

AAON INC
Form 10-K
February 28, 2019

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

FORM 10-K

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

For the fiscal year ended December 31, 2018

or

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

For the transition period from _____ to _____

Commission file number: 0-18953

AAON, INC.

(Exact name of registrant as specified in its charter)

Nevada	87-0448736
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2425 South Yukon, Tulsa, Oklahoma 74107
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (918) 583-2266

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.004

(Title of Class)

Rights to Purchase Series A Preferred Stock

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

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

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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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

[X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer [X] Accelerated filer []

Non-accelerated filer [] Smaller reporting company []

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

[] Yes [X] No

The aggregate market value of the common equity held by non-affiliates computed by reference to the closing price of registrant's common stock on the last business day of registrant's most recently completed second quarter June 30, 2018 was \$1,360.8 million.

As of February 25, 2019, registrant had outstanding a total of 51,976,455 shares of its \$.004 par value Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of registrant's definitive Proxy Statement to be filed in connection with the Annual Meeting of Stockholders to be held May 14, 2019, are incorporated into Part III.

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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.

Based on our 2018 sales of \$433.9 million, we estimate that we have approximately a 11% share of the greater than five ton rooftop market and a 2% share of the less than five ton market. During 2018, approximately 50% of our sales were generated from the renovation and replacement markets and 50% from new construction. The percentage of sales for new construction vs. replacement to particular customers is related to the customer's stage of development.

We purchase certain components, fabricate sheet metal and tubing and then assemble and test the finished products. Our primary finished products consist of a single unit system containing heating and cooling in a self-contained cabinet, referred to in the industry as “unitary products”. Our other finished products are chillers, packaged outdoor mechanical rooms, coils, air handling units, condensing units, makeup air units, energy recovery units, rooftop units and geothermal/ water-source heat pumps.

We offer four groups of rooftop units: the RQ Series, consisting of five cooling sizes ranging from two to six tons; the RN Series, offered in 28 cooling sizes ranging from six to 140 tons; the RL Series, which is offered in 21 cooling sizes ranging from 45 to 240 tons; and the RZ Series, which is offered in 11 cooling sizes ranging from 55 to 240 tons.

We also offer the SA, SB and M2 Series as indoor packaged, water-cooled or geothermal/water-source heat pump self-contained units with cooling capacities of three to 70 tons.

Our small packaged geothermal/water-source heat pump units consist of the WH Series horizontal configuration and WV Series vertical configuration, both from one-half to 30 tons.

We manufacture a LF Series air-cooled chiller, a LN Series air-cooled chiller, and a LZ Series chiller and packaged outdoor mechanical room, which are available in both air-cooled condensing and evaporative-condensed configurations, covering a range of four to 540 tons. BL Series boiler outdoor mechanical rooms are also available with 400-6,000 MBH heating capacity. FZ Series fluid cooler outdoor mechanical rooms are also available with a range of 50 to 450 tons.

We offer four groups of condensing units: the CB Series, two to five tons; the CF Series, two to 70 tons; the CN Series, 55 to 140 tons; and the CL Series, 45 to 230 tons.

Our air handling units consist of the indoor F1, H3 and V3 Series and the modular M2 and M3 Series, as well as air handling unit configurations of the RQ, RN, RL, RZ and SA Series units.

Our energy recovery option applicable to our RQ, RN, RL, RZ and SB units, as well as our H3, V3, M2 and M3 Series air handling units, responds to the U.S. Clean Air Act mandate to increase fresh air in commercial structures. Our products are designed to compete on the higher quality end of standardized products.

Our air-cooled chillers (LF, LN and LZ Series) are certified with the Air-Conditioning, Heating, and Refrigeration Institute (“AHRI”) in accordance with AHRI Standard 550/590. Our water-source heat pump products, including RN, RQ, M2, SB, WH and WV Series, are AHRI certified in accordance with ANSI/AHRI/ASHRAE/ISO 13256.

Performance characteristics of our products range in cooling capacity from one-half to 540 tons and in heating capacity from 7,200 to 9,000,000 BTUs. All of our products meet the Department of Energy’s (“DOE”) minimum efficiency standards, which define the maximum amount of energy to be used in producing a given amount of cooling. Many of our units far exceed these minimum standards and are among the highest efficiency units currently available.

