

AAON Inc.

NASDAQ:AAON

Analyst: Cindy Missaoui

Sector: Industrials Goods

BUY

Price Target: \$50.18

Key Statistics as of 11/22/2016

| | |
|----------------|-------------------|
| Market Price: | \$33.40 |
| Industry: | General Buildings |
| Market Cap: | \$1.76B |
| 52-Week Range: | \$19.06-33.55 |
| Beta: | 1.09 |
| ROIC: | 33.7% |

Catalysts:

- Earnings call on February, 27th 2017.
- Mid/Long-Term: Innovation and technology

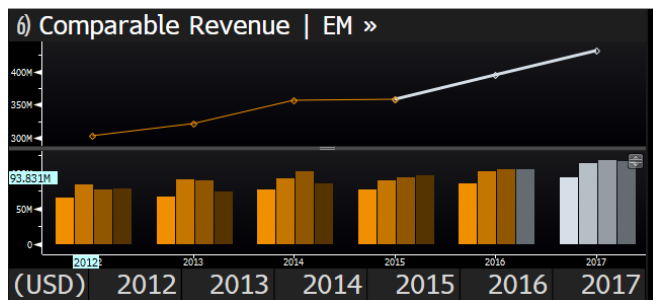
Company Description:

Headquartered in Tulsa, Oklahoma AAON is a manufacturing corporation founded in 1988 that sells heating, ventilating, and cooling equipment in the United States and certain provinces in Canada. The company products consist of rooftop units, chillers, packaged outdoors mechanical rooms, air handling units, and condensing units. AAON provides the commercial and industrials new construction and replacement markets. The company employs 1600 people, and competes principally with Lennox International, Johnson Controls Inc., and United Technologies Corporation.



Thesis

As seen through its fundamentals, AAON Inc. has great growth potential and will continue to perform in the future. Even though FY 2015, was a difficult year in terms of economical atmosphere, AAON recorded all-time records for both sales and earnings. Besides, given the increasing demand for heating and cooling products, revenues are expected to rise in the future, giving AAON the possibility to expand its horizon even more. In fact, the company plans to diversify its products portfolio by launching new products in a near future.



I recommend that we buy AAON Inc. stock which is currently undervalued – I expect the price to rise around \$45-\$50 in the future.

Growth Strategy

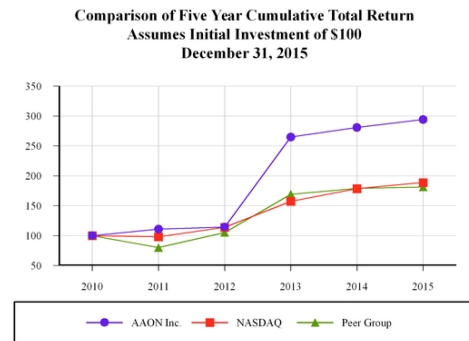
In comparison with its main competitors, which are Lennox International, Johnson Controls Inc., and United Technologies Corporation, AAON is a small company far less diversified and with less revenues. As a matter of fact, AAON can achieve impressive growth through its growth strategy by stealing market share to its competitors. As explained in the 10-K, AAON manufactures semi-customized Heating, Ventilating, Air Conditioning units (HVAC), which offers a compelling value to its competitors. When it comes to Heating, Ventilating, and Air Conditioning units, customers want some degree of customization as offered by AAON and at low price. AAON's strategy was to build an efficient manufacturing system that permits customization at low cost. This strategy allows AAON to earn the highest margin in the industry and be attractive for customers that will increase sales revenues.

Moreover, AAON growth strategy can be described as wise. In fact, instead of focusing in saturated market mainly controlled by huge companies, AAON tries to serve the market poorly served and not interesting for huge companies.

For example, with that strategy, AAON succeeded to

enter the commercial rooftop Heating, Ventilating, and Air Conditioning.

As shown in the graph below, AAON succeeded to outperform NASDAQ and Peers in term on total return.



People

AAON Inc. has been founded in 1988 by Norman Asbjornson who is actually Chairman of the Board and Chief Executive Officer of AAON Inc. Besides, Scott Asbjornson joined the company in 1999, is the Chief Financial Officer, and Vice-President of Finance at AAON.

