

Edgar Filing: AAON INC - Form 10-Q

AAON INC
Form 10-Q
November 08, 2011
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 September 30, 2011

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
(State or other jurisdiction
of incorporation or organization)

87-0448736
(IRS Employer
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 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, or a smaller reporting company.

Edgar Filing: AAON INC - Form 10-Q

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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 October 28, 2011 registrant had outstanding a total of 24,641,082 shares of its \$.004 par value Common Stock.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

AAON, Inc., and Subsidiaries
Consolidated Balance Sheets
(unaudited)

| | September 30, 2011 | December 31, 2010 |
|--|--|-------------------|
| Assets | (in thousands except share and per share data) | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,278 | \$ 2,393 |
| Certificates of deposit | - | 1,503 |
| Investments held to maturity at amortized cost | 572 | 9,520 |
| Accounts receivable, net | 40,082 | 39,901 |
| Note receivable | 26 | 26 |
| Inventories, net | 42,256 | 33,602 |
| Prepaid expenses and other | 850 | 656 |
| Deferred tax assets | 4,735 | 4,147 |
| Total current assets | 90,799 | 91,748 |
| Property, plant and equipment: | | |
| Land | 1,340 | 1,328 |
| Buildings | 53,846 | 45,482 |
| Machinery and equipment | 121,256 | 100,559 |
| Furniture and fixtures | 7,456 | 6,356 |
| Total property, plant and equipment | 183,898 | 153,725 |
| Less: Accumulated depreciation | 93,533 | 86,307 |
| Property, plant and equipment, net | 90,365 | 67,418 |
| Note receivable, long-term | 1,090 | 1,111 |
| Total assets | \$ 182,254 | \$ 160,277 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Revolving credit facility | \$ 13,965 | \$ - |
| Accounts payable | 11,260 | 13,017 |
| Accrued liabilities | 23,923 | 23,229 |
| Total current liabilities | 49,148 | 36,246 |
| Deferred tax liabilities | 7,832 | 7,292 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.001 par value, 11,250,000 shares authorized, no shares issued* | - | - |
| Common stock, \$.004 par value, 112,500,000 shares authorized, 24,653,493 and 24,758,480 issued and outstanding at September 30, 2011 and December 31, 2010, respectively* | 99 | 99 |
| Retained earnings | 125,175 | 116,640 |
| Total stockholders' equity | 125,274 | 116,739 |
| Total liabilities and stockholders' equity | \$ 182,254 | \$ 160,277 |

* Reflects three-for-two stock split effective June 13, 2011.

The accompanying notes are an integral part of these statements.

-1-

Edgar Filing: AAON INC - Form 10-Q

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

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------------------|--------------------|--------------------|--------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| | (in thousands, except per share data) | | | |
| Net sales | \$ 73,829 | \$ 64,886 | \$ 202,818 | \$ 178,726 |
| Cost of sales | 59,570 | 52,389 | 165,184 | 137,729 |
| Gross profit | 14,259 | 12,497 | 37,634 | 40,997 |
| Selling, general and administrative expenses | 5,445 | 5,166 | 16,685 | 16,592 |
| Income from operations | 8,814 | 7,331 | 20,949 | 24,405 |
| Interest expense | (59) | (4) | (173) | (4) |
| Investment interest income | 11 | 44 | 54 | 162 |
| Note receivable interest income | 11 | - | 33 | - |
| Other income (expense), net | (122) | (64) | (690) | (186) |
| Income before income taxes | 8,655 | 7,307 | 20,173 | 24,377 |
| Income tax provision | 3,029 | 2,134 | 7,058 | 8,265 |
| Net income | \$ 5,626 | \$ 5,173 | \$ 13,115 | \$ 16,112 |
| Earnings per share: | | | | |
| Basic* | \$ 0.23 | \$ 0.21 | \$ 0.53 | \$ 0.64 |
| Diluted* | \$ 0.23 | \$ 0.21 | \$ 0.53 | \$ 0.63 |
| Cash dividends declared per common share*: | \$ 0.12 | \$ 0.12 | \$ 0.12 | \$ 0.12 |
| Weighted average shares outstanding: | | | | |
| Basic* | 24,667 | 24,833 | 24,708 | 25,337 |
| Diluted* | 24,844 | 24,971 | 24,902 | 25,471 |

*Reflects three-for-two stock split effective June 13, 2011.

The accompanying notes are an integral part of these statements.

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

| | Common Stock | | Paid-in Capital | Retained Earnings | Total |
|--|--------------------------|---------|--------------------|----------------------|------------|
| | Shares (in thousands) | Amount | | | |
| Balance at December 31, 2010 | 24,758 * | \$ 99 * | \$ – | \$ 116,640 * | \$ 116,739 |
| Net income | – | – | – | 13,115 | 13,115 |
| Stock options exercised and restricted stock awards vested, including tax benefits | 58 | – | 549 | – | 549 |
| Share-based compensation | – | – | 509 | – | 509 |
| Stock repurchased and retired | (163) | – | (1,048) | (1,614) | (2,662) |
| Dividends declared and paid | – | – | (10)** | (2,966) | (2,976) |
| Balance at September 30, 2011 | 24,653 * | \$ 99 * | \$ – | \$ 125,175 * | \$ 125,274 |

*Reflects three-for-two stock split effective June 13, 2011.

**Includes cash payment in lieu of fractional shares resulting from three-for-two stock split effective June 13, 2011.

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries

Consolidated Statements of Cash Flows
(unaudited)

| | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|--|--|
| | (in thousands) | |
| Operating Activities | | |
| Net income | \$ 13,115 | \$ 16,112 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 8,174 | 7,330 |
| Amortization of bond premiums | 155 | - |
| Provision for losses on accounts receivable, net of adjustments | (242) | (36) |
| Share-based compensation | 509 | 609 |
| Excess tax benefits from stock options exercised and restricted stock awards vested | (176) | (331) |
| Gain on disposition of assets | (14) | (105) |
| Deferred income taxes | (48) | (705) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 61 | (3,522) |
| Inventories | (8,654) | (5,862) |
| Prepaid expenses and other | (194) | 542 |
| Financial derivative assets | - | 1,743 |
| Accounts payable | (2,281) | 4,149 |
| Accrued liabilities | 870 | 3,748 |
| Net cash provided by operating activities | 11,275 | 23,672 |
| Investing Activities | | |
| Proceeds from sale of property, plant and equipment | 55 | 105 |
| Investment in certificates of deposit | - | (2,744) |
| Maturities of certificates of deposit | 1,503 | 799 |
| Investments held to maturity | - | (13,692) |
| Maturities of investments | 8,793 | 2,149 |
| Capital expenditures | (30,638) | (13,050) |
| Deposits on sale of asset held for sale | - | 453 |
| Proceeds from note receivable | 21 | - |
| Net cash used in investing activities | (20,266) | (25,980) |
| Financing Activities | | |
| Borrowings under revolving credit facility | 66,557 | 6,682 |
| Payments under revolving credit facility | (52,592) | (2,691) |
| Payments of long-term debt | - | (68) |
| Stock options exercised | 373 | 1,054 |
| Excess tax benefits from stock options exercised and restricted stock awards vested | 176 | 331 |
| Repurchases of stock | (2,662) | (18,377) |
| Cash dividends paid to stockholders | (2,976)* | (6,192) |

Edgar Filing: AAON INC - Form 10-Q

| | | |
|---|----------|-----------|
| Net cash provided by (used) in financing activities | 8,876 | (19,261) |
| Effect of exchange rate on cash | - | 79 |
| Net decrease in cash and cash equivalents | (115) | (21,490) |
| Cash and cash equivalents, beginning of year | 2,393 | 25,639 |
| Cash and cash equivalents, end of period | \$ 2,278 | \$ 4,149 |

*Includes cash payment in lieu of fractional shares resulting from three-for-two stock split effective June 13, 2011.

The accompanying notes are an integral part of these statements.

-4-

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

| | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|--|--|--|
| (in thousands) | | |
| Non Cash Investing Activities | | |
| Capital expenditures accrued in accounts payable | \$ 524 | - |

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries
Notes to the Consolidated Financial Statements
September 30, 2011
(unaudited)

1. Basis of Presentation

AAON, Inc. is a Nevada corporation which was incorporated on August 18, 1987. Our operating subsidiaries include AAON, Inc., an Oklahoma corporation and AAON Coil Products, Inc., a Texas corporation. The Consolidated Financial Statements include our accounts and the accounts of our subsidiaries. Unless the context otherwise requires, references in this Quarterly Report to “AAON,” the “Company,” “we,” “us,” “our” or “ours” refer to AAON, Inc., and subsidiaries.

We have prepared the financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures made in these financial statements are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in our latest audited financial statements which were included in the Form 10-K Report for the fiscal year ended December 31, 2010, filed with the SEC. In the opinion of management, the accompanying financial statements include all normal, recurring adjustments required for a fair presentation of the results of the periods presented. Operating results for the nine months ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Revenue Recognition

We recognize revenues from sales of products when the products are shipped and the title and risk of ownership pass to the customer. 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. Our policy is to record the collection and payment of sales taxes through a liability account.

We present revenues 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 which is negotiated by the Representative with the end user customer.

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 do not provide us with a break-out of the amount of the total order price over the minimum sales price which includes the Representatives' fee and Third Party Product amounts ("Due to Representatives"). The Due to Representatives amount is paid only after all amounts associated with the order are collected from the customer. The amount of payments to our Representatives was \$39.3 million and \$37.9 million for the nine months ending September 30, 2011 and 2010, respectively.

Common Stock Split

On May 4, 2011, the Company's Board of Directors approved a three-for-two stock split of the Company's outstanding stock for shareholders of record as of May 27, 2011. The stock split was effected in the form of a 50% stock dividend which was distributed on June 13, 2011. The applicable share and per share data for all periods included herein has been restated to reflect the stock split.

Investments

We made investments with a large firm which included cash equivalents and money market accounts, certificates of deposit and corporate notes and bonds. We record the amortized cost basis and accrued interest on the corporate notes and bonds in the Consolidated Balance Sheets. We record the interest and amortization of bond premiums on the corporate notes and bonds to investment interest income in the Consolidated Statements of Income.

Reclassification

Certain amounts in the 2010 consolidated financial statements have been reclassified to conform to the 2011 financial statement presentation. Such reclassifications have no effect on net income.

Subsequent Events

We have determined that no subsequent events exist which require recognition or disclosure in our Consolidated Financial Statements.

New Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board "FASB" issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs ("ASU 2011-04"). The amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. The amendment includes specific requirements for measuring fair value of instruments classified in a reporting entity's shareholders' equity, however, per 820-10-15 Other Considerations, does not apply to share-based payment transactions which are covered under Topic 718. The amendment also clarifies disclosures required regarding unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy. FASB concluded that the amendments updating a requirement for measuring fair value do not affect many reporting entities, however, might affect entities that have been applying the in-use valuation premise more broadly than was intended. Entities that apply a premium or discount when measuring the fair value of an asset or liability on the basis of a quantity differing from a unit of account specified in GAAP within Level 2 or Level 3 of the hierarchy may also be affected. The amendments also expand disclosures related to Level 3 fair value measurements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2011. Adoption of ASU 2011-04 should not have a material impact on our Consolidated Financial Statements.

2. Certificates of Deposit

As of September 30, 2011, we have no investments in certificates of deposit. We invested \$1.5 million in certificates of deposits as of December 31, 2010 with various maturities of one year or less and interest rates ranging from 0.5% to 4.2% per annum.

-7-

3. Investments Held to Maturity

Our investments held to maturity at September 30, 2011 include \$0.6 million of corporate notes and bonds with maturities of one year or less. Our investments held to maturity at December 31, 2010 were comprised of \$9.5 million in corporate notes and bonds with maturities of one year or less. Investments at December 31, 2010 had moderate risk with S&P ratings ranging from AA+ to BBB-. Investments at September 30, 2011 had ratings of BBB.

The following summarizes the amortized cost and estimated fair value of our investments held to maturity:

| | Amortized Cost(1) | Gross Unrealized Gain (in thousands) | Gross Unrealized Loss | Fair Value |
|------------------------------|----------------------|---|-----------------------------|---------------|
| Current Assets: | | | | |
| Investments held to maturity | \$ 572 | \$ - | \$ - | \$ 572 |
| Total | \$ 572 | \$ - | \$ - | \$ 572 |

(1) We evaluate for other-than-temporary impairments on a quarterly basis.