A typical commercial building installation requires one ton of air conditioning for every 300-400 square feet or, for a 100,000 square foot building, 250 tons of air conditioning, which can involve multiple units.

We also offer six control options: the Pioneer Silver, Pioneer Gold, Touchscreen Controller, Orion Controller, terminal block for field installed controls, and factory installed customer provided controls.

Major Customers

One customer, Texas AirSystems, accounted for 10% or more of our sales during 2018, 2017, and 2016.

Sources and Availability of Raw Materials

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The most important materials we purchase 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. We attempt to obtain the lowest possible cost in our purchases of raw materials and components, consistent with meeting specified quality standards. We are not dependent upon any one source for raw materials or the major components of our manufactured products. By having multiple suppliers, we believe that we will have adequate sources of supplies to meet our manufacturing requirements for the foreseeable future.

We attempt to limit the impact of price fluctuations on these materials by entering into cancellable and non-cancellable fixed price contracts with our major suppliers for periods of six to 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations.

We have not been significantly impacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) that contains provisions to improve transparency and accountability concerning the supply of certain minerals, known as “conflict minerals”, originating from the Democratic Republic of Congo and adjoining countries.

Representatives

We employ a sales staff of 41 individuals and utilize approximately 63 independent manufacturer representatives’ organizations (“Representatives”) having 101 offices to market our products in the United States and Canada. We also have one international sales organization, which utilizes 19 distributors in other countries. Sales are made directly to the contractor or end user, with shipments being made from our Tulsa, Oklahoma, and Longview, Texas, plants and our Parkville, Missouri, facility to the job site.

Our products and sales strategy focuses on niche markets. The targeted markets for our equipment are customers seeking products of better quality than offered, and/or options not offered, by standardized manufacturers.

To support and service our customers and the ultimate consumer, we provide parts availability through our sales offices. We also have factory service organizations at each of our plants. Additionally, a number of the Representatives we utilize have their own service organizations, which, in connection with us, provide the necessary warranty work and/or normal service to customers.

Warranties

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 for compressors (if applicable); 15 years on aluminized steel gas-fired heat exchangers (if applicable); 25 years on stainless steel heat exchangers (if applicable); and ten years on gas-fired heat exchangers in RL products (if applicable). Our warranty policy for the RQ series covers parts for two years from date of unit shipment. Our warranty policy for the WH and WV Series geothermal/water-source heat pumps covers parts for five years from the date of manufacture.

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

Research and Development

Our products are engineered for performance, flexibility and serviceability. This has become a critical factor in competing in the heating, ventilation and air conditioning (“HVAC”) equipment industry. We must continually develop new and improved products in order to compete effectively and to meet evolving regulatory standards in all of our major product lines.

All of our Research and Development (“R&D”) activities are self-sponsored, rather than customer-sponsored. R&D activities have involved the RQ, RN, RL and RZ (rooftop units), F1, H3, SA, V3, M2 and M3 (air handling units), LF, LN and LZ (chillers), CB, CF, CN and CL (condensing units), SA and SB (self-contained units), WH and WV (water-source heat pumps), FZ (fluid coolers) and BL (boilers), as well as component evaluation and refinement, development of control systems and new product development. We incurred R&D expenses of approximately \$13.5 million, \$13.0 million, and \$12 million in 2018, 2017, and 2016, respectively.

Our Norm Asbjornson Innovation Center ("NAIC") research and development laboratory facility that open in 2019, includes many unique capabilities that exist nowhere else in the world. A few features of the lab include supply, return, and outside sound testing at actual load conditions, testing up to a 300 ton air conditioning system, testing of up to a 540 ton chiller system, and 80 million Btu/h of gas heating test capacity. Environmental application testing capabilities include -20 to 140°F testing conditions, up to 8 inches per hour rain testing, up to 2 inches per hour snow testing, and up to 50 mph wind testing. We have the largest sound-testing chamber in the world for testing heating and air conditioning equipment, and the only one that can do this testing while putting the equipment under full environmental load. This will enable AAON to lead the industry in the development of quiet, energy efficient commercial and industrial heating and air conditioning equipment.

