96 | \$ 8,414 |

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A summary of option activity under the plans is as follows:

| | Shares | Weighted Average Exercise Price |
|----------------------------------|-----------|--|
| Outstanding at December 31, 2017 | 1,567,109 | \$ 25.27 |
| Granted | 1,432,720 | 34.51 |
| Exercised | (79,081) | 16.93 |
| Forfeited or Expired | (99,150) | 33.84 |
| Outstanding at March 31, 2018 | 2,821,598 | \$ 29.91 |
| Exercisable at March 31, 2018 | 560,848 | \$ 18.67 |

The total intrinsic value of options exercised during the three months ended March 31, 2018 and 2017 was \$1.6 million and \$2.3 million, respectively. The cash received from options exercised during the three months ended March 31, 2018 and 2017 was \$1.3 million and \$0.9 million, respectively. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statements of Cash Flows.

Restricted Stock - Since 2007, as part of the LTIP and since May 2016 as part of the 2016 Plan, the Compensation Committee of the Board of Directors has authorized and issued restricted stock awards to directors and key employees. Restricted stock awards granted to directors vest one-third each year. All other restricted stock awards vest at a rate of 20% per year. The fair value of restricted stock awards is based on the fair market value of AAON, Inc. common stock on the respective grant dates, reduced for the present value of dividends.

These awards are recorded at their fair value on the date of grant and compensation cost is recorded using straight-line vesting over the service period. At March 31, 2018, unrecognized compensation cost related to unvested restricted stock awards was approximately \$7.3 million, which is expected to be recognized over a weighted average period of 2.0 years.

A summary of the unvested restricted stock awards is as follows:

| | Shares | Weighted Average Grant Date Fair Value |
|-------------------------------|-----------|---|
| Unvested at December 31, 2017 | 341,800 | \$ 25.52 |
| Granted | 61,190 | 34.55 |
| Vested | (47,168) | 23.99 |
| Forfeited | (29,489) | 28.20 |
| Unvested at March 31, 2018 | 326,333 | \$ 27.20 |

A summary of share-based compensation is as follows:

| | Three months ended March 31 | |
|--|-----------------------------------|---------------|
| | 2018 | 2017 |
| Grant date fair value of awards during the period: (in thousands) | | |
| Options | \$12,527 | \$ 2,874 |
| Restricted stock | 2,114 | 2,600 |
| Total | \$14,641 | \$ 5,474 |
| Share-based compensation expense: | | |
| Options | \$758 | \$727 |
| Restricted stock | 966 | 918 |
| Total | \$1,724 | \$1,645 |
| Income tax benefit/(deficiency) related to share-based compensation: | | |
| Options | | \$301 \$791 |
| Restricted stock | | 162 273 |
| Total | | \$463 \$1,064 |

13. Earnings Per Share

Basic net income per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income per share assumes the conversion of all potentially dilutive securities and is calculated by dividing net income by the sum of the weighted average number of shares of common stock outstanding plus all potentially dilutive securities. Dilutive common shares consist primarily of stock options and restricted stock awards.

| | Three months ended March 31 | |
|---|---|-----------|
| | 2018 | 2017 |
| | (in thousands, except share and per share data) | |
| Numerator: | | |
| Net income | \$4,260 | \$ 10,217 |
| Denominator: | | |
| Basic weighted average shares | 52,433,902 | 622,539 |
| Effect of dilutive stock options and restricted stock | 476,321 | 567,518 |
| Diluted weighted average shares | 52,910,223 | 1,190,057 |
| Earnings per share: | | |
| Basic | \$0.08 | \$ 0.19 |
| Diluted | \$0.08 | \$ 0.19 |
| Anti-dilutive shares: | | |
| Shares | 1,676,778 | 83,965 |