4. Accounts Receivable

We grant credit to our customers and perform ongoing credit evaluations. We generally do not require collateral or charge interest. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, economic and market conditions and the age of the receivables. Accounts are considered past due when the balance has been outstanding for greater than ninety days. Past due accounts are generally written off against the allowance for doubtful accounts only after all collection attempts have been exhausted. There are no concentrations of credit risk.

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

| | September 30, 2011 | December 31, 2010 |
|---------------------------------------|-----------------------|----------------------|
| | (in thousands) | |
| Accounts receivable | \$ 40,397 | \$ 40,501 |
| Less: Allowance for doubtful accounts | (315) | (600) |
| Total, net | \$ 40,082 | \$ 39,901 |

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 |
| | (in thousands) | |
| Allowance for doubtful accounts: | | |
| Balance, beginning of period | \$ 600 | \$ 776 |
| Provision for losses on accounts receivable | 513 | 451 |
| Adjustments to provision | (755) | (487) |
| Accounts receivable written off, net of recoveries | (43) | (60) |
| Balance, end of period | \$ 315 | \$ 680 |

5. Note Receivable

In September 2010, we sold our Canadian facility and assumed a note receivable from one borrower secured by the property. The \$1.1 million, fifteen-year note receivable is based on a 4.0% interest rate with a \$0.6 million balloon payment due in October 2025. The note calls for monthly combined interest and principal payments beginning in October 2010. Interest payments are recognized in note receivable interest income.

-8-

We evaluate for impairment on a quarterly basis. We determine the note receivable to be impaired if we are uncertain of the collectability of the note based on the contractual terms. The loan was current as of September 30, 2011. The note receivable is not considered impaired and no impairment was recorded at September 30, 2011.

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.

Inventory balances are as follows:

| | September 30, 2011 (in thousands) | December 31, 2010 |
|---|---|----------------------|
| Raw materials | \$ 38,132 | \$ 28,560 |
| Work in process | 2,247 | 3,334 |
| Finished goods | 2,182 | 2,058 |
| | 42,561 | 33,952 |
| Less: Allowance for excess and obsolete inventories | (305) | (350) |
| Total, net | \$ 42,256 | \$ 33,602 |

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

| | Nine Months Ended September 30, 2011 (in thousands) | September 30, 2010 |
|--|--|-----------------------|
| Allowance for excess and obsolete inventories: | | |
| Balance, beginning of period | \$ 350 | \$ 760 |
| Provision for excess and obsolete inventories | 205 | 600 |
| Adjustments to reserve | (250) | (600) |
| Inventories written off | - | (410) |
| Balance, end of period | \$ 305 | \$ 350 |

7. Accrued Liabilities

Accrued liabilities are as follows:

| | September 30, 2011 | December 31, 2010 |
|-----------------------------|--------------------|-------------------|
| | (in thousands) | |
| Warranties | \$ 7,255 | \$ 7,300 |
| Due to Representatives | 9,877 | 9,668 |
| Payroll | 2,317 | 2,398 |
| Income Taxes | 913 | - |
| Workers' compensation | 895 | 855 |
| Medical self-insurance | 712 | 734 |
| Employee benefits and other | 1,954 | 2,274 |

Edgar Filing: AAON INC - Form 10-Q

| | | | | |
|-------|----|--------|----|--------|
| Total | \$ | 23,923 | \$ | 23,229 |
|-------|----|--------|----|--------|

-9-

8. Supplemental Cash Flow Information

Interest payments of approximately \$0.2 million and \$4,000 were made for the nine months ended September 30, 2011 and September 30, 2010 respectively. Payments for income taxes of \$5.4 million and \$6.7 million were made during the nine months ended September 30, 2011 and September 30, 2010 respectively. Dividends payable of \$3.0 million were accrued in June 2011 and were paid in July 2011. Dividends declared in December 31, 2009 were paid in January 2010. Dividends payable of \$3.1 million were declared in June 2010, released for payment to our transfer agent in June 2010 and paid to stockholders in July 2010. Dividends declared in December 2010 were also paid in December 2010.

9. Revolving Credit Facility

Our revolving credit facility provides for maximum borrowings of \$30.0 million which is provided by the Bank of Oklahoma, National Association. Under the line of credit, there is one standby letter of credit totaling \$2.4 million. Borrowings available under the revolving credit facility at September 30, 2011, were \$13.7 million. Interest on borrowings is payable monthly at LIBOR plus 2.5% (2.7% at September 30, 2011). No fees are associated with the unused portion of the committed amount. We had a \$14.0 million outstanding balance under the revolving credit facility at September 30, 2011. We had no borrowings outstanding under the revolving credit facility at December 31, 2010.

On July 30, 2011, we renewed the line of credit with a maturity date of July 29, 2012. The renewal increased our maximum borrowings to \$30.0 million. Interest on borrowings will be payable monthly at LIBOR plus 2.5% per annum, the tangible net worth requirement shall be at or above \$95.0 million and our working capital requirement remains at \$30.0 million until December 31, 2011. As of December 31, 2011, the working capital requirement minimum will be \$35.0 million and as of June 30, 2012 will increase to \$40.0 million.

At September 30, 2011, we were in compliance with our financial ratio covenants. The covenants are related to our tangible net worth, total liabilities to tangible net worth ratio and working capital. At September 30, 2011 our tangible net worth was \$125.3 million which meets the requirement of being at or above \$95.0 million. Our total liabilities to tangible net worth ratio was 0.45 to 1 which meets the requirement of not being above 2 to 1. Our working capital was \$41.7 million which meets the requirement of being at or above \$30.0 million. Effective January 1, 2011, as a requirement of our workers compensation insurance, our standby letter of credit was extended with an increase of \$1.5 million to \$2.4 million and will expire December 31, 2011. We expect to renew our revolving credit agreement in July 2012. We do not anticipate that the current situation in the credit market will impact that renewal.