Ten testing chambers within the NAIC allow AAON to meet and maintain AHRI (Air-Conditioning Heating and Refrigeration Institute) and DOE certification, and solidify the company's industry position as a technological leader in the manufacturing of HVAC equipment. Current voluntary industry certification programs and government regulations only go to 63 tons of air conditioning as that is the largest environmental chamber currently available for testing. The NAIC contain contains both a 100 ton and a 540 ton chamber allowing us to prove to customers our capacity and efficiency on these larger units.

The NAIC was designed to test units well beyond the standard AHRI rating points and we offer testing services on AAON equipment throughout its range of application. This is very important on critical facilities where the units must perform properly and there is great risk in waiting to see once installed. These same capabilities will enable AAON to develop new extended range of operation equipment and prove its capabilities.

Backlog

Our backlog as of February 1, 2019 was approximately \$147.0 million compared to approximately \$64.9 million as of February 1, 2018. The current backlog consists of orders considered by management to be firm and our goal is to fill orders within approximately 60 to 90 days after an order is deemed to become firm; however, the orders are subject to cancellation by the customers in which case, cancellation charges apply up to the full price of the equipment.

Working Capital Practices

Working capital practices in the industry center on inventories and accounts receivable. Our management regularly reviews our working capital with a view of maintaining the lowest level consistent with requirements of anticipated levels of operation. Our greatest needs arise during the months of July - November, the peak season for inventory (primarily purchased material) and accounts receivable. Our working capital requirements are generally met by cash flow from operations and a bank revolving credit facility, which currently permits borrowings up to \$30 million and had no balance outstanding at December 31, 2018. We believe that we will have sufficient funds available to meet our working capital needs for the foreseeable future.

Seasonality

Sales of our products are moderately seasonal with the peak period being July - November of each year due to timing of construction projects being directly related to warmer weather.

Competition

In the standardized market, we compete primarily with Lennox International, Inc., Trane (Ingersoll Rand Limited), York (Johnson Controls Inc.) and Carrier (United Technologies Corporation). All of these competitors are substantially larger and have greater resources than we do. Our products compete on the basis of total value, quality,

function, serviceability, efficiency, availability of product, reliability, product line recognition and acceptability of sales outlets. However, in new construction where the contractor is the purchasing decision maker, we are often at a competitive disadvantage because of the emphasis placed on initial cost. In the replacement market and other owner-controlled purchases, we have a better chance of getting business since quality and long-term cost are generally taken into account.

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Employees

As of February 5, 2019, we employed 2,221 direct employees and contract personnel. Our employees are not represented by unions. Management considers its relations with our employees to be good.

Patents, Trademarks, Licenses and Concessions

We do not consider any patents, trademarks, licenses or concessions to be material to our business operations, other than patents issued regarding our energy recovery wheel option, blower, gas-fired heat exchanger, evaporative-cooled condenser de-superheater and low leakage damper which have terms of 20 years with expiration dates ranging from 2019 to 2033.

Environmental Matters

Laws concerning the environment that affect or could affect our operations include, among others, the Clean Water Act, the Clean Air Act, the Resource Conservation and Recovery Act, the Occupational Safety and Health Act, the National Environmental Policy Act, the Toxic Substances Control Act, regulations promulgated under these Acts, and any other federal, state or local laws or regulations governing environmental matters. We believe that we are in compliance with these laws and that future compliance will not materially affect our earnings or competitive position.

We also strive to protect the environment, work with suppliers who do the same, and encompass sustainable business practices in our manufacturing operations. AAON is dedicated to leading the company into a bright sustainable future. We have joined Sustainable Tulsa, a local non-profit organization, in creating an AAON Scorecard to implement more sustainable processes throughout all the company locations (Tulsa, Longview and Parkville). We recognize that sustainability is both profitable and economical.

Since 2014, we have changed out our lighting to a much more energy efficient system. 80% of our lighting was Metal Halide and 20% was fluorescent. Currently, we are about 80-90% LED, and 10-20% fluorescent. We will be 100% LED by 2020. When you combine the LED upgrade with our advanced lighting control system, AAON saves about \$400,000/year on electricity. We have also received a similar amount from power company rebates. These power savings equate to about 5,000,000 kWh saved per year. The LED lighting has also created a better work environment for our employees and requires less maintenance.