Risks

Economic conditions are a major risk in the General Buildings Industry. In fact, AAON Inc. business highly depends on the new homes and buildings that are built, which highly depends on inflation, interest rates, and consumer spending rates. These factors can negatively affect AAON Inc. business by impacting sales revenues and profitability. In our current economy, interest rates are significantly low which helped the company to record strong financial performance including high sale volumes and earnings. Moreover, even though interest rates are expected to rise in a near future, which can represent a danger for AAON Inc, the company become in 2016 one of the most efficient company in the General Buildings Industry. In addition to that, increase in the prices of raw materials is a risk for the company, as it will increase the costs of production, and potentially reduce sales volume and profitability. However, as explained in the 10-K, AAON Inc. enters into cancellable and non cancellable contracts from six to eighteen months for raw material at fixed price. By doing so, it helps the company to reduce increase in the price of raw materials risk factors.

| | Years Ending December 31, | | | % Change |
|------------------|---------------------------|---------|--|----------|
| | 2015 | 2014 | | |
| Copper | \$ 3.54 | \$ 4.07 | | (13.0)% |
| Galvanized Steel | \$ 0.42 | \$ 0.47 | | (10.6)% |
| Stainless Steel | \$ 1.30 | \$ 1.51 | | (13.9)% |
| Aluminum | \$ 1.67 | \$ 1.64 | | 1.8 % |

Financials

AAON Corp. financial health strength can be seen in multiples areas. First, as explained before the company reported strong financial results in FY 2015. The company's revenues are driven by three main components, which are Rooftop Units, Split Systems, and Outdoor Mechanical Rooms.

Units sold for years ended December 31:

| | 2015 | 2014 | 2013 |
|--------------------------|--------|--------|--------|
| Rooftop Units | 15,134 | 14,587 | 13,969 |
| Split Systems | 3,385 | 2,622 | 2,604 |
| Outdoor Mechanical Rooms | 57 | 114 | 93 |
| Total Units | 18,576 | 17,323 | 16,666 |

As seen in the annual report, revenues rose by 0.6% from \$356M to \$358M, and AAON Inc. succeeded to increase their units sold over the last three years, which is reflected into their net sales. Besides, Net Income rose by 4% from \$44M to \$46M between 2014 and 2015.

| | Years Ending December 31, | | | |
|-------------|---|------------|-----------|----------|
| | 2015 | 2014 | \$ Change | % Change |
| | <i>(in thousands, except unit data)</i> | | | |
| Net sales | \$ 358,632 | \$ 356,322 | \$ 2,310 | 0.6% |
| Total units | 18,576 | 17,323 | 1,253 | 7.2% |

In addition to that, AAON Inc. ROIC and WACC ratios highlight the company strong ability to generate return on invested capital and so to create value. The ROIC without Goodwill ratio, which allows having a better measure of the company's performance in comparison to its peers, highlights also the company's capacity to create value compared with that of its peers. As said before, its growth strategy allows AAON Inc. to take advantage over its competitors, and create value by differentiate itself from its main competitors.

| | ROIC | |
|-------------|---------|-------|
| | History | LFY |
| aaon | 28.3% | 33.7% |
| Competitors | 12.7% | 16.3% |

When analyzing the key drivers of value which are revenue growth and ROIC, it seems obvious that the company's trend in the long run performance would be positive and will generate positive free cash flow.

Furthermore, AAON Inc. is debt free, which allows the conservative management of the company to have more financial flexibility, as they do not depend on debt to grow their business. The company's culture adds even more value to the company and enforces company's success and profitable growth on the long run.

Given the company's competitive advantage, strong financial performance, financial health and the increasing demand towards HVAC products, the company stock price will continue to rise making AAON Inc. a growth opportunity company which is currently undervalued in its industry.

Important dates and Catalysts

The company announced earnings date on December 27th 2016. Moreover, on February 24th 2016 Norman Asbjornson inaugurated the construction of a new research and development lab at AAON Inc, which should be ready in 2018. This lab creates even more value to the company at it should allow the company to expand more through innovation and technology in order to outperform and stay competitive in the market. In addition to that, the company announced 18% increased in cash dividend payment. The company's strong position capital with a significant free cash flow increases considerably shareholders value.

Summary

AAON inc. is a BUY because it delivers strong performance and strong financial results in FY 2015. The company is expected to growth in the future due to investments in innovation and technology. Even if AAON Inc. is a small company compared to its competitors, it has the possibility to grow even more and is clearly undervalued in its industry.

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Analyst: Cindy Mirzamani **Current Price: \$33.05** **Intrinsic Value: \$33.41**
11/23/2016 **Dividend Yield: 0.9%** **Target Price: \$45.00**

Description:
ARON, Inc., together with its subsidiaries, manufactures and sells air conditioning and heating equipment in the United States and Canada.