10. Share-Based Compensation

We have historically maintained a stock option plan for key employees, directors and consultants (the "1992 Plan"). The 1992 Plan provided for 6.6 million shares of common stock to be issued under the plan. Under the terms of the 1992 Plan, the exercise price of shares granted may not be less than 85% of the fair market value at the date of the grant. Options granted to directors prior to May 25, 2004, vest one year from the date of grant and are exercisable for three years thereafter. Options granted to directors on or after May 25, 2004, vest one-third each year, commencing one year after the date of grant. All other options granted vest at a rate of 20% per year, commencing one year after date of grant, and are exercisable during years 2-10.

On May 22, 2007, our stockholders adopted a Long-Term Incentive Plan ("LTIP") which provides an additional 1,125,000 shares that can 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 have been granted with the same vesting schedule as the previous plan. Under the LTIP, the exercise price of shares granted may not be less than 100% of the fair market value at the date of the grant.

We apply the provisions of FASC Topic 718, Compensation – Stock Compensation. The compensation cost is based on the grant date fair value of stock options issued calculated using a Black-Scholes-Merton Option Pricing Model, or the grant date fair value of a restricted stock award less the present value of dividends expected during the vesting period.

We recognized approximately \$88,000 and \$107,000 for the three months ended and \$293,000 and \$334,000 for the nine months ended September 30, 2011 and 2010, respectively, in pre-tax compensation expense related to stock options in the Consolidated Statements of Income. The total pre-tax compensation cost related to unvested stock options not yet recognized as of September 30, 2011 is \$1.2 million and is expected to be recognized over a weighted average period of 2.4 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:

| | Nine Months Ended | |
|--------------------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 |
| Directors and Officers: | | |
| Expected dividend yield | N/A | 1.59% |
| Expected volatility | N/A | 45.37% |
| Risk-free interest rate | N/A | 2.63% |
| Expected life | N/A | 7.0 years |
| Forfeiture rate | N/A | 0% |
| Employees: | | |
| Expected dividend yield | 1.20% | 1.59% |
| Expected volatility | 45.13% | 45.42% |
| Risk-free interest rate | 1.40% | 2.48% |
| Expected life | 8.0 years | 8.0 years |
| Forfeiture rate | 31% | 31% |

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.

A summary of stock options outstanding is as follows:

| Range of Exercise Prices* | Number Outstanding at September 30, 2011* | Options Outstanding | | Aggregate Intrinsic Value | Options Exercisable | |
|---------------------------------|--|---|---|---------------------------------|---|---|
| | | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price* | | Number Exercisable at September 30, 2011* | Weighted Average Exercise Price* |
| 6.45 – 7.21 | 92,650 | 2.54 | \$ 6.86 | \$ 8.89 | 92,650 | \$ 6.86 |
| 7.53 – 10.66 | 232,500 | 5.98 | 9.78 | 5.97 | 139,350 | 9.46 |
| | 171,200 | 6.12 | 12.29 | 3.46 | 110,900 | 12.12 |

Edgar Filing: AAON INC - Form 10-Q

| | | | | | | | |
|---------|---------|------|----------|---------|---------|---------|--|
| 10.75 – | | | | | | | |
| 13.79 | | | | | | | |
| 14.28 – | | | | | | | |
| 18.30 | 170,500 | 9.28 | 15.96 | (0.21) | 16,500 | 15.34 | |
| Total | 666,850 | 6.38 | \$ 11.60 | \$ 5.87 | 359,400 | \$ 9.88 | |

*Reflects three-for-two stock split effective June 13, 2011.

-11-

A summary of stock option activity is as follows:

| | Shares* | Weighted Average Exercise Price* | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (\$000) |
|-----------------------------------|-----------|--|---|---|
| Outstanding at January 1, 2011 | 629,250 | \$ 10.83 | | |
| Granted | 82,000 | 16.15 | | |
| Exercised | (42,000) | 8.90 | | |
| Forfeited or Expired | (2,400) | 13.70 | | |
| Outstanding at September 30, 2011 | 666,850 | 11.60 | 6.38 | \$ 2,769 |
| Exercisable at September 30, 2011 | 359,400 | \$ 9.88 | 4.72 | \$ 2,109 |

*Reflects three-for-two stock split effective June 13, 2011.

The weighted average grant date fair value of options granted during the nine months ended September 30, 2011 and 2010 was \$6.81 and \$6.42, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2011 and 2010 was approximately \$0.8 million and \$2.6 million, respectively. The cash received from options exercised during the nine months ended September 30, 2011 and 2010, was approximately \$0.4 and \$1.1 million, respectively. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statements of Cash Flows.

A summary of the unvested stock options is as follows:

| | Shares* | Weighted Average Grant Date Fair Value* |
|--------------------------------|-----------|--|
| Unvested at January 1, 2011 | 309,900 | \$ 5.37 |
| Granted | 82,000 | 6.81 |
| Vested | (82,050) | 5.16 |
| Forfeited | (2,400) | 6.19 |
| Unvested at September 30, 2011 | 307,450 | \$ 5.81 |

*Reflects three-for-two stock split effective June 13, 2011.

Based upon recommendations of the Compensation Committee of the Board of Directors, the Board has authorized and issued restricted stock awards to our directors and key employees. The restricted stock award program offers the opportunity to earn shares of AAON common stock over time, rather than options that give the right to purchase stock at a set price. Restricted stock awards granted to directors vest one-third each year. All other restricted stock awards vest at a rate of 20% per year. Restricted stock awards are grants that entitle the holder to shares of common stock subject to certain terms. The fair value of restricted stock awards is based on the fair market value of AAON common stock on the respective grant dates, reduced for the present value of dividends expected during the vesting period.

These awards are recorded at their fair values on the date of grant and compensation cost is recorded using straight-line vesting over the service period. We recognized approximately \$75,000 and \$80,000 for the three months and \$216,000 and \$275,000 for the nine months ended September 30, 2011 and 2010, respectively in pre-tax compensation expense related to restricted stock awards in the Consolidated Statements of Income. In addition, as of September 30, 2011, unrecognized compensation cost related to unvested restricted stock awards was approximately

\$0.5 million which is expected to be recognized over a weighted average period of 1.6 years.

-12-

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

| | Shares* |
|--------------------------------|-----------|
| Unvested at January 1, 2011 | 42,075 |
| Granted | 15,750 |
| Vested | (19,875) |
| Forfeited | - |
| Unvested at September 30, 2011 | 37,950 |

*Reflects three-for-two stock split effective June 13, 2011.