14. Stockholders' Equity

Stock Repurchase - The Board has authorized three stock repurchase programs for the Company. The Company may purchase shares on the open market from time to time, up to a total of 5.7 million shares. The Board must authorize the timing and amount of these purchases. Effective May 24, 2016, the Board authorized up to \$25.0 million in open market repurchases and on June 2, 2016, the Company executed a repurchase agreement in accordance with the rules and regulations of the SEC allowing the Company to repurchase an aggregate amount of \$25.0 million or a total of approximately 2.0 million shares from the open market. The agreement expired on April 15, 2017. The Company also has a stock repurchase arrangement by which employee-participants in our 401(k) savings and investment plan are entitled to have shares in AAON, Inc. stock in their accounts sold to the Company. The maximum number of shares to be repurchased is contingent upon the number of shares sold by employee-participants. Lastly, the Company repurchases shares of AAON, Inc. stock from certain of its directors and employees for payment of statutory tax withholdings on stock transactions. All other repurchases from directors or employees are contingent upon Board approval. All repurchases are done at current market prices.

Our repurchase activity is as follows:

| Program | Three Months Ended | | | Inception to date | | | | | |
|-------------------------|--------------------|-------------|--------------|-------------------|-------------|--------------|------------|---------------|--------------|
| | March 31, 2018 | | | 2017 | | | | | |
| | Shares | Total \$ | \$ per share | Shares | Total \$ | \$ per share | Shares | Total \$ | \$ per share |
| Open market | — | \$— | \$— | 6,100 | \$195,993 | \$32.13 | 3,843,495 | \$61,232,115 | \$15.93 |
| 401(k) | 118,203 | \$4,378,925 | 37.05 | 176,429 | \$6,107,515 | 34.62 | 6,668,226 | \$86,447,730 | 12.96 |
| Directors and employees | 15,492 | \$59,688 | 36.13 | 16,399 | \$59,605 | 34.12 | 1,935,002 | \$17,845,721 | 9.22 |
| Total | 133,695 | \$4,938,613 | \$36.94 | 198,928 | \$6,863,113 | \$34.50 | 12,446,723 | \$165,525,566 | \$13.30 |

Dividends - At the discretion of the Board, we pay semi-annual cash dividends. Board approval is required to determine the date of declaration and amount for each semi-annual dividend payment.

Our recent dividends are as follows:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|------------------|-------------------|-------------------|--------------------|
| May 16, 2017 | June 9, 2017 | July 7, 2017 | \$ 0.13 |
| November 7, 2017 | November 30, 2017 | December 21, 2017 | \$ 0.13 |

15. Commitments and Contingencies

We are subject to various claims and legal actions that arise in the ordinary course of business. We closely monitor these claims and legal actions and frequently consult with our legal counsel to determine whether they may, when resolved, have a material adverse effect on our financial position, results of operations or cash flows and we accrue and/or disclose loss contingencies as appropriate. We have concluded that the likelihood is remote that the ultimate resolution of any pending litigation or claims will be material or have a material adverse effect on the Company's business, financial position, results of operations and/or cash flows.

16. Related Parties

The Company purchases some supplies from an entity controlled by the Company's CEO. The Company sometimes makes sales to the CEO for parts. Additionally, the Company sells units to an entity owned by a member of the President's immediate family. This entity is also one of the Company's Representatives and as such, the Company makes payments to the entity for third party products. All related party transactions are made on standard Company terms. The following is a summary of transactions and balance with affiliates:

| | Three months ended March 31, 2018 | | March 31, 2017 | |
|------------------------|---|--------|----------------------|--|
| | (in thousands) | | | |
| Sales to affiliates | \$ 145 | \$ 684 | | |
| Payments to affiliates | 10 | 3 | | |
| | March 31, 2018 | | December 31, 2017 | |
| | (in thousands) | | | |
| Due from affiliates | \$ 12 | \$ 9 | | |
| Due to affiliates | 10 | — | | |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes thereto, which are included in this report, and our audited consolidated financial statements and the notes thereto, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. This discussion contains or incorporates by reference “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts, but rather are based on expectations, estimates, assumptions and projections about our industry, business and future financial results, based on information available at the time this report is filed with the SEC or, with respect to any document incorporated by reference, available at the time that such document was prepared. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those identified in the section entitled “Forward-Looking Statements” in this Item 2 of this Quarterly Report on Form 10-Q and in the section entitled “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. We do not assume any obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, new information or circumstances or otherwise, except as required by law.

