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AAON INC
Form 10-Q
May 09, 2007

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, 2007
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
of incorporation or organization)

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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 May 1, 2007, registrant had outstanding a total of 12,450,506 shares of its \$.004 par value Common Stock.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

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

| | March 31, 2007 |
|--|-----------------------|
| | (in thousands, except |
| Assets | |
| Current assets: | |
| Cash and cash equivalents | \$ 550 |
| Accounts receivable, net | 37,535 |
| Inventories, net | 32,684 |
| Prepaid expenses and other | 307 |
| Deferred tax assets | 3,783 |
| Total current assets | 74,859 |
| Property, plant and equipment, net | 61,490 |
| Notes receivable, long-term | 75 |
| Total assets | \$ 136,424 |
| Liabilities and Stockholders' Equity | |
| Current liabilities: | |
| Current maturities of long-term debt | \$ 32 |
| Accounts payable | 14,870 |
| Dividends payable | - |
| Accrued liabilities | 19,413 |
| Total current liabilities | 34,315 |
| Other long-term liabilities | 104 |
| Deferred tax liabilities | 3,740 |
| Commitments and contingencies | |
| Stockholders' equity: | |
| Preferred stock, \$.001 par value, 5,000,000 shares authorized, no shares issued | - |
| Common stock, \$.004 par value, 50,000,000 shares authorized, 12,457,383 and 12,338,832 issued and outstanding at March 31, 2007, and December 31, 2006, respectively | 50 |
| Additional paid-in capital | 962 |
| Accumulated other comprehensive income, net of tax | 666 |
| Retained earnings | 96,587 |
| Total stockholders' equity | 98,265 |
| Total liabilities and stockholders' equity | \$ 136,424 |

The accompanying notes are an integral part of these statements.

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

| | Three Months Ended March 31, 2007 | Ma |
|---|--------------------------------------|----|
| | (in thousands, except share and pe | |
| Net sales | \$ 58,628 | |
| Cost of sales | 42,906 | |
| Gross profit | 15,722 | |
| Selling, general and administrative expenses | 5,747 | |
| Income from operations | 9,975 | |
| Interest expense | (10) | |
| Interest income | 3 | |
| Other income, net | 188 | |
| Income before income taxes | 10,156 | |
| Income tax provision | 3,839 | |
| Net income | \$ 6,317 | |
| Earnings Per Share: | | |
| Basic | \$ 0.51 | |
| Diluted | \$ 0.50 | |
| Weighted Average Shares Outstanding: | | |
| Basic | 12,374 | |
| Diluted | 12,612 | |

The accompanying notes are an integral part of these statements.

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AAON, Inc., and Subsidiaries Consolidated Statement of Stockholders' Equity and Comprehensive Income (unaudited)

| Common Stock Shares | Amount | Paid-in Capital | Accumulated Other Comprehensive Income |
|------------------------|--------|--------------------|---|
|------------------------|--------|--------------------|---|

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(in thousands)

| | | | | |
|---|--------|-------|---------|--------|
| Balance at December 31, 2006 | 12,339 | \$ 49 | \$ 210 | \$ 667 |
| Adjustment for the adoption of FASB Interpretation (FIN) No. 48 | - | - | - | - |
| Comprehensive income: | | | | |
| Net income | - | - | - | - |
| Foreign currency translation adjustment | - | - | - | (1) |
| Total comprehensive income | | | | |
| Stock options exercised, including tax benefits | 179 | 1 | 2,222 | - |
| Share based compensation | - | - | 163 | - |
| Stock repurchased and retired | (61) | - | (1,633) | - |
| Balance at March 31, 2007 | 12,457 | \$ 50 | \$ 962 | \$ 666 |

The accompanying notes are an integral part of these statements.

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

Three Months
Ended
March 31, 2007

(in thousands)

OPERATING ACTIVITIES

| | |
|---|----------|
| Net income | \$ 6,317 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Depreciation | 2,273 |
| Provision for losses on accounts receivable | 186 |
| Gain on disposition of assets | (13) |
| Share-based compensation | 163 |
| Excess tax benefits from stock options exercised | (1,563) |
| Deferred income taxes | (148) |
| Changes in assets and liabilities: | |
| Accounts receivable | (973) |
| Inventories | (3,179) |
| Prepaid expenses and other | (41) |
| Accounts payable | (955) |
| Accrued liabilities | 4,624 |
| Net cash provided by operating activities | 6,691 |

INVESTING ACTIVITIES

| | |
|---|---------|
| Proceeds from sale of property, plant and equipment | 13 |
| Proceeds from matured certificate of deposit | - |
| Investment in certificate of deposit | - |
| Capital expenditures | (4,537) |
| Net cash used in investing activities | (4,524) |

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FINANCING ACTIVITIES

| | |
|---|---------|
| Borrowings under revolving credit facility | 8,537 |
| Payments under revolving credit facility | (8,537) |
| Payments of long-term debt | (27) |
| Stock options exercised | 659 |
| Excess tax benefits from stock options exercised | 1,563 |
| Repurchase of stock | (1,633) |
| Cash dividends paid to stockholders | (2,465) |
| Net cash (used in) provided by financing activities | (1,903) |
| Effect of exchange rate on cash | (2) |
| Net Increase in cash and cash equivalents | 262 |
| Cash and cash equivalents, beginning of year | 288 |
| Cash and cash equivalents, end of period | \$ 550 |

The accompanying notes are an integral part of these statements.