In addition to this, we have installed more energy efficient HVAC systems, air compressors, and building insulation. At the Tulsa facility currently paper and metal recycling are being conducted. Numerous waste streams have been identified by our internal GoGreen employee committee that could be recycled, reused, or reduced. We are also implementing a program to sort all our metals that has been identified to produce more profits. At the Longview facility currently metal, cardboard, and wood recycling is being conducted. The metal recycling also includes sorting all metals for maximum rebates. At the Parkville, facility recycling efforts are currently being researched and pursued. We recover oil in our sheet metal manufacturing area, which is then recycled. The rags are washed and returned to us be used again, preventing them from entering a landfill.

AAON is also committed to designing and manufacturing innovative HVAC products of the highest quality, efficiency, and performance. Our water-source heat pumps products recover otherwise wasted energy and employ it to cool, heat, and provide dehumidification to a building - making it one of the most efficient and environmentally friendly systems. AAON packaged rooftop units with two stage compressors are optimized with high efficiency evaporator and condenser coils, and variable speed fans leading to an AHRI Certified performance up to 19.15 SEER and 20.2 IEER. AAON H3/V3 Series energy recovery wheel air handling units provide energy efficient 100% outside air ventilation, by recovering energy that would otherwise be exhausted from a building. LZ Series packaged outdoor

mechanical rooms are engineered to maximize the efficiency of the complete hydronic system - compressors, condenser, and evaporator. Factory installed 98% efficiency boilers with pumping packages available for applications that require hot water. Energy saving waterside economizers are available for chilled water systems that require cooling at low ambient conditions.

Available Information

Our Internet website address is <http://www.aaon.com>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, will be available free of charge through our Internet website as

soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website is not a part of, or incorporated by reference into, this annual report on Form 10-K. Copies of any materials we file with the SEC can also be obtained free of charge through the SEC's website at <http://www.sec.gov>, at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549, or by calling the SEC at 1-800-732-0330.

Item 1A. Risk Factors.

The following risks and uncertainties may affect our performance and results of operations. The discussion below contains "forward-looking statements" as outlined in the Forward-Looking Statements section above. Our ability to mitigate risks may cause our future results to materially differ from what we currently anticipate. Additionally, the ability of our competitors to react to material risks will affect our future results.

Our business can be hurt by economic conditions.

Our business is affected by a number of economic factors, including the level of economic activity in the markets in which we operate. Sales in the commercial and industrial new construction markets correlate to the number of new homes and buildings that are built, which in turn is influenced by cyclical factors such as interest rates, inflation, consumer spending habits, employment rates and other macroeconomic factors over which we have no control. In the HVAC business, a decline in economic activity as a result of these cyclical or other factors typically results in a decline in new construction and replacement purchases which could impact our sales volume and profitability.

Our results of operations and financial condition could be negatively impacted by the loss of a major customer.

From time to time in the past we derived a significant portion of our sales from a limited number of customers, and such concentration may continue in the future. In 2018, 2017, and 2016, one customer, Texas AirSystems, accounted for more than 10% of our sales. The loss of, or significant reduction in sales to, a major customer could have a material adverse effect on our results of operations, financial condition and cash flow. Further, the addition of new major customers in the future could increase our customer concentration risks as described above.

We may be adversely affected by problems in the availability, or increases in the prices, of raw materials and components.

Problems in the availability, or increases in the prices, of raw materials or components could depress our sales or increase the costs of our products. We are dependent upon components purchased from third parties, as well as raw materials such as steel, copper and aluminum. Occasionally, we enter into cancellable and non-cancellable contracts on terms from six to 18 months for raw materials and components at fixed prices. However, if a key supplier is unable or unwilling to meet our supply requirements, we could experience supply interruptions or cost increases, either of which could have an adverse effect on our gross profit.

We risk having losses resulting from the use of non-cancellable fixed price contracts.

Historically, we have attempted to limit the impact of price fluctuations on commodities by entering into non-cancellable fixed price contracts with our major suppliers for periods of six to 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations. These fixed price contracts are not accounted for using hedge accounting since they meet the normal purchases and sales exemption.

We may not be able to successfully develop and market new products.

Our future success will depend upon our continued investment in research and new product development and our ability to continue to achieve new technological advances in the HVAC industry. Our inability to continue to successfully develop and market new products or our inability to implement technological advances on a pace consistent with that of our competitors could lead to a material adverse effect on our business and results of operations.

We may incur material costs as a result of warranty and product liability claims that would negatively affect our profitability.