Overview

We engineer, manufacture and market air conditioning and heating equipment consisting of standard, semi-custom and custom rooftop units, chillers, packaged outdoor mechanical rooms, air handling units, makeup air units, energy recovery units, condensing units, geothermal/water-source heat pumps and coils. These products are marketed and

sold to retail, manufacturing, educational, lodging, supermarket, medical and other commercial industries. We market our products to all 50 states in the United States and certain provinces in Canada. Foreign sales were approximately \$4.1 million of our total net sales for the three months just ended and \$2.1 million of our sales during the same period of 2017.

Our business can be affected by a number of economic factors, including the level of economic activity in the markets in which we operate. The uncertainty of the economy has negatively impacted the commercial and industrial new construction markets. A further decline in economic activity could result in a decrease in our sales volume and profitability. Sales in the commercial and industrial new construction markets correlate closely to the number of new homes and buildings that are built, which in turn is influenced by cyclical factors such as interest rates, inflation, consumer spending habits, employment rates and other macroeconomic factors over which we have no control.

We sell our products to property owners and contractors through a network of manufacturers' representatives and our internal sales force. The demand for our products is influenced by national and regional economic and demographic factors. The commercial and industrial new construction market is subject to cyclical fluctuations in that it is generally tied to housing starts, but has a lag factor of six to 18 months. Housing starts, in turn, are affected by such factors as interest rates, the state of the economy, population

growth and the relative age of the population. When new construction is down, we emphasize the replacement market. The new construction market in 2017 through the first quarter of 2018 continued to be unpredictable and uneven. Thus, we continue to emphasize promotion of the benefits of AAON equipment to property owners in the replacement market.

The principal components of cost of goods sold are labor, raw materials, component costs, factory overhead, freight and engineering expense. The principal high volume raw materials used in our manufacturing processes are steel, copper and aluminum, and are obtained from domestic suppliers. We also purchase from domestic manufacturers certain components, including compressors, motors and electrical controls.

The price levels of our raw materials have remained relatively consistent the past few years, but the market continues to be volatile and unpredictable as a result of the uncertainty related to the U.S. economy and a weakening global economy. For the three months ended March 31, 2018, the price (twelve month trailing average) for copper, galvanized steel, stainless steel and aluminum increased by approximately 12.5%, 12.5%, 4.3% and 4.2%, respectively, as compared to the three months ended March 31, 2017.

In 2015, AAON initiated the design of a new Water Source Heat Pump product line and its affiliated manufacturing facility. We have brought the product into the marketplace and are in the final stages of completing this introduction into a \$500-\$600 million new market.

We continued construction of our three-story 134,000 square foot laboratory building with ten testing cells contained within it. This unique laboratory will have capabilities beyond anything known to exist in the world and will elevate AAON's research and design capabilities accordingly. Completion of this lab in 2018 will therefore be quite significant.

The following are recent highlights and items that impacted our results of operations, cash flows and financial condition:

- Overall units sold increased approximately 20.4% as compared to the same period last year.
- We saw declines in our gross margin from one-time bonuses to our employees for the new tax changes, increases in headcounts and lower profitability in our start-up water source heat pump business.
- We invested \$8.5 million in capital expenditures in connection with the construction of our new research and development lab, water source heat pump line and other internal projects.