11. 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 | | Nine Months Ended | |
|--|---|-----------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| | (in thousands, except share and per share data) | | | |
| Numerator: | | | | |
| Net income | \$ 5,626 | \$ 5,173 | \$ 13,115 | \$ 16,112 |
| Denominator: | | | | |
| Denominator for basic earnings per share – | | | | |
| Weighted average shares* | 24,666,775 | 24,832,961 | 24,708,391 | 25,337,451 |
| Effect of dilutive employee stock options and restricted stock awards* | | | | |
| | 177,114 | 137,631 | 193,158 | 133,423 |
| Denominator for diluted earnings per share – | | | | |
| Weighted average shares* | 24,843,889 | 24,970,592 | 24,901,549 | 25,470,874 |
| Earnings per share: | | | | |
| Basic* | \$ 0.23 | \$ 0.21 | \$ 0.53 | \$ 0.64 |
| Diluted* | \$ 0.23 | \$ 0.21 | \$ 0.53 | \$ 0.63 |
| Anti-dilutive shares* | | | | |
| | 178,750 | 137,775 | 178,750 | 137,775 |
| Weighted average exercise price* | | | | |
| | \$ 16.03 | \$ 14.79 | \$ 16.03 | \$ 14.79 |

*Reflects three-for-two stock split effective June 13, 2011.

12. Income Taxes

We file U.S. and various state income tax returns and account for income taxes in accordance with FASC Topic 740, Income Taxes. As of September 30, 2011, we do not have any unrecognized tax benefits that if recognized would affect the effective tax rate. We do not expect to record any unrecognized tax benefits during the next twelve months.

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. At September 30, 2011, we did not have any accruals for the potential payment of interest or penalties.

-13-

As of September 30, 2011, we are subject to U.S. income tax examinations for the tax year 2010, and to Canadian income tax examinations for the tax years of 2007 through 2009. In addition, we are subject to state and local income tax examinations for the tax years 2006 through 2010. Our 2008 and 2009 U.S. tax returns are currently under audit.

13. Stock Repurchase

On November 6, 2007, we began a stock buyback program, targeting repurchases of up to approximately 10% (2.7 million shares) of our outstanding stock from time to time in open market transactions. On May 12, 2010, we completed the stock buyback program, having repurchased a total of 2,700,000 shares for an aggregate price of \$36,061,425, or an average price of \$13.36 per share. We purchased the shares at current market prices.

On May 17, 2010, the Board authorized a new stock buyback program, targeting repurchases of up to approximately 5% (approximately 1,275,000 shares) of our outstanding stock from time to time in open market transactions. Through September 30, 2011, we repurchased a total of 717,740 shares under this program for an aggregate price of \$11,509,433, or an average price of \$16.04 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 stock in their accounts sold to us to provide diversification of their investments. The number of shares to be repurchased is unknown under the program as the amount is contingent on the number of shares sold by employees. Through September 30, 2011, we repurchased 1,651,579 shares for an aggregate price of \$20,706,227, or an average price of \$12.54 per share. We purchased the shares at current market prices.

On November 7, 2006, the Board of Directors authorized us to repurchase shares from certain directors and officers following their exercise of stock options. The number of shares to be repurchased under the program is unknown as the amount is contingent on the number of shares sold. Through September 30, 2011, we repurchased 569,625 shares for an aggregate price of \$7,894,792, or an average price of \$13.86 per share. We purchased the shares at current market prices.

14. Commitments and Contingencies

We are subject to claims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability from these claims and actions, if any, will not have a material effect on our results of operations or financial position.

We are a party to several short-term, cancelable and noncancelable, fixed price contracts with major suppliers for the purchase of raw material and component parts. We expect to receive delivery of raw materials for use in our manufacturing operations from our fixed price contracts. These contracts are not accounted for as derivative instruments because they meet the normal purchases and sales exemption. In the normal course of business we expect to purchase 0.4 million pounds of aluminum at a price of \$1.138 per pound or \$0.4 million during the remainder of 2011.

15. Fair Value Measurements

We follow the provisions of FASC Topic 820, Fair Value Measurements and Disclosures related to financial assets and liabilities that are being measured and reported on a fair value basis. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market at the measurement date (exit price). We are required to classify fair value measurements in one of the following categories:

Level 1 inputs which are defined as quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs which are defined as inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly.

-14-

Level 3 inputs are defined as unobservable inputs for the assets or liabilities.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

-15-

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

We engineer, manufacture and market air-conditioning and heating equipment consisting of rooftop units, chillers, air-handling units, make-up air units, heat recovery units, condensing units, commercial self-contained units and coils. These products are marketed and sold to retail, manufacturing, educational, medical and other commercial industries. We market units to all 50 states in the United States and certain provinces in Canada. Foreign sales were approximately 5% of our 2011 sales.

We sell our products to property owners and contractors through a network of manufacturers' representatives and our internal sales force. 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 6-18 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.

Cost of goods sold consists primarily of 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.

The raw materials market was volatile during 2011 and 2010 due to the economic environment. Prices increased by approximately 8% for steel, 22% for copper and 6% for aluminum from September 30, 2010 to September 30, 2011. During 2010, we entered into an aluminum contract for 2011 purchases. The contract price was below the average index price as of September 30, 2011.

We attempt to limit the impact of price fluctuations on these materials by entering into cancelable and noncancelable fixed price contracts with our major suppliers for periods of 6 - 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations. These contracts are not accounted for as derivative instruments since they meet the normal purchases and sales exemption.

We are subject to claims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability from these claims and actions, if any, will not have a material effect on our results of operations or financial position.

Selling, general, and administrative ("SG&A") costs include our internal sales force, warranty costs, profit sharing and administrative expenses. Warranty expense is estimated based on historical trends and other factors. Our product warranty policy is: the earlier of one year from the date of first use or 18 months from date of shipment for parts only; an additional four years on compressors (if applicable); 15 years on aluminized steel gas-fired heat exchangers (if applicable); 25 years on stainless steel heat exchangers (if applicable); and 10 years on gas-fired heat exchangers in RL products (if applicable). Warranty charges on heat exchangers do not occur frequently. With the introduction of the RQ product line in 2010, our warranty policy for the RQ series was implemented to cover parts for two years from date of unit shipment and labor for one year from date of unit shipment.