The development, manufacture, sale and use of our products involve a risk of warranty and product liability claims. Our product liability insurance policies have limits that, if exceeded, may result in material costs that would have an adverse effect on our future profitability. In addition, warranty claims are not covered by our product liability insurance and there may be types of product liability claims that are also not covered by our product liability insurance.

We may not be able to compete favorably in the highly competitive HVAC business.

Competition in our various markets could cause us to reduce our prices or lose market share, which could have an adverse effect on our future financial results. Substantially all of the markets in which we participate are highly competitive. The most significant competitive factors we face are product reliability, product performance, service and price, with the relative importance of these factors varying among our product line. Other factors that affect competition in the HVAC market include the development and application of new technologies and an increasing emphasis on the development of more efficient HVAC products. Moreover, new product introductions are an important factor in the market categories in which our products compete. Several of our competitors have greater financial and other resources than we have, allowing them to invest in more extensive research and development. We may not be able to compete successfully against current and future competition and current and future competitive pressures faced by us may materially adversely affect our business and results of operations.

The loss of Norman H. Asbjornson could impair the growth of our business.

Norman H. Asbjornson, our founder, has served as our Chief Executive Officer from inception to date and President from inception to November 2016. He has provided the leadership and vision for our strategy and growth. Although important responsibilities and functions have been delegated to other highly experienced and capable management personnel, and our products are technologically advanced and well positioned for sales well into the future, the death, disability or retirement of Mr. Asbjornson could impair the growth of our business. We do not have an employment agreement with Mr. Asbjornson.

The Board of Directors attempts to manage this risk by continually engaging in succession planning concerning Mr. Asbjornson (as well as other key management personnel), as demonstrated by the Board's appointment of Gary D. Fields as President of AAON in November 2016.

Our business is subject to the risks of interruptions by cybersecurity attacks.

We depend upon information technology infrastructure, including network, hardware and software systems to conduct our business. Despite our implementation of network and other cybersecurity measures, our information technology system and networks could be disrupted or experience a security breach from computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Our security measures may not be adequate to protect against highly targeted sophisticated cyber-attacks, or other improper disclosures of confidential and/or sensitive information. Additionally, we may have access to confidential or other sensitive information of our customers, which, despite our efforts to protect, may be vulnerable to security breaches, theft, or other improper disclosure. Any cyber-related attack or other improper disclosure of confidential information could have a material adverse effect on our business, as well as other negative consequences, including significant damage to our reputation, litigation, regulatory actions and increased cost.

Exposure to environmental liabilities could adversely affect our results of operations.

Our future profitability could be adversely affected by current or future environmental laws. We are subject to extensive and changing federal, state and local laws and regulations designed to protect the environment in the United States and in other parts of the world. These laws and regulations could impose liability for remediation costs and result in civil or criminal penalties in case of non-compliance. Compliance with environmental laws increases our costs of doing business. Because these laws are subject to frequent change, we are unable to predict the future costs resulting from environmental compliance.

We are subject to potentially extreme governmental regulations and policies.

We always face the possibility of new governmental regulations, policies and trade agreements which could have a substantial or even extreme negative effect on our operations and profitability. Negotiations during the summer of 2013 mitigated some of the negative effects of the Department of Energy Final Rule, Regulatory Identification No. 1904-AC23, published on March 7, 2011. However, certain additional testing and listing requirements are still in place and scheduled to be phased in.

Several other intrusive component part governmental regulations are in process. If these proposals become final rules, the effect would be the regulation of compressors and fans in products for which the Department of Energy does not have current authority. This could affect equipment we currently manufacture and could have an impact on our product design, operations and profitability.

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of certain minerals, known as “conflict minerals”, originating from the Democratic Republic of Congo and adjoining countries. As a result, in August 2012, the SEC adopted annual disclosure and reporting requirements for those companies who use conflict minerals in their products. Accordingly, we began our reasonable country of origin inquiries in fiscal year 2013, with initial disclosure requirements beginning in May 2014. There are costs associated with complying with these disclosure requirements, including for due diligence to determine the sources of conflict minerals used in our products and other potential changes to products, processes or sources of supply as a consequence of such verification activities. The implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering “conflict free” conflict minerals, we cannot be sure that we will be able to obtain necessary conflict minerals from such suppliers in sufficient quantities or at competitive prices. Also, we may face reputational challenges if we determine that certain of our products contain minerals not determined to be conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we may implement.