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AAON, Inc., and Subsidiaries Notes to the Consolidated Financial Statements March 31, 2007 (unaudited)

1. BASIS OF PRESENTATION

The financial statements included herein have been prepared by the Company, 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. The Company believes 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 the Company's latest audited financial statements which were included in the Form 10-K Report for the fiscal year ended December 31, 2006, filed by AAON, Inc. with the SEC. In the opinion of management, the accompanying financial statements include all normal, recurring adjustments and estimated provisions considered necessary by management to fairly state the results of the periods presented. Operating results for the three months ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Currency

Foreign currency transactions and financial statements are translated in accordance with Statement of Financial Standards ("SFAS") No. 52, Foreign Currency Translations. The Company uses the U.S. dollar as its functional currency, except for the Company's Canadian subsidiaries, which use the Canadian dollar. Adjustments arising from translation of the Canadian subsidiaries'

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financial statements are reflected in the Consolidated Statement of Stockholders' Equity and Comprehensive income. Transaction gains or losses that arise from exchange rate fluctuations applicable to transactions are denominated in Canadian currency and are included in Other income in the results of operations as incurred.

New Accounting Pronouncements

In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109, Accounting for Income Taxes. This interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recorded a \$551,000 increase in the liability for unrecognized tax benefits, which is offset by an increase of the deferred tax assets of \$155,000, resulting in a decrease to the January 1, 2007, retained earnings balance of \$396,000 (for additional information see Note 8 to the Consolidated Financial Statements).

In September 2006, the FASB released SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value and establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. Although SFAS 157 applies to (and amends) the provisions of existing authoritative literature, it does not, of itself, require any new fair value measurements or establish valuation standards. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will adopt SFAS 157 on January 1, 2008. Adoption of SFAS 157 is not expected to have a material impact on the Company's Consolidated Financial Statements.

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In February, 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which creates an alternative measurement treatment for certain financial assets and financial liabilities. SFAS 159 permits fair value to be used for both the initial and subsequent measurements on an instrument by instrument basis, with changes in the fair value to be recognized in earnings as those changes occur. This election is referred to as the fair value option. SFAS 159 also requires additional disclosures to compensate for the lack of comparability that will arise from the use of the fair value option. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Adoption of SFAS 159 is not expected to have a material impact on the Company's Consolidated Financial Statements.

2. ACCOUNTS RECEIVABLE

The Company grants credit to its customers and performs ongoing credit evaluations. The Company generally does not require collateral or charge interest. The Company establishes 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 receivable. Past due accounts are generally written off against the allowance for doubtful accounts only after

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all collection attempts have been exhausted.

Accounts receivable balances at March 31, 2007 and December 31, 2006 and the changes in the allowance for doubtful accounts for the three months ended March 31, 2007 and 2006 are as follows:

| | March 31, 2007 | December 31, 2006 |
|---------------------------------------|-------------------|----------------------|
| | ----- | |
| | (in thousands) | |
| Accounts receivable | \$ 37,986 | \$ 37,014 |
| Less: allowance for doubtful accounts | (451) | (266) |
| | ----- | |
| Total, net | \$ 37,535 | \$ 36,748 |
| | ===== | |

| | March 31, 2007 | March 31, 2006 |
|--|-------------------|-------------------|
| | ----- | |
| | (in thousands) | |
| Allowance for doubtful accounts: | | |
| Balance, beginning of period | \$ 266 | \$ 685 |
| Provision for losses on accounts receivable | 244 | 106 |
| Adjustments to provision | (58) | (49) |
| Accounts receivable written off, net of recoveries | (1) | (167) |
| | ----- | |
| Balance, end of period | \$ 451 | \$ 575 |
| | ===== | |

3. INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method. The Company establishes 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 at March 31, 2007 and December 31, 2006, and the changes in the allowance for excess and obsolete inventories account for the three months ended March 31, 2007 and 2006, are as follows:

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| | March 31, 2007 | December 31, 2006 |
|-----------------|-------------------|----------------------|
| | ----- | |
| | (in thousands) | |
| Raw materials | \$ 27,688 | \$ 25,977 |
| Work in process | 2,650 | 2,226 |
| Finished goods | 2,696 | 1,649 |
| | ----- | |
| | 33,034 | 29,852 |

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| | | |
|-------------------------|-----------|-----------|
| Less: Inventory reserve | (350) | (350) |
| Total, net | \$ 32,684 | \$ 29,502 |

| | Three Months Ended March 31, 2007 | March 31, 2006 |
|--|---|-------------------|
| | (in thousands) | |
| Allowance for excess and obsolete inventories: | | |
| Balance, beginning of period | \$ 350 | \$ 350 |
| Provision for excess and obsolete inventories | - | - |
| Adjustments to reserve | - | - |
| Balance, end of period | \$ 350 | \$ 350 |

4. ACCRUED LIABILITIES

At March 31, 2007, and December 31, 2006, accrued liabilities were comprised of the following:

| | March 31, 2007 | December 31, 2006 |
|------------------------|-------------------|----------------------|
| | (in thousands) | |
| Warranty | \$ 6,000 | \$ 5,572 |
| Commissions | 7,310 | 6,862 |
| Payroll | 2,249 | 1,890 |
| Income taxes | 2,129 | - |
| Workers' compensation | 415 | 494 |
| Medical self-insurance | 696 | 837 |
| Other | 614 | 403 |
| Total | \$ 19,413 | \$ 16,058 |

5. REVOLVING CREDIT FACILITY

The Company's revolving credit facility provides for maximum borrowings of \$15.2 million which is provided by the Bank of Oklahoma, National Association. Under the line of credit, there is one standby letter of credit totaling approximately \$600,000. The letter of credit is a requirement of the Company's workers compensation insurance and will expire December 31, 2007. Interest on borrowings is payable monthly at the Wall Street Journal prime rate less 0.5% or LIBOR plus 1.6%, at the election of the Company (6.92% at March 31, 2007). No fees are associated with the unused portion of the committed amount. At March 31, 2007 and December 31, 2006, the Company had no borrowings outstanding under the revolving credit facility. Borrowings available under the revolving credit facility at March 31, 2007, were \$14.6 million. The credit facility requires the Company to maintain certain financial ratios. At March 31, 2007, the Company was

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in compliance with its financial ratio covenants. The line of credit has a maturity date of July 30, 2007.

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6. STOCK COMPENSATION

The Company maintains a stock option plan for key employees, directors and consultants. The Company's stock option plan provided for 2,925,000 shares of common stock to be issued under the plan. Under the terms of the 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 nine years thereafter. Options granted to directors on or after May 25, 2004, vest one-third each after 1-3 years. 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.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R) Share-Based Payment (SFAS 123R), using the modified-prospective-transition provisions. Under that transition method, compensation cost recognized in 2006 and the first three months of 2007 includes all share-based payments granted prior to, but not yet vested as of January 1, 2006, and compensation cost for all share-based payments granted subsequent to January 1, 2006. The compensation cost is based on the grant date fair value calculated using a Black-Scholes-Merton Option Pricing Model in accordance with provisions of Statement 123(R).

For the three month periods ended March 31, 2007 and 2006, the Company recognized approximately \$163,000 and \$129,000, respectively, in pre-tax compensation expense in the Consolidated Statements of Income related to the stock option plan. The total pre-tax compensation cost related to nonvested stock options not yet recognized as of March 31, 2007, is \$2.0 million and is expected to be recognized over a weighted-average period of 2.5 years. Statement 123(R) requires that cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) be classified as financing cash flows. For the three months ended March 31, 2007 and 2006, \$1,563,000 and \$612,000, respectively, of such excess tax benefits from share-based payment plans was classified as financing cash flows.

The following assumptions were used to determine the fair value of the unvested stock options on the original grant date for expense recognition purposes for options granted during the three months ended March 31, 2007 and March 31, 2006. No Options were granted to directors or officers for the three months ended March 31, 2007.

| | Three Months Ended | |
|-------------------------|--------------------|-------------------|
| | March 31, 2007 | March 31, 2006 |
| ----- | | |
| Directors and Officers: | | |
| Expected dividend yield | N/A | - |
| Expected volatility | N/A | 32.32% |
| Risk-free interest rate | N/A | 4.86% |
| Expected life | N/A | 8.0 yrs |
| Forfeiture Rate | N/A | 0% |
| Employees: | | |
| Expected dividend yield | 1.47% | - |
| Expected volatility | 42.24% | 32.32% |

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| | | |
|-------------------------|----------|---------|
| Risk-free interest rate | 4.77% | 4.86% |
| Expected life | 6.30 yrs | 8.0 yrs |
| Forfeiture Rate | 28% | 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 the Company's stock. The Company had not declared dividends in prior years, but initiated a dividend payout in the second quarter of 2006. The Company used board approved semi-annual dividend payouts of \$0.20 per share to calculate the expected dividend yield.