Backlog

The following table shows our historical backlog levels:

| 3/31/2018 | 3/31/2017 | 3/31/2017 |
|-----------|-----------|-----------|
| \$74,068 | \$ 81,226 | \$ 68,899 |

(in thousands)

Results of Operations

Three Months Ended March 31, 2018 vs. Three Months Ended March 31, 2017

Units Sold

Three
Months
Ended
March 31,
2018 2017

| | | |
|--------------------------|-------|-------|
| Rooftop Units | 3,468 | 3,474 |
| Condensing Units | 411 | 532 |
| Air Handlers | 536 | 613 |
| Outdoor Mechanical Rooms | 14 | 24 |
| Water Source Heat Pumps | 1,614 | 378 |
| Total Units | 6,043 | 5,021 |

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Net Sales

| | Three Months Ended March 31, | | | |
|-------------|------------------------------------|----------|----------|-------------|
| | 2018 | 2017 | Change | % Change |
| | (in thousands, except unit data) | | | |
| Net sales | \$99,082 | \$86,078 | \$13,004 | 15.1 % |
| Total units | 6,043 | 5,021 | 1,022 | 20.4 % |

Net sales for the quarter are up mainly due to the increase in our water source heat pumps line which has a lower profit margin causing the percentage of net sales to not increase as proportionate to the percentage increase in total units.

Cost of Sales

| | Three Months Ended March 31, | | Percent of Sales | |
|---------------|------------------------------------|----------|---------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| | (in thousands) | | | |
| Cost of sales | \$83,692 | \$61,092 | 84.5% | 71.0% |
| Gross profit | 15,390 | 24,986 | 15.5% | 29.0% |

The principal components of cost of sales are labor, raw materials, component costs, factory overhead, freight out and engineering expense. The principal high volume raw materials used in our manufacturing processes are steel, copper and aluminum, which are obtained from domestic suppliers. In January 2018, the Company paid all employees a one-time bonus of \$1,000 per employee as a result of the Tax Cuts and Jobs Act (the "Act") which lowered the federal corporate tax rate from 35% to 21%. This bonus increased cost of sales by \$1.9 million, excluding taxes and benefits. Additionally, the Company typically has seasonality in its sales and workforce with the fourth and first quarter being lower in production. The Company maintained a higher level of workforce through the end of 2017 and beginning of 2018 in anticipation of our growing business. The Company's water source heat pump business also has a lower profit margin and given it is still in early stages of production, this part of the business is not yet as profitable as our other products.

Twelve-month average raw material cost per pound as of March 31,:

| | 2018 | 2017 | % Change |
|------------------|--------|--------|-------------|
| Copper | \$3.77 | \$3.35 | 12.5 % |
| Galvanized Steel | \$0.45 | \$0.40 | 12.5 % |
| Stainless Steel | \$1.22 | \$1.17 | 4.3 % |
| Aluminum | \$1.74 | \$1.67 | 4.2 % |

Selling, General and Administrative Expenses

| | Three Months | | Percent of | | | |
|---------------------|----------------|----------|------------|------|------|------|
| | Ended | | Sales | | | |
| | March 31, | | | | | |
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| | (in thousands) | | | | | |
| Warranty | \$1,524 | \$1,218 | 1.5 | % | 1.4 | % |
| Profit Sharing | 622 | 1,656 | 0.6 | % | 1.9 | % |
| Salaries & Benefits | 3,276 | 3,001 | 3.3 | % | 3.5 | % |
| Stock Compensation | 997 | 1,078 | 1.0 | % | 1.3 | % |
| Advertising | 222 | 966 | 0.2 | % | 1.1 | % |
| Depreciation | 218 | 158 | 0.2 | % | 0.2 | % |
| Insurance | 358 | 244 | 0.4 | % | 0.3 | % |
| Professional Fees | 782 | 577 | 0.8 | % | 0.7 | % |
| Donations | 498 | 214 | 0.5 | % | 0.2 | % |
| Bad Debt Expense | (11 |) 184 | — | % | 0.2 | % |
| Other | 1,733 | 1,234 | 1.7 | % | 1.4 | % |
| Total SG&A | \$10,219 | \$10,530 | 10.3 | % | 12.2 | % |

The overall decrease in SG&A was primarily due to the decrease in advertising expense and profit sharing.