General Information:
Sector: Industrials
Industry: Building Products
Listed On: November 3, 2015
Next earnings date: March 1, 2017
Estimated Company Risk Premium: 6.88X
Effective Tax rate: 38X
Effective Operating Tax rate: 48X

Market Data:
Market Capitalization
Daily volume (mil)
Shares outstanding (mil)
Diluted shares outstanding (mil)
X shares held by institutions
X shares held by Institutional Managers
X shares held by Hedge Funds
X shares held by insiders
Short interest
Days to next short interest
52 week high
52 week low
Levered Beta
Volatility

| Quarter ending | | Pool Earning Surprise | | EPSDA | | Payout | |
|----------------|---------|-----------------------|---------|-------|--|--------|--|
| 3/30/2015 | -12.63X | | -14.77X | | | | |
| 12/31/2015 | 7.25X | | 12.38X | | | | |
| 9/30/2015 | 8.58X | | 8.33X | | | | |
| 6/30/2015 | 2.32X | | 1.85X | | | | |
| 3/30/2015 | -3.48X | | -4.24X | | | | |
| Mean | -1.45X | | -8.32X | | | | |
| Standard error | 3.3X | | 3.3X | | | | |

| Management | | Position | | Total compensation year | | Total return to shareholders | |
|-------------------|--|--------------------------------|--|--------------------------|--|------------------------------|--|
| Robertson, Herman | | Chairman of the Board and CEO | | 45.85X per annum over 5y | | 3.64X per annum over 5y | |
| Field, Gary | | President and Director | | N/A | | 8X per annum over 5y | |
| Robertson, Scott | | Chief Financial Officer and | | 19.65X per annum over 5y | | 3.64X per annum over 5y | |
| Shreffler, Kelly | | Senior Vice President of R&D | | 19.81X per annum over 5y | | 3.64X per annum over 5y | |
| Perigo, Robert | | Vice President, Vice President | | 18.75X per annum over 5y | | 3.64X per annum over 5y | |
| Healy, Sam | | Vice President | | 23.75X per annum over 5y | | 3.64X per annum over 5y | |

| Financial Ratios | | 5 years Historical as of | | Industry [LTM] | |
|-----------------------------|-------|--------------------------|--|----------------|--|
| ROIC | 25.3X | 24.28X | | 16.14X | |
| NOPAT Margin | 14X | 16.65X | | 16.8X | |
| Revenue/Invested Capital | 1.32 | 2.88 | | 1.51 | |
| ROE | 22.7X | 19.28X | | 19.94X | |
| Adjusted margin | 14X | 16.64X | | 8.5X | |
| Revenue/Adjusted Book Value | 1.58 | 1.88 | | 2.18 | |

| Invested Funds | | 5 years Historical as of | | Industry [LTM] | |
|--|-------|--------------------------|--|----------------|--|
| Total Cash/Total Capital | 15.2X | 14.2X | | 28X | |
| Estimated Operating Cash/Total Capital | 4.8X | 3.7X | | N/A | |
| Nonworking Capital/Total Capital | 28.3X | 21.1X | | 12X | |
| Invested Capital/Total Capital | 85.5X | 85.4X | | 88X | |

| Capital Structure | | 5 years Historical as of | | Industry [LTM] | |
|-----------------------------------|--------|--------------------------|--|----------------|--|
| Total Debt/Common Equity [LTM] | 1.88 | 1.88 | | 0.29 | |
| Cost of Existing Debt | 8.88X | 8.88X | | 3.78X | |
| Estimated Cost of new Debt/equity | 22.32X | 22.32X | | 3.78X | |
| COPE Risk Ratio | F | F | | D | |
| Unlevered Beta [LTM] | 1.28 | 1.28 | | 1.14 | |
| WACC | 7.94% | 7.94% | | 10.42X | |

Target Price Distribution—P(price) = 100%

Sensitivity Attribution Analysis

Porter's 5 Forces (score out of 100)

| Period | Revenue growth | NOPAT margin |
|-------------------|----------------|--------------|
| Year Year | 12.5X | 15.5X |
| 3/30/2017 | 7.6X | 14.1X |
| 3/30/2016 | 14.6X | 15.3X |
| 3/30/2015 | 18.7X | 15.3X |
| 3/30/2014 | 3.3X | 15.3X |
| 3/30/2013 | 3.1X | 15.4X |
| 3/30/2012 | 8.2X | 15.4X |
| 3/30/2011 | 7.4X | 15.4X |
| 3/30/2010 | 6.6X | 15.4X |
| 3/30/2009 | 3.7X | 15.4X |
| 3/30/2008 | 4.3X | 15.4X |
| Continuing Period | 4.1X | 15.4X |

| Period | Invested Capital | Net Claims |
|-------------------|------------------|------------|
| Year Year | \$168.11 | -\$22.78 |
| 3/30/2017 | \$158.82 | -\$66.82 |
| 3/30/2016 | \$166.27 | -\$122.24 |
| 3/30/2015 | \$188.24 | -\$182.85 |
| 3/30/2014 | \$283.33 | -\$248.36 |
| 3/30/2013 | \$294.58 | -\$318.28 |
| 3/30/2012 | \$245.15 | -\$332.47 |
| 3/30/2011 | \$258.65 | -\$478.36 |
| 3/30/2010 | \$272.19 | -\$553.57 |
| 3/30/2009 | \$283.42 | -\$633.53 |
| 3/30/2008 | \$291.45 | -\$727.83 |
| Continuing Period | | |