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The following is a summary of stock options outstanding as of March 31, 2007:

| Range of Exercise Prices | Options Outstanding | | | |
|-----------------------------|--|---|--|---------------------------------|
| | Number Outstanding at March 31, 2007 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| \$3.39 - \$3.39 | 80,698 | 0.79 | \$ 3.39 | \$ 22.74 |
| \$4.00 - \$5.78 | 250,730 | 2.18 | 4.98 | 21.15 |
| \$8.59 - \$16.94 | 181,575 | 5.55 | 12.59 | 13.54 |
| \$17.10 - \$18.00 | 50,000 | 8.27 | 17.71 | 8.42 |
| \$19.02 - \$22.32 | 82,250 | 6.38 | 20.08 | 6.05 |
| \$23.32 - \$27.65 | 186,000 | 9.45 | 25.18 | 0.95 |
| Total | 831,253 | 5.19 | \$ 13.27 | \$ 12.86 |

A summary of option activity under the plan as of March 31, 2007, is as follows:

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term |
|--------------------------------|-----------|------------------------------------|---|
| Outstanding at January 1, 2007 | 974,330 | \$ 11.00 | |
| Granted | 37,500 | 25.98 | |
| Exercised | (179,227) | 3.68 | |
| Forfeited or Expired | (1,350) | 5.78 | |
| Outstanding at March 31, 2007 | 831,253 | 13.27 | 5.19 |
| Exercisable at March 31, 2007 | 525,433 | \$ 8.00 | 3.00 |

The weighted average grant date fair value of options granted during the three months ended March 31, 2007 was \$11.15. The total intrinsic value of options

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exercised during the three months ended March 31, 2007 was \$4.12 million. The cash received from options exercised during the three months ended March 31, 2007 was \$659,000. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statements of Cash Flows.

A summary of the unvested options for the three month period ended March 31, 2007, is as follows:

| | Shares | Weighted Average Grant Date Fair Value |
|------------------------------|---------|--|
| Nonvested at January 1, 2007 | 277,320 | \$ 9.13 |
| Granted | 37,500 | \$ 11.15 |
| Vested | (9,000) | \$ 7.34 |
| Forfeited | - | \$ - |
| Nonvested at March 31, 2007 | 305,820 | \$ 9.43 |

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7. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

| | Three Months Ended March 31, 2007 | March 31, 2006 |
|--|---|----------------|
| | (in thousands, except share and per share data) | |
| Numerator: | | |
| Net income | \$ 6,317 | \$ 3,743 |
| Denominator: | | |
| Denominator for basic earnings per share- Weighted average shares | 12,374,064 | 12,277,155 |
| Effect of dilutive stock options | 237,473 | 359,642 |
| Denominator for diluted earnings per share- Weighted average shares | 12,611,537 | 12,633,797 |
| Basic earnings per share | \$ 0.51 | \$ 0.30 |
| Diluted earnings per share | \$ 0.50 | \$ 0.30 |
| Anti-dilutive shares | 172,000 | 79,500 |
| Weighted average exercise price | \$ 25.33 | \$ 18.45 |

8. INCOME TAXES

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. Effective January 1,

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2007, the Company adopted FIN 48. In accordance with FIN 48, the Company recorded \$551,000 increasing its liability for unrecognized tax benefits, interest, and penalties, which is offset by an increase of the deferred tax assets of \$155,000, resulting in a decrease to the January 1, 2007, retained earnings balance of \$396,000. The total amount of unrecognized tax benefits that if recognized would affect the effective tax rate is \$396,000. Included in the balance of unrecognized tax benefits at January 1, 2007, is \$447,000 related to tax positions for which it is reasonably possible that the total amounts could significantly decrease during the next twelve months. This amount represents the unrecognized tax benefits comprised of items related to determination of state nexus which should be resolved through a voluntary compliance program to be initiated during the three months ended June 30, 2007.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in Income tax expense. At January 1, 2007, the Company had accrued \$141,000 and \$29,000 for the potential payment of interest and penalties, respectively.

As of January 1, 2007, the Company is subject to U.S. Federal income tax examinations for the tax years 2003 through 2006, and to non-U.S. income tax examinations for the tax years of 2004 through 2006. In addition, the Company is subject to state and local income tax examinations for the tax years 2001 through 2006.

There were no significant changes to any of these amounts during the first quarter of 2007.