Income Taxes

| | Three | | Effective Tax | |
|----------------------|------------|---------|---------------|-------|
| | Months | | Rate | |
| | Ended | | | |
| | March 31, | | | |
| | 2018 | 2017 | 2018 | 2017 |
| | (in | | | |
| | thousands) | | | |
| Income tax provision | \$980 | \$4,311 | 18.7% | 29.7% |

The Company's estimated annual 2018 effective tax rate, excluding discrete events, is expected to be approximately 28%. The decrease in our effective rate was due to the Act that was enacted on December 22, 2017 lowering the federal corporate tax rate to 21%.

Liquidity and Capital Resources

Our working capital and capital expenditure requirements are generally met through net cash provided by operations and the occasional use of our revolving credit facility.

Our cash and investments decreased \$7.3 million from December 31, 2017 to March 31, 2018 and totaled \$23.1 million at March 31, 2018.

Under the line of credit, there was one standby letter of credit of \$0.8 million as of March 31, 2018. At March 31, 2018, we have \$29.2 million of borrowings available under the revolving credit facility. No fees are associated with

the unused portion of the committed amount.

We had no outstanding balance under the revolving credit facility at March 31, 2018 and December 31, 2017. Interest on borrowings is payable monthly at LIBOR plus 2.5%. The termination date of the revolving credit facility is July 27, 2018. The Company expects to renew the facility with similar terms.

At March 31, 2018, we were in compliance with all of the covenants under the revolving credit facility. We are obligated to comply with certain financial covenants under the revolving credit facility. These covenants require that we meet certain parameters related

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to our tangible net worth and total liabilities to tangible net worth ratio. At March 31, 2018, our tangible net worth was \$239.6 million, which meets the requirement of being at or above \$125.0 million. Our total liabilities to tangible net worth ratio was 0.28 to 1.0 which meets the requirement of not being above 2 to 1.

Authorizations - The Board has authorized three stock repurchase programs for the Company. The Company may purchase shares on the open market from time to time, up to a total of 5.7 million shares. The Board must authorize the timing and amount of these purchases. Effective May 24, 2016, the Board authorized up to \$25.0 million in open market repurchases and on June 2, 2016, the Company executed a repurchase agreement in accordance with the rules and regulations of the SEC allowing the Company to repurchase an aggregate amount of \$25.0 million or a total of approximately 2.0 million shares from the open market. The agreement expired on April 15, 2017. The Company also has a stock repurchase arrangement by which employee-participants in our 401(k) savings and investment plan are entitled to have shares in AAON, Inc. stock in their accounts sold to the Company. The maximum number of shares to be repurchased is contingent upon the number of shares sold by employee-participants. Lastly, the Company repurchases shares of AAON, Inc. stock from certain of its directors and employees for payment of statutory tax withholdings on stock transactions. Any other repurchases from directors or employees are contingent upon Board approval. All repurchases are done at current market prices.

Repurchase Activity

| Program | Three Months Ended March 31, 2018 | | | 2017 | | | Inception to date | | |
|-------------------------|---|-------------|-----------------|---------|-------------|-----------------|-------------------|---------------|-----------------|
| | Shares | Total \$ | \$ per share | Shares | Total \$ | \$ per share | Shares | Total \$ | \$ per share |
| Open market | — | \$— | \$— | 6,100 | \$195,993 | \$32.13 | 3,843,495 | \$61,232,115 | \$15.93 |
| 401(k) | 118,203 | 4,378,925 | 37.05 | 176,429 | 6,107,515 | 34.62 | 6,668,226 | 86,447,730 | 12.96 |
| Directors and employees | 15,492 | 559,688 | 36.13 | 16,399 | 559,605 | 34.12 | 1,935,002 | 17,845,721 | 9.22 |
| Total | 133,695 | \$4,938,613 | \$36.94 | 198,928 | \$6,863,113 | \$34.50 | 12,446,723 | \$165,525,566 | \$13.30 |

Dividends - At the discretion of the Board, we pay semi-annual cash dividends. Board approval is required to determine the date of declaration and amount for each semi-annual dividend payment.