Our plant and office facilities in Tulsa, Oklahoma consist of a 342,000 sq. ft. building (327,000 sq. ft. of manufacturing/warehouse space and 15,000 sq. ft. of office space) located at 2425 S. Yukon Avenue ("the original facility"), and a 693,000 sq. ft. manufacturing/warehouse building and a 22,000 sq. ft. office building ("the expansion facility") located across the street from the original facility at 2440 S. Yukon Avenue. We own both the original facility and the expansion facility.

In the expansion facility we use 22,000 sq. ft. for office space, 20,000 sq. ft. for warehouse space and 80,000 sq. ft. for two production lines; an additional 106,000 sq. ft. is utilized for sheet metal fabrication. The remaining 487,000 sq. ft.

is presently being prepared as additional plant space for long-term growth.

Other operations in Longview, Texas are conducted in a plant/office building at 203-207 Gum Springs Road, containing 258,000 sq. ft. (251,000 sq. ft. of manufacturing/ warehouse and 7,000 sq. ft. of office space). An additional 15 acres were purchased in 2004 and 2005 for future expansion. We own both the existing plant/office building, and the 15 acres designated for future expansion.

-16-

Edgar Filing: AAON INC - Form 10-Q

Set forth below is unaudited income statement information for the periods ended September 30, 2011 and 2010:

| | Three Months Ended | | | | Nine Months Ended | | | |
|--|-----------------------|---------|-----------------------|---------|-----------------------|---------|-----------------------|---------|
| | September 30, 2011 | | September 30, 2010 | | September 30, 2011 | | September 30, 2010 | |
| | (In thousands) | | | | | | | |
| Net sales | \$ 73,829 | 100 % | \$ 64,886 | 100 % | \$ 202,818 | 100 % | \$ 178,726 | 100 % |
| Cost of sales | 59,570 | 80.7 % | 52,389 | 80.7 % | 165,184 | 81.5 % | 137,729 | 77.1 % |
| Gross profit | 14,259 | 19.3 % | 12,497 | 19.3 % | 37,634 | 18.5 % | 40,997 | 22.9 % |
| Selling, general and administrative expenses | 5,445 | 7.4 % | 5,166 | 8.0 % | 16,685 | 8.2 % | 16,592 | 9.2 % |
| Income from operations | 8,814 | 11.9 % | 7,331 | 11.3 % | 20,949 | 10.3 % | 24,405 | 13.7 % |
| Interest Expense | (59) | (0.1)% | (4) | 0.0 % | (173) | (0.1)% | (4) | 0.0 % |
| Investment interest income | 11 | 0.0 % | 44 | 0.1 % | 54 | 0.0 % | 162 | 0.1 % |
| Note receivable interest income | 11 | 0.0 % | - | 0.0 % | 33 | 0.0 % | - | 0.0 % |
| Other income (expense), net | (122) | (0.2)% | (64) | (0.1)% | (690) | (0.3)% | (186) | (0.1)% |
| Income before income taxes | 8,655 | 11.6 % | 7,307 | 11.3 % | 20,173 | 9.9 % | 24,377 | 13.7 % |
| Income tax provision | 3,029 | 4.0 % | 2,134 | 3.3 % | 7,058 | 3.4 % | 8,265 | 4.7 % |
| Net income | \$ 5,626 | 7.6 % | \$ 5,173 | 8.0 % | \$ 13,115 | 6.5 % | \$ 16,112 | 9.0 % |

Results of Operations

Key events impacting our cash balance, financial condition and results of operations for the nine months ended September 30, 2011, include the following:

- A severe snowstorm in February caused extensive damage to the roof over the west manufacturing production area at our Tulsa facility affecting three production lines which resulted in eight and one-half days of lost production. Repair costs to the facility are covered by an insurance policy with a \$0.5 million deductible that was recorded in other expense in the first quarter of 2011. The lost production resulted in increased labor costs and labor inefficiencies which increased our cost of sales. The majority of the repair was completed in the third quarter. The uninsured amount of damage to equipment is yet to be determined.
- We have again taken a leading position in energy savings with the introduction of the direct drive blower which has eliminated the traditional V-belt drive, thus saving energy and maintenance problems associated with the V-belt drives. This has been made possible by advances in electronic motor control by use of variable frequency drive on

larger motors and electrically commutated motors on smaller horsepower. All of this is being further enhanced by requirements on buildings through American Society of Heating, Refrigerating and Air-Conditioning Engineers "ASHRAE" Standard 189-1 which requires one of these concepts on high efficiency buildings at the present time and will be required by ASHRAE Standard 90-1 on January 1, 2012. We also utilize a high performance composite foam panel to eliminate over half of the heat transfer from typical fiberglass insulated panels. All of these innovations increase the demand for our products thus increasing market share.

- We released new products and set up new manufacturing lines in the new Tulsa building addition in 2010.
- We attempt to moderate the volatility of certain commodity costs by utilizing purchase agreements and pricing strategies which affect our gross margins.

- In February 2006, our Board of Directors initiated a program of semi-annual cash dividend payments. Dividends of \$3.0 million were declared in June 2011 and were paid in July 2011. Cash payments of \$9.2 million were made in 2010 which included dividends of \$3.0 million declared and paid in December 2010.
- Our stock repurchases totaled \$2.7 million. This cash outlay is partially offset by cash received from options exercised by employees as a part of an incentive bonus program of \$0.5 million.
- Our operational efficiencies have contributed to a working capital balance of \$41.7 million at September 30, 2011.
- Purchases of equipment and renovations to manufacturing facilities remained a priority. Our capital expenditures were \$31.2 million. Equipment purchases create significant efficiencies, lower production costs and allow continued growth in production. We currently estimate dedicating an additional \$0.8 million to capital expenditures in 2011 for continued growth.
- The gross margin decline is partially attributable to price increases for raw materials and component parts which were offset by price increases to customers during the third quarter.

Net Sales

Net sales increased \$8.9 million or 14% to \$73.8 million from \$64.9 million for the three months, and \$24.1 million or 13% to \$202.8 million from \$178.7 million for the nine months ended, September 30, 2011 and 2010, respectively. The increase in net sales was a result of the favorable reception to our new products, a significant increase in the replacement market which is up 10% from 2010, a highly successful trade show on January 30, 2011, increased market share despite eight and one-half days of lost production due to an unprecedented severe snowstorm in February which damaged the roof and several production lines at the Tulsa facility and a price increase on one product line during the third quarter.