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9. STOCK REPURCHASE

Following repurchases of approximately 12% of its outstanding Common Stock between September 1999 and September 2001, the Company announced and began a stock repurchase program on October 17, 2002, targeting repurchases of up to an additional 10% (1,325,000 shares) of its outstanding stock. Through December 31, 2006, the Company had repurchased a total of 1,257,864 shares under the current program for an aggregate price of \$22,034,568, or an average of \$17.52 per share. On February 14, 2006, the Board of Directors approved the suspension of the Company's repurchase program.

On July 1, 2005, the Company entered into a stock repurchase arrangement by which employee participants in AAON's 401(k) savings and investment plan are entitled to have shares of AAON stock in their accounts sold to the Company to provide diversification of their investments. Through March 31, 2007, the Company repurchased 262,352 shares for an aggregate price of \$5,615,000 or an average price of \$21.40 per share.

On November 7, 2006, the Board of Directors authorized the Company to repurchase shares from certain directors following their exercise of stock options expiring on March 11, 2007. To date, the Company repurchased 44,875 shares for an aggregate price of \$1,203,000 or an average price of \$26.81.

10. CONTINGENCIES

The Company is subject to claims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability, if any, will not have a material effect on the Company's results of operations or financial position.

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

AAON engineers, manufactures and markets air-conditioning and heating equipment consisting of standardized and custom rooftop units, chillers, air-handling units, make-up units, heat recovery units, condensing units, coils and boilers. The Company has successfully gained market share through its "semi-custom" product lines, which offer the customer value, quality, function, serviceability and efficiency. Custom units are marketed and sold to retail, manufacturing, educational, medical and other commercial industries. AAON markets units to all 50 states in the United States and certain provinces in Canada. International sales are less than five percent as the majority of all sales are domestic.

AAON sells its products to property owners and contractors through a network of manufacturers' representatives and its internal sales force. Demand for the Company's 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, the Company emphasizes the replacement market.

The principal components of cost of goods sold are labor, raw materials, component costs, factory overhead, freight out and engineering expense. The principal raw materials used in AAON's manufacturing processes are steel, copper and aluminum. Raw materials ranged in prices and at times increases were incurred up to approximately 24% for steel, 42% for aluminum and 400% for copper from 2004 to March 31, 2007. The increases resulted in economic challenges to AAON. AAON reviewed and adjusted current pricing strategies, created efficiencies in production, and continued relationships with suppliers in order to mitigate the economic factors of increasing commodity prices. The major component costs include compressors, electric motors and electronic controls, which also increased due to increases in commodities.

Selling, general, and administrative ("SG&A") costs include the Company's internal sales force, warranty costs, profit sharing and administrative expense. Warranty expense is estimated based on historical trends and other factors. The Company's warranty on its products is: for parts only, the earlier of one year from the date of first use or 14 months from date of shipment; compressors (if applicable), an additional four years; on gas-fired heat exchangers (if applicable), 15 years; and on stainless steel heat exchangers (if applicable), 25 years. Warranty charges on heat exchangers do not occur frequently.

The office facilities of the Company consist of a 337,000 square foot building (322,000 sq. ft. of manufacturing/warehouse space and 15,000 sq. ft. of office space) located at 2425 S. Yukon Avenue, Tulsa, Oklahoma (the "original facility"), and a 563,000 square foot manufacturing/warehouse building and a 22,000 square foot office building (the "expansion facility") located across the street from the original facility at 2440 S. Yukon Avenue. The Company utilizes 39% of the expansion facility and the remaining 61% is leased to a third party.

Other operations are conducted in a plant/office building at 203-207 Gum Springs Road in Longview, Texas, containing 258,000 square feet (251,000 sq. ft. of manufacturing/warehouse and 7,000 sq. ft. of office space). An additional 15 acres of land was purchased for future expansion in 2004 and 2005 in Longview, Texas. The Company's operations in Burlington, Ontario, Canada, are located at 279 Sumach Drive, consisting of an 82,000 sq. ft. office/manufacturing facility on a 5.6 acre tract of land.

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Set forth below is unaudited income statement information with respect to the Company for the periods ended March 31, 2007 and 2006:

| | Three Months Ended March 31, | | | |
|--|------------------------------|--------|-----------|--------|
| | 2007 | | 2006 | |
| | ---- | | ---- | |
| | (in thousands) | | | |
| Net sales | \$ 58,628 | 100.0% | \$ 53,620 | 100.0% |
| Cost of sales | 42,906 | 73.2% | 43,236 | 80.6% |
| | ----- | | ----- | |
| Gross profit | 15,722 | 26.8% | 10,384 | 19.3% |
| Selling, general and administrative expenses | 5,747 | 9.8% | 4,565 | 8.5% |
| | ----- | | ----- | |
| Income from operations | 9,975 | 17.0% | 5,819 | 10.8% |
| | ----- | | ----- | |
| Interest expense | (10) | 0.0% | (12) | 0.0% |
| Interest income | 3 | 0.0% | 9 | 0.0% |
| Other income, net | 188 | 0.3% | 126 | 0.2% |
| | ----- | | ----- | |
| Income before income taxes | 10,156 | 17.3% | 5,942 | 11.0% |
| Income tax provision | 3,839 | 6.5% | 2,199 | 4.1% |
| | ----- | | ----- | |
| Net income | \$ 6,317 | 10.8% | \$ 3,743 | 7.0% |
| | ===== | | ===== | |