Our recent dividends are as follows:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|------------------|-------------------|-------------------|--------------------------|
| May 16, 2017 | June 9, 2017 | July 7, 2017 | \$ 0.13 |
| November 7, 2017 | November 30, 2017 | December 21, 2017 | \$ 0.13 |

Based on historical performance and current expectations, we believe our cash and cash equivalents balance, the projected cash flows generated from our operations, our existing committed revolving credit facility (or comparable financing) and our expected ability to access capital markets will satisfy our working capital needs, capital expenditures and other liquidity requirements associated with our operations in 2018 and the foreseeable future.

Statement of Cash Flows

The following table reflects the major categories of cash flows for the three months ended March 31, 2018 and 2017. For additional details, see the Condensed Consolidated Statements of Cash Flows in the condensed consolidated financial statements.

| | Three months ended March 31, | |
|--|---------------------------------|-----------|
| | 2018 | 2017 |
| | (in thousands) | |
| Operating Activities | | |
| Net Income | \$4,260 | \$10,217 |
| Income statement adjustments, net | 6,373 | 6,250 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,897) | (1,560) |
| Income taxes | (5,673) | 3,230 |
| Inventories | 3,447 | (8,696) |
| Prepaid expenses and other | (712) | (313) |
| Accounts payable | 9,833 | 1,736 |
| Deferred revenue | 37 | 78 |
| Accrued liabilities & donations | (3,924) | (776) |
| Net cash provided by operating activities | 10,744 | 10,166 |
| Investing Activities | | |
| Capital expenditures | (8,451) | (6,071) |
| Cash paid in business combination | (6,000) | — |
| Purchases of investments | (11,815) | — |
| Maturities of investments and proceeds from called investments | 5,825 | 9,320 |
| Other | 20 | 20 |
| Net cash (used in) provided by investing activities | (20,421) | 3,269 |
| Financing Activities | | |
| Stock options exercised | 1,340 | 898 |
| Repurchase of stock | (4,379) | (6,303) |
| Employee taxes paid by withholding shares | (568) | (560) |
| Net cash used in financing activities | \$(3,607) | \$(5,965) |

Cash Flows Provided by Operating Activities

Cash inflows for inventory purchases has increased related to increased volume of unit sales, as well as for new production on our Water Source Heat Pump line. Cash outflows from receivables has also increased as we've seen activity in our prepayment program decrease slightly and sales slightly increase too.

Cash Flows Provided by Investing Activities

Our capital expenditures continue to increase with new equipment for our various product lines and construction on our research and development lab. We also closed on our acquisition of substantially all of the assets of WattMaster Controls, Inc. in February 2018. The capital expenditure program for 2018 is estimated to be approximately \$53.2 million.

Cash Flows Used in Financing Activities

While the number of shares repurchased remained relatively consistent as compared to the prior year, the increase in the Company's share price drove the increased cash outflows for buyback activity.

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Off-Balance Sheet Arrangements

We are not party to any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations

We had no material contractual purchase agreements as of March 31, 2018.

Critical Accounting Policies

There have been no material changes in the Company's critical accounting policies during the three months ended March 31, 2018.

Recent Accounting Pronouncements

See Note 1 of the Notes to the Consolidated Financial Statements for a discussion of recent accounting pronouncements.

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", "should", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Important factors that could cause results to differ materially from those in the forward-looking statements include (1) the timing and extent of changes in raw material and component prices, (2) the effects of fluctuations in the commercial/industrial new construction market, (3) the timing and extent of changes in interest rates, as well as other competitive factors during the year, and (4) general economic, market or business conditions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Commodity Price Risk

We are exposed to volatility in the prices of commodities used in some of our products and we may use fixed price cancellable and non-cancellable contracts with our major suppliers for periods of six to 18 months to manage this exposure.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer with the oversight of the Audit Committee, regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded, as of the end of the period covered by this Quarterly Report, that our disclosure controls and procedures were effective.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We acquired substantially all of the assets and certain related operations of WattMaster Controls, Inc. ("WattMaster") on February 28, 2018, as described in Note 3 to our consolidated financial statements included in this Quarterly Report on Form 10 - Q. At