Our operations could be negatively impacted by new legislation as well as changes in regulations and trade agreements, including tariffs and taxes. Unfavorable conditions resulting from such changes could have a material adverse effect on our business, financial condition and results of operations.

We are subject to adverse changes in tax laws.

Our tax expense or benefits could be adversely affected by changes in tax provisions, unfavorable findings in tax examinations or differing interpretations by tax authorities. We are unable to estimate the impact that current and future tax proposals and tax laws could have on our results of operations. We are currently subject to state and local tax examinations for which we do not expect any major assessments.

We are subject to international regulations that could adversely affect our business and results of operations.

Due to our use of representatives in foreign markets, we are subject to many laws governing international relations, including those that prohibit improper payments to government officials and commercial customers, and restrict where we can do business, what information or products we can supply to certain countries and what information we can provide to a non-U.S. government, including but not limited to the Foreign Corrupt Practices Act, U.K. Bribery Act and the U.S. Export Administration Act. Violations of these laws, which are complex, may result in criminal penalties or sanctions that could have a material adverse effect on our business, financial condition and results of operations.

Operations may be affected by natural disasters, especially since most of our operations are performed at a single location.

Natural disasters such as tornadoes and ice storms, as well as accidents, acts of terror, infection and other factors beyond our control could adversely affect our operations. Especially, as our facilities are in areas where tornadoes are likely to occur, and the majority of our operations are at our Tulsa facilities, the effects of natural disasters and other events could damage our facilities and equipment and force a temporary halt to manufacturing and other operations, and such events could consequently cause severe damage to our business. We maintain insurance against these sorts of events; however, this is not guaranteed to cover all the losses and damages incurred.

If we are unable to hire, develop or retain employees, it could have an adverse effect on our business.

We compete to hire new employees and then seek to train them to develop their skills. We may not be able to successfully recruit, develop and retain the personnel we need. Unplanned turnover or failure to hire and retain a diverse, skilled workforce, could increase our operating costs and adversely affect our results of operations.

Variability in self-insurance liability estimates could impact our results of operations.

We self-insure for employee health insurance and workers' compensation insurance coverage up to a predetermined level, beyond which we maintain stop-loss insurance from a third-party insurer for claims over \$200,000 and \$750,000 for employee health insurance claims and workers' compensation insurance claims, respectively. Our aggregate exposure varies from year to year based upon the number of participants in our insurance plans. We estimate our self-insurance liabilities using an analysis provided by our claims administrator and our historical claims experience. Our accruals for insurance reserves reflect these estimates and other management judgments, which are subject to a high degree of variability. If the number or severity of claims for which we self-insure increases, it could cause a material and adverse change to our reserves for self-insurance liabilities, as well as to our earnings.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of December 31, 2018, we own all of our Tulsa, Oklahoma, and Longview, Texas, facilities, consisting of approximately 1.76 million square feet of space for office, manufacturing, warehouse, assembly operations and parts sales. We believe that our facilities are well maintained and are in good condition and suitable for the conduct of our business.

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 on a 12-acre tract of land at 2425 South Yukon Avenue, and a 940,000 sq. ft. manufacturing/warehouse building and a 70,000 sq. ft. office building located on an approximately 78-acre tract of land across the street from the original facility (2440 South Yukon Avenue) (the "Tulsa facilities").

Our manufacturing area is in heavy industrial type buildings, with some coverage by overhead cranes, containing manufacturing equipment designed for sheet metal fabrication and metal stamping. The manufacturing equipment contained in the facilities consists primarily of automated sheet metal fabrication equipment, supplemented by presses. Assembly lines consist of six cart-type conveyor lines and one roller-type conveyor line with variable line speed adjustment, which are motor driven. Subassembly areas and production line manning are based upon line speed.

In 2018, construction continued on a new engineering research and development laboratory at the Tulsa facilities, since named the Norman Asbjornson Innovation Center. The three-story 134,000 square foot stand alone facility will be both an acoustical and a performance measuring laboratory. The new facility will consist of ten test chambers allowing AAON to meet and maintain industry certifications. This facility is located West of the 940,000 sq. ft. manufacturing/warehouse building at 2425 South Yukon Avenue.