Results of Operations

Key events impacting AAON's cash balance, financial condition, and results of operations for the three months ended March 31, 2007 include the following:

- o Effective moderation of commodity costs with purchase agreements and pricing strategies affected gross margin positively, which resulted in significantly higher revenues and income.
- o In February 2006, the Board of Directors authorized a semi-annual cash dividend payment. Cash dividends were declared in the fourth quarter of 2006, but were not paid until January of 2007, affecting cash by \$2.5 million.
- o Stock repurchases of AAON stock from employee's 401(k) savings and investments plan was authorized in 2005. AAON continued to repurchase stock from employees and made repurchases from other incentive plans throughout the three months ended March 31, 2007, resulting in cash payments of \$1.6 million. This cash outlay is partially offset by cash received from options exercised by employees as a part of an incentive bonus program. The cash received in the first quarter of 2007 from options exercised was \$659,000.
- o Purchases of equipment to create efficiencies remained a priority. AAON capital expenditures were \$4.5 million. Equipment purchases and proper upkeep of manufacturing facilities create significant efficiencies, lower production costs and allow continued growth in production. The Company currently estimates it will spend a total of approximately \$10.0 million on capital expenditures in 2007 for continued growth.

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Net Sales

Net sales were approximately \$58.6 million and \$53.6 million for the three months ended March 31, 2007 and 2006, respectively. The increase of 9.3% in sales is due in part from certain pricing strategies implemented in 2006 and are now being fully recognized as back orders from 2006 become completed. Management anticipates continued growth throughout 2007.

Gross Profit

Gross profits for the three months ended March 31, 2007 and 2006 were \$15.7 million and \$10.4 million, respectively. As a percentage of sales, gross margins were 26.8% and 19.4% for the three months ended March 31, 2007 and 2006. This increase in gross profit of 51.0% results from pricing strategies becoming fully utilized and production and labor efficiencies as volume remains at a high and steady level. The Company also began to see a leveling off of raw material increases, thus lowering the cost of raw materials and allowing for higher gross profits.

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Steel, copper and aluminum are high volume materials used in the manufacturing of the Company's products, which are obtained from domestic suppliers. Raw materials ranged in prices and at times increases were incurred up to approximately 24% for steel, 42% for aluminum and 400% for copper from 2004 to March 31, 2007, causing increased inventory costs. The Company also purchases from other domestic manufacturers certain components, including compressors, electric motors and electrical controls used in its products. The suppliers of these components are significantly affected by the rising raw material costs, as steel, copper and aluminum are used in the manufacturing of their products; therefore the Company is also experiencing price increases from component part suppliers. The Company is beginning to see some leveling off of the increases in certain materials, but continues to monitor these costs and price units accordingly. The Company instituted several price increases from 2004 to 2006 to customers in an attempt to offset the continued increases in steel, copper and aluminum. The Company attempts to limit the impact of price increases on these materials by entering into cancelable fixed price contracts with its major suppliers for periods of 6-12 months.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$5.7 million and \$4.6 million for the three months ended March 31, 2007 and 2006, respectively. The increase in selling, general and administrative expenses was primarily caused by an increase in profit sharing due to increased net income. The Company contributes 10% of pre-tax profit to all eligible employees equally on a quarterly basis to reward employee productivity. Other increases included sales expenditures for an annual representative meeting and other sales related expenses.

Other Income

Other income was \$188,000 and \$126,000 for the three months ended March 31, 2007 and 2006, respectively. Other income is attributable primarily to rental income from the Company's expansion facility. All expenses associated with the facility that are allocated to the rental portion of the building are included in other income. The Company plans to continue to monetize the expansion facility until it is needed for increased capacity.

Analysis of Liquidity and Capital Resources

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AAON's working capital and capital expenditure requirements are generally met through net cash provided by operations and the revolving bank line of credit.

CASH FLOWS PROVIDED BY OPERATING ACTIVITIES. Net cash provided by operating activities decreased in the three months ended March 31, 2007 by \$579,000 from the prior years three months ended March, 31, 2006. The decrease is primarily the result of increased inventory due to increased levels to accommodate future sales. The increased inventory is partially offset by the increase in Net Income based on factors stated above.