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this time, we continue to evaluate the business and internal controls and processes associated with WattMaster and are making various changes to its operating and organizational structure based on our business plan.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are subject to various claims and legal actions that arise in the ordinary course of business. We closely monitor these claims and legal actions and frequently consult with our legal counsel to determine whether they may, when resolved, have a material adverse effect on our financial position, results of operations, or cash flows and we accrue and/or disclose loss contingencies as appropriate. We have concluded that the likelihood is remote that the ultimate resolution of any pending litigation or claims will be material or have a material adverse effect on the Company's business, financial position, results of operations or cash flows.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017. The risk factors described in our Annual Report could materially adversely affect our business, financial condition or future results. There have been no material changes to the risk factors included in our 2017 Annual Report.

Item 2. Unregistered Sales of Equity and Securities and Use of Proceeds.

On May 17, 2010, the Board authorized a stock buyback program, targeting open market repurchases of up to approximately 5% (2.9 million shares) of the Company's outstanding stock. In May 2015, the Board authorized repurchases up to an additional 2.75 million shares, or a total of approximately 5.7 million shares. In October 2015, the Board authorized \$25.0 million for use under the Company's stock buyback program. Effective May 24, 2016, the Board authorized up to \$25.0 million in open market repurchases and on June 2, 2016, the Company executed a repurchase agreement in accordance with the rules and regulations of the SEC allowing the Company to repurchase an aggregate amount of \$25.0 million or a total of approximately 2.0 million shares from the open market. The agreement expired on April 15, 2017. We have repurchased a total of approximately 3.8 million shares under these programs for an aggregate price of \$61.2 million, or an average price of \$15.93 per share. We purchased the shares at current market prices.

On July 1, 2005, we entered into a stock repurchase arrangement by which employee-participants in our 401(k) savings and investment plan are entitled to have shares of AAON, Inc. stock in their accounts sold to the Company. The maximum number of shares to be repurchased is contingent upon the number of shares sold by employees. From inception through March 31, 2018, we repurchased approximately 6.7 million shares for an aggregate price of \$86.4 million, or an average price of \$12.96 per share. We purchased the shares at current market prices.

Periodically, the Company repurchases shares of AAON, Inc. stock from certain of its directors and employees. The number of shares to be repurchased is contingent upon Board approval. From inception through March 31, 2018, we repurchased approximately 1.9 million shares for an aggregate price of \$17.8 million, or an average price of \$9.22 per share. We purchased the shares at current market prices.

Repurchases during the first quarter of 2018 were as follows:

| Period | ISSUER PURCHASES OF EQUITY SECURITIES | | | |
|--------|--|-----|-----|-----|
| | (a) | (b) | (c) | (d) |
| | | | | |

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| | Total Number of Shares (or Units) Purchased | Average Price Paid Per Share (or Unit) | Total Number of Shares (or Units) Purchased as part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that may yet be Purchased under the Plans or Programs |
|---------------|---|--|---|--|
| January 2018 | 42,610 | \$ 38.75 | 42,610 | — |
| February 2018 | 24,190 | 35.36 | 24,190 | — |
| March 2018 | 66,895 | 36.36 | 66,895 | — |
| Total | 133,695 | \$ 36.94 | 133,695 | — |

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Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 4A. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

(a) Exhibits

- (i) Exhibit 31.1 Section 302 Certification of CEO
- (ii) Exhibit 31.2 Section 302 Certification of CFO
- (iii) Exhibit 32.1 Section 1350 Certification of CEO
- (iv) Exhibit 32.2 Section 1350 Certification of CFO

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AAON, INC.

Dated: 5/3/2018 By: /s/ Norman H. Asbjornson
Norman H. Asbjornson
President/CEO

Dated: 5/3/2018 By: /s/ Scott M. Asbjornson
Scott M. Asbjornson
Chief Financial Officer

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