In 2018, we purchased a 13,500 sq. ft. stand alone building (7,500 sq. ft. warehouse and 6,000 sq. ft. office) which will be utilized as an additional retail parts store to provide our customers more accessibly to our products. The building is on approximately one acre and is located at 9528 E 51st St in Tulsa, Oklahoma. We expect to open the retail parts store in early 2019.

Our operations in Longview, Texas, are conducted in a plant/office building at 203-207 Gum Springs Road, containing 263,000 sq. ft. on 35.0 acres. The manufacturing area (approximately 256,000 sq. ft.) is located in three 120-foot wide sheet metal buildings connected by an adjoining structure. The remaining 7,000 square feet are utilized as office space. The facility is built for light industrial manufacturing.

Our operations in Parkville, Missouri, are conducted in a leased plant/office at 8500 NW River Park Drive, containing 48,000 sq. ft. We believe that the leased facility is well maintained and in good condition and suitable for the conduct of our business.

Item 3. Legal Proceedings.

We are not a party to any pending legal proceeding which management believes is likely to result in a material liability and no such action has been threatened against us, or, to the best of our knowledge, is contemplated.

Item 4. Mine Safety Disclosure.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is quoted on the NASDAQ Global Select Market under the symbol "AAON". The table below summarizes the intraday high and low reported sale prices for our common stock for the past two fiscal years. As of the close of business on February 25, 2019, there were 1,119 holders of record of our common stock.

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Quarter Ended	High	Low
March 31, 2017	\$37.00	\$31.95
June 30, 2017	\$38.10	\$33.95
September 30, 2017	\$37.65	\$31.65
December 31, 2017	\$37.55	\$33.35
March 31, 2018	\$40.25	\$32.50
June 30, 2018	\$39.03	\$29.05
September 30, 2018	\$43.30	\$32.84
December 31, 2018	\$44.90	\$31.55

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

Our recent dividends are as follows:

Declaration Date	Record Date	Payment Date	Dividend per Share
May 24, 2016	June 10, 2016	July 1, 2016	\$0.11
November 9, 2016	December 2, 2016	December 23, 2016	\$0.13
May 16, 2017	June 9, 2017	July 7, 2017	\$0.13
November 7, 2017	November 30, 2017	December 21, 2017	\$0.13
May 18, 2018	June 8, 2018	July 6, 2018	\$0.16
November 8, 2018	November 29, 2018	December 20, 2018	\$0.16

The following is a summary of our share-based compensation plans as of December 31, 2018:

EQUITY COMPENSATION PLAN INFORMATION

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
The 2007 Long-Term Incentive Plan	341,787	\$ 16.20	—
The 2016 Long-Term Incentive Plan	174,190	\$ 33.03	4,289,718

Repurchases during the fourth quarter of 2018, which include repurchases from our open market, 401(k) and employee repurchase programs, were as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

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
October 2018	123,106	\$ 33.15	123,106	—
November 2018	74,560	41.83	74,560	—
December 2018	72,235	34.34	72,235	—
Total	269,901	\$ 35.51	269,901	—

Comparative Stock Performance Graph

The following performance graph compares our cumulative total shareholder return, the NASDAQ Composite and a peer group of U.S. industrial manufacturing companies in the air conditioning, ventilation, and heating exchange equipment markets from December 31, 2013 through December 31, 2018. The graph assumes that \$100 was invested at the close of trading December 31, 2013, with reinvestment of dividends. Our peer group includes Lennox International, Inc., Ingersoll Rand Limited, Johnson Controls Inc., and United Technologies Corporation. This table is not intended to forecast future performance of our Common Stock.

This stock performance Graph is not deemed to be “soliciting material” or otherwise be considered to be “filed” with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 (Exchange Act) or to the liabilities of Section 18 of the Exchange Act, and should not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, except to the extent the Company specifically incorporates it by reference into such a filing.

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with our Consolidated Financial Statements and Notes thereto included under Item 8 of this report and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in Item 7.