CASH FLOWS USED IN INVESTING ACTIVITIES. Cash flows used in investing activities were \$4.5 million and \$5.0 million for the three months ended March 31, 2007 and 2006, respectively. The decrease in cash flows used in investing activities in 2007 was primarily related to lower capital expenditures of \$4.5 million for additions to manufacturing facilities, machinery and equipment compared to \$6.0 million for the same period in 2006. Capital expenditures in 2007 related to building renovations and machinery and equipment to further automate production. Management utilizes cash flows provided from operating activities to fund capital expenditures that are expected to spur growth and create efficiencies. The Company is currently in line with budgeted capital expenditures of approximately \$10.0 million in 2007 for equipment requirements. The Company expects the cash requirements to be provided from cash flows from operations.

For the three months ended March, 31, 2007, the Company did not invest nor receive proceeds from any certificate of deposits. For the same period in 2006, the Company received proceeds from the investment of \$1 million invested in 2005 and reinvested another \$500 million, which became due within the first quarter of 2006.

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CASH FLOWS USED IN FINANCING ACTIVITIES. Cash flows used in financing activities were \$1.9 million for the three months ended March 31, 2007 compared to cash flows provided by financing activities of \$390,000 for the same period in 2006. The increase of cash used in financing activities primarily relates to cash dividends declared and paid and the continued repurchase of the Company's stock.

The Company repurchased shares of stock from employees' 401(k) savings and investment plan and other incentive plans for the three months ended March 31, 2007 in the amount of \$1.6 million for 60,676 shares of stock. There were 36,529 shares of stock repurchased for a total of \$747,000 for the same period in 2006.

In February of 2006, the Board of Directors authorized a semi-annual cash dividend payment. Cash dividends were declared in December of 2006 and were paid in January of 2007 in the amount of \$2.5 million. Board approval is required to determine the date of declaration for each semi-annual payment. No cash dividends were declared or paid in the three months ended March 31, 2006. Prior to 2006, no cash dividends had been declared or paid.

The Company received cash from stock options exercised of \$659,000 and classified the tax benefit of stock options exercised of \$1.6 million in financing activities for the three months ended March 31, 2007. Due to the increase in stock price and the exercise price of options, the tax effect of the gains received by the Company increased significantly for the three months ended March 31, 2007. The cash received for options exercised and income tax effect partially offset the stock repurchase and dividend payments for the three months ended March 31, 2007. The cash received from stock options exercised for the same period in 2006 was \$552,000 and the tax benefit of stock options exercised was \$612,000.

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General

The Company's revolving credit facility provides for maximum borrowings of \$15.2 million which is provided by the Bank of Oklahoma, National Association. Under the line of credit, there is one standby letter of credit totaling approximately \$600,000. The letter of credit is a requirement of the Company's workers compensation insurance and will expire December 31, 2007. Interest on borrowings is payable monthly at the Wall Street Journal prime rate less 0.5% or LIBOR plus 1.6%, at the election of the Company (6.92% at March 31, 2007). No fees are associated with the unused portion of the committed amount. At March 31, 2007 and December 31, 2006, the Company had no borrowings outstanding under the revolving credit facility. Borrowings available under the revolving credit facility at March 31, 2007, were \$14.6 million. The credit facility requires the Company to maintain certain financial ratios. At March 31, 2007, the Company was in compliance with its financial ratio covenants. The line of credit has a maturity date of July 30, 2007.

Management believes the Company's bank revolving credit facility (or comparable financing), and projected cash flows from operations will provide the necessary liquidity and capital resources to the Company for fiscal year 2007 and the foreseeable future. The Company's belief that it will have the necessary liquidity and capital resources is based upon its knowledge of the HVAC industry and its place in that industry, its ability to limit the growth of its business if necessary, its ability to authorize dividend cash payments, and its relationship with its existing bank lender. For information concerning the Company's revolving credit facility at March 31, 2007, see Note 5 to the financial statements included in this report.

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 the Company's results of operations, financial position and cash flows. The Company reevaluates its estimates and assumptions on a monthly basis.

Effective January 1, 2007, the Company adopted FIN 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." FIN 48 provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In accordance with FIN 48, the Company recognized a cumulative-effect adjustment of \$396,000, increasing its liability for unrecognized tax benefits, interest and penalties and reducing the January 1, 2007 balance of retained earnings. See Note 8 for more information on income taxes.

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Except for the adoption of FIN 48, there have been no significant changes in critical accounting policies or management estimates since the year ended December 31, 2006. A comprehensive discussion of the Company's critical accounting policies and management estimates is included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

New Accounting Pronouncements

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In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109, Accounting for Income Taxes. This interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recorded a \$551,000 increase in the liability for unrecognized tax benefits, which is offset by an increase of the deferred tax assets of \$155,000, resulting in a decrease to the January 1, 2007, retained earnings balance of \$396,000 (for additional information see Note 8 to the Consolidated Financial Statements).