Gross Profit

Gross profit increased \$1.8 million or 14% to \$14.3 million from \$12.5 million for the three months, and decreased \$3.4 million or 8% to \$37.6 million from \$41.0 million for the nine months, ended September 30, 2011 and 2010, respectively. As a percentage of sales, gross margins remained constant at 19.3% for the three months, and decreased to 18.5% from 22.9% for the nine months, ended September 30, 2011 and 2010, respectively. The three month gross margin was affected by raw material price increases which were offset by a price increase related to one product line. The decrease in gross profit for the nine months was caused by a number of factors including escalating raw material and component part costs that we were unable to pass on to our customers, increased labor costs and labor inefficiencies associated with the severe snow damage at our Tulsa production facility that affected three production lines, caused eight and one-half days of lost production and adversely affected productivity due to the inability to properly heat and cool the facilities and manufacturing inefficiencies related to production facilities rearrangement.

Cost of goods sold consists primarily of 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. We also purchase from other domestic manufacturers certain components, including compressors, electric motors and electrical controls used in our products. The suppliers of these components are significantly affected by the raw material costs of steel, copper and aluminum used in their products.

The raw materials market was volatile during 2011 and 2010 due to the economic environment. Prices increased by approximately 8% for steel, 22% for copper and 6% for aluminum from September 30, 2010 to September 30, 2011. These price increases impacted our gross margins and may impact margins in future periods.

We attempt to limit the impact of price fluctuations on these materials by entering into cancelable and noncancelable fixed price contracts with our major suppliers for periods of 6 - 18 months. We expect to receive delivery of raw materials for use in our manufacturing operations from our fixed price contracts. These contracts are not accounted

for as derivative instruments since they meet the normal purchases and sales exemption.

-18-

Selling, General and Administrative Expenses

SG&A expenses remained consistent at \$5.4 million and \$5.2 million for the three months and \$16.7 million and \$16.6 million for the nine months, ended September 30, 2011 and 2010, respectively.

Other Income (Expense)

Other expense stayed consistent at \$0.1 million for the three months, and increased \$0.5 million to \$0.7 million from \$0.2 million for the nine months, ended September 30, 2011 and 2010, respectively. The increase is primarily due to repair expenses related to the damage to the west manufacturing roof at our Tulsa facility caused by a severe snowstorm in February 2011. We have an insurance deductible of \$0.5 million.

Analysis of Liquidity and Capital Resources

Our working capital and capital expenditure requirements are generally met through net cash provided by operations and occasionally, based on current liquidity at the time, the revolving bank line of credit.

General

Our revolving credit facility provides for maximum borrowings of \$30.0 million which is provided by the Bank of Oklahoma, National Association. Under the line of credit, there is one standby letter of credit totaling \$2.4 million. Borrowings available under the revolving credit facility at September 30, 2011, were \$13.7 million. Interest on borrowings is payable monthly at LIBOR plus 2.5% (2.7% at September 30, 2011). No fees are associated with the unused portion of the committed amount. We had a \$14.0 million outstanding balance under the revolving credit facility at September 30, 2011. We had no borrowings outstanding under the revolving credit facility at December 31, 2010.

On July 30, 2011, we renewed the line of credit with a maturity date of July 29, 2012. The renewal increased our maximum borrowings to \$30.0 million. Per the renewed agreement, interest on borrowings will be payable monthly at LIBOR plus 2.5% per annum, the tangible net worth requirement shall be at or above \$95.0 million and our working capital requirement remains at \$30.0 million until December 31, 2011. As of December 31, 2011, the working capital requirement minimum will be \$35.0 million and as of June 30, 2012 will increase to \$40.0 million.

At September 30, 2011, we were in compliance with our financial ratio covenants. The covenants are related to our tangible net worth, total liabilities to tangible net worth ratio and working capital. At September 30, 2011 our tangible net worth was \$125.3 million which meets the requirement of being at or above \$95.0 million. Our total liabilities to tangible net worth ratio was 0.45 to 1 which meets the requirement of not being above 2 to 1. Our working capital was \$41.7 million which meets the requirement of being at or above \$30.0 million. Effective January 1, 2011, as a requirement of our workers compensation insurance, our standby letter of credit was extended with an increase of \$1.5 million to \$2.4 million and will expire December 31, 2011. We expect to renew our revolving credit agreement again in July 2012. We do not anticipate that the current situation in the credit market will impact that renewal.

Management believes our projected cash flows from operations and bank revolving credit facility, or comparable financing, will provide the necessary liquidity and capital resources for fiscal year 2011 and the foreseeable future. Our belief that we will have the necessary liquidity and capital resources is based upon our knowledge of the heating, ventilation, and air conditioning ("HVAC") industry and our place in that industry, our ability to limit the growth of our business if necessary, our ability to adjust dividend cash payments, capital expenditures and our relationship with the existing bank lender.

Cash Flows from Operating Activities

Net cash provided by operating activities decreased in the nine months ended September 30, 2011, by \$12.4 million from the nine months ended September 30, 2010. The decrease was primarily due to a decline in net income, accounts payable and accrued liabilities and increases in inventories, partially offset by a decrease in accounts receivable.

Cash Flows from Investing Activities

Cash flows used in investing activities were \$20.3 million and \$26.0 million for the nine months ended September 30, 2011 and 2010, respectively. The decrease in cash flows used in investing activities in 2011 was related to maturities of investments in certificates of deposit and corporate notes and bonds that were purchased in 2010, partially offset by an increase in capital expenditures. Management utilizes cash flows provided from operating activities and investing activities to fund capital expenditures that are expected to increase growth and create efficiencies. We expect to expend an additional \$0.8 million in the remainder of 2011 for a building addition at the Tulsa facility and machinery and equipment to accommodate anticipated growth. We expect the cash requirements to be primarily provided by cash flows from operations, matured investments and borrowing from our revolving loan agreement.

Cash Flows from Financing Activities

Cash flows provided by financing activities were \$8.9 million for the nine months ended September 30, 2011 as compared to cash flows used in financing activities of \$19.3 million for the nine months ended September 30, 2010. The increase of cash provided by financing activities is due to borrowings on the revolving credit facility and decreases in the repurchase of stock and cash dividends paid.

We had a \$14.0 million outstanding balance under the revolving credit facility at September 30, 2011. We did not have an outstanding balance under the revolving credit facility at December 31, 2010. We repurchased shares of stock from employees' 401(k) savings and investment plan in the amount of \$2.7 million for 161,848 shares of stock and \$18.4 million for 1,171,409 shares of stock for the nine months ended September 30, 2011 and 2010, respectively.

We received cash from stock options exercised of approximately \$373,000 and classified the excess tax benefit of stock options exercised and restricted stock awards vested of approximately \$176,000 in financing activities for the nine months ended September 30, 2011. The cash received for options exercised and income tax effect partially offset the stock repurchase for the nine months ended September 30, 2011.

Dividends payable of \$3.0 million were declared in June 2011 and were paid in July 2011. Cash payments of \$9.2 million were made in 2010 which included dividends of \$3.0 million declared and paid in December 2010.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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, future 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 on a monthly basis.

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, 2010. There have been no significant changes in critical accounting

policies or management estimates other than as related to investments stated below since the year ended December 31, 2010.

-20-

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” 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.

Interest Rate Risk

With the July 30, 2011 renewal of the revolving credit facility, we are subject to interest rate risk of LIBOR plus 2.5%. Prior to the renewal, the rate was the greater of 4% or LIBOR plus 2.5%. At September 30, 2011, the outstanding balance under the revolving credit facility was \$14.0 million.

Commodity Price Risk

Cost of goods sold consists primarily of 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. The raw materials market was volatile during 2011 and 2010 due to the economic environment. Prices increased by approximately 8% for steel, 22% for copper and 6% for aluminum from September 30, 2010 to September 30, 2011. During 2010, we entered into an aluminum contract for 2011 purchases. The contract price was below the average index price as of September 30, 2011.

We attempt to limit the impact of price fluctuations on these materials by entering into cancelable and noncancelable fixed price contracts with our major suppliers for periods of 6 - 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations. These contracts are not accounted for as financial derivative instruments since they meet the normal purchases and sales exemption.

We do not utilize financial derivative financial instruments to hedge our interest rate risk. We occasionally use financial derivatives to economically hedge our commodity price risk.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

At the end of the period covered by this Quarterly Report on Form 10-Q, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer believe that:

- Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and

-21-

- Our disclosure controls and procedures operate such that important information flows to appropriate collection and disclosure points in a timely manner and are effective to ensure that such information is accumulated and communicated to our management, and made known to our Chief Executive Officer and Chief Financial Officer, particularly during the period when this Quarterly Report was prepared, as appropriate to allow timely decisions regarding the required disclosure.

Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures and concluded that these controls and procedures were effective as of September 30, 2011.

Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1A. Risk Factors.

There have been no material changes in risk factors as previously disclosed in our Form 10-K in response to Item 1A, to Part I of Form 10-K.

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

On November 6, 2007, our Board of Directors authorized a stock buyback program, targeting repurchases of up to approximately 10% (2.7 million shares) of our outstanding stock from time to time in open market transactions. On May 12, 2010, we completed the stock buyback program, having repurchased a total of 2,700,000 shares for an aggregate price of \$36,061,425, or an average price of \$13.36 per share. We purchased the shares at current market prices.

On May 17, 2010, the Board authorized a new stock buyback program, targeting repurchases of up to approximately 5% (approximately 1,275,000 shares) of our outstanding stock from time to time in open market transactions. Through September 30, 2011, we repurchased a total of 717,740 shares under this program for an aggregate price of \$11,509,433, or an average price of \$16.04 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 stock in their accounts sold to us to provide diversification of their investments. The number of shares to be repurchased is contingent upon the number of shares sold by employees. Through September 30, 2011, we repurchased 1,651,579 shares for an aggregate price of \$20,706,227, or an average price of \$12.54 per share. We purchased the shares at current market prices.

On November 7, 2006, the Board of Directors authorized us to repurchase shares from certain directors and officers following their exercise of stock options. The number of shares to be repurchased is contingent upon the number of shares sold. Through September 30, 2011, we repurchased 569,625 shares for an aggregate price of \$7,894,792, or an average price of \$13.86 per share. We purchased the shares at current market prices.

The numbers of shares stated above have been adjusted for the three-for-two stock split effective June 13, 2011.

Repurchases during the third quarter of 2011 were as follows:

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid Per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|----------------|---|--|---|---|
| July 2011 | 14,249 | \$ 22.88 | 14,249 | - |
| August 2011 | 9,370 | 18.89 | 9,370 | - |
| September 2011 | 22,914 | 16.33 | 22,914 | - |
| Total | 46,533 | \$ 18.85 | 46,533 | - |

Item 3. Defaults Upon Senior Securities.

None.

-23-

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

None

Item 5. Other Information.

On May 4, 2011, the Company's Board of Directors approved a three-for-two stock split of AAON's outstanding stock for shareholders of record as of May 27, 2011. The stock split was effected in the form of a 50% stock dividend which was distributed on June 13, 2011. The applicable share and per share data for all periods included herein has been restated to reflect the stock split.

On May 17, 2011, the Board of Directors approved a semi-annual cash dividend of \$0.18 per share to the holders of our outstanding Common Stock as of the close of business on June 10, 2011, the record date. Those dividends were paid on July 1, 2011. The \$0.18 per share dividend was effective prior to the June 13, 2011 stock split; but has been restated to \$0.12 per share to reflect the split.

Item 6. Exhibits.

- | | | |
|-------|---------------------|-----------------------------------|
| (a) | Exhibits | |
| (i) | <u>Exhibit 31.1</u> | Section 302 Certification of CEO |
| (ii) | <u>Exhibit 31.2</u> | Section 302 Certification of CFO |
| (iii) | <u>Exhibit 32.1</u> | Section 1350 Certification of CEO |
| (iv) | <u>Exhibit 32.2</u> | 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: November 8, 2011

By:

/s/ Norman H. Asbjornson
Norman H. Asbjornson
President/CEO

Dated: November 8, 2011

By:

/s/ Kathy I. Sheffield
Kathy I. Sheffield
Vice President/CFO