In September 2006, the FASB released SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value and establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. Although SFAS 157 applies to (and amends) the provisions of existing authoritative literature, it does not, of itself, require any new fair value measurements or establish valuation standards. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will adopt SFAS 157 on January 1, 2008. Adoption of SFAS 157 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In February, 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which creates an alternative measurement treatment for certain financial assets and financial liabilities. SFAS 159 permits fair value to be used for both the initial and subsequent measurements on an instrument by instrument basis, with changes in the fair value to be recognized in earnings as those changes occur. This election is referred to as the fair value option. SFAS 159 also requires additional disclosures to compensate for the lack of comparability that will arise from the use of the fair value option. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Adoption of SFAS 159 is not expected to have a material impact on the Company's Consolidated Financial Statements.

Forward-Looking Statements

This Quarterly Report 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", "will", 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. The Company undertakes no obligations 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

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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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company is subject to interest rate risk on its revolving credit facility which bears variable interest based upon a prime or LIBOR rate. The Company had no outstanding balance as of March 31, 2007.

Foreign sales accounted for less than approximately 5% of the Company's sales for the three months ended March, 31, 2007 and the Company accepts payment for such sales in U.S. and Canadian dollars; therefore, the Company believes it is not exposed to significant foreign currency exchange rate risk on these sales. Foreign currency transactions and financial statements are translated in accordance with SFAS No. 52, Foreign Currency Translation. The Company uses the U.S. dollar as its functional currency, except for the Company's Canadian subsidiaries, which use the Canadian dollar. Adjustments arising from translation of the Canadian subsidiaries' financial statements are reflected in accumulated other comprehensive income. Transaction gains or losses that arise from exchange rate fluctuations applicable to transactions denominated in Canadian currency are included in the results of operations as incurred. The exchange rate of the United States dollar to the Canadian dollar was \$0.864 and \$0.860 at March 31, 2007 and March 31, 2006, respectively.

Important raw materials purchased by the Company are steel, copper and aluminum, which are subject to price fluctuations. The Company attempts to limit the impact of price increases on these materials by entering cancelable fixed price contracts with its major suppliers for periods of 6 -12 months. However, from 2004 to March 31, 2007 cost increases in basic commodities, such as steel, aluminum and copper, ranged in price increases of up to 24%, 42% and 400%, respectively. These price increases impacted profit margins during those periods and may impact profit margin in future periods.

The Company does not utilize derivative financial instruments to hedge its interest rate or raw materials price risks.

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Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

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

- o The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files 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
- o The Company's disclosure controls and procedures operate such that

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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 the Company's management, and made known to the Company's 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.

AAON's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures and concluded that these controls and procedures were effective as of March 31, 2007.

(b) Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1A. Risk Factors.

There have been no material changes from risk factors as previously disclosed in registrant's 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.

Following repurchases of approximately 12% of its outstanding Common Stock between September 1999 and September 2001, the Company announced and began a stock repurchase program on October 17, 2002, targeting repurchases of up to an additional 10% (1,325,000 shares) of its outstanding stock. Through December 31, 2005, the Company had repurchased a total of 1,257,864 shares under the current program for an aggregate price of \$22,034,568, or an average of \$17.52 per share. On February 14, 2006, the Board of Directors approved the suspension of the Company's repurchase program.

On July 1, 2005, the Company entered into a stock repurchase arrangement by which employee-participants in AAON's 401(k) savings and investment plan are entitled to have shares of AAON stock in their accounts sold to the Company to provide diversification of their investments. The maximum 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 March 31, 2007, the Company repurchased 262,352 shares for an aggregate price of \$5,615,000 or an average price of \$21.40 per share. The Company purchases the shares at the current market price.

On November 7, 2006, the Board of Directors authorized the Company to repurchase shares from certain directors following their exercise of stock options expiring on March 11, 2007. To date, the Company repurchased 44,875 shares for an aggregate price of \$1,203,000 or an average price of \$26.81.

Repurchases during the first quarter of 2007 were as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

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| 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 |
|------------------------------------|---|--|---|--|
| Month #1 January 1-31, 2007 | 11,239 | \$ 27.18 | 11,239 | - |
| Month #2 February 1-28, 2007 | 2,016 | \$ 28.00 | 2,016 | - |
| Month #3 March 1-31, 2007 | 47,422 | \$ 26.81 | 2,547 | - |
| Total | 60,676 | \$ 26.91 | 15,801 | - |

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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: May 8, 2007

By: /s/ Norman H. Asbjornson

Norman H. Asbjornson
President/CEO

Dated: May 8, 2007

By: /s/ Kathy I. Sheffield

Kathy I. Sheffield
Vice President/CFO