Results of Operations:	Years Ended December 31,				
	2018	2017	2016	2015	2014
	(in thousands, except per share data)				
Net sales	\$433,947	\$405,232	\$383,977	\$358,632	\$356,322
Net income	\$42,572	\$54,498	\$53,376	\$45,728	\$44,158
Earnings per share:					
Basic	\$0.81	\$1.04	\$1.01	\$0.85	\$0.81
Diluted	\$0.81	\$1.03	\$1.00	\$0.84	\$0.80
Cash dividends declared per common share:	\$0.32	\$0.26	\$0.24	\$0.22	\$0.18
	December 31,				
Financial Position at End of Fiscal Year:	2018	2017	2016	2015	2014
	(in thousands)				
Working capital	\$92,790	\$103,662	\$101,939	\$80,800	\$82,227
Total assets	308,197	296,780	256,530	232,854	226,974
Long-term and current debt	—	—	—	—	—
Total stockholders’ equity	247,499	237,226	205,898	178,918	174,059

Use of Non-GAAP Financial Measure

To supplement the Company’s consolidated financial statements presented in accordance with generally accepted accounting principles (“GAAP”), an additional non-GAAP financial measure is provided and reconciled in the following table. The Company believes that this non-GAAP financial measure, when considered together with the GAAP financial measures, provides information that is useful to investors in understanding period-over-period operating results. The Company believes that this non-GAAP financial measure enhances the ability of investors to analyze the Company’s business trends and operating performance.

EBITDAX

EBITDAX (as defined below) is presented herein and reconciled from the GAAP measure of net income because of its wide acceptance by the investment community as a financial indicator of a company’s ability to internally fund operations.

The Company defines EBITDAX as net income, plus (1) depreciation, (2) amortization of bond premiums, (3) share-based compensation, (4) interest (income) expense and (5) income tax expense. EBITDAX is not a measure of net income or cash flows as determined by GAAP.

The Company’s EBITDAX measure provides additional information which may be used to better understand the Company’s operations. EBITDAX is one of several metrics that the Company uses as a supplemental financial measurement in the evaluation of its business and should not be considered as an alternative to, or more meaningful than, net income, as an indicator of operating performance. Certain items excluded from EBITDAX are significant components in understanding and assessing a company’s financial performance. EBITDAX, as used by the Company, may not be comparable to similarly titled measures reported by other companies. The Company believes that EBITDAX is a widely followed measure of operating performance and is one of many metrics used by the Company’s management team, and by other users of the Company’s consolidated financial statements.

The following table provides a reconciliation of net income (GAAP) to EBITDAX (non-GAAP) for the periods indicated:

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	December 31,				
	2018	2017	2016	2015	2014
	(in thousands)				
Net Income, a GAAP measure	\$42,572	\$54,498	\$53,376	\$45,728	\$44,158
Depreciation and amortization	17,655	15,007	13,035	11,741	11,553
Amortization of bond premiums	13	47	249	266	688
Share-based compensation	7,374	6,458	4,357	2,891	2,178
Interest income	(209)	(345)	(541)	(427)	(964)
Income tax expense	13,367	19,994	26,615	25,611	24,088
EBITDAX, a non-GAAP measure	\$80,772	\$95,659	\$97,091	\$85,810	\$81,701

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We engineer, manufacture, market and sell air conditioning and heating equipment consisting of standard, semi-custom and custom rooftop units, chillers, packaged outdoor mechanical rooms, air handling units, makeup air units, energy recovery units, condensing units, geothermal/water-source heat pumps and coils. These products are marketed and sold to retail, manufacturing, educational, lodging, supermarket, medical and other commercial industries. We market our products to all 50 states in the United States and certain provinces in Canada.

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

We sell our products to property owners and contractors through a network of manufacturers' representatives and our internal sales force. The demand for our products is influenced by national and regional economic and demographic factors. The commercial and industrial new construction market is subject to cyclical fluctuations in that it is generally tied to housing starts, but has a lag factor of six to 18 months. Housing starts, in turn, are affected by such factors as interest rates, the state of the economy, population growth and the relative age of the population. When new construction is down, we emphasize the replacement market. The new construction market in 2018 continued to be unpredictable and uneven. Thus, throughout the year, we emphasized promotion of the benefits of AAON equipment to property owners in the replacement market.

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

The price levels of our raw materials fluctuate given that the market continues to be volatile and unpredictable as a result of the uncertainty related to the U.S. economy and global economy. For the year ended December 31, 2018, the prices for copper, galvanized steel, stainless steel and aluminum increased approximately 4.75%, 18.18%, 11.76% and 6.43%, respectively, from 2017. For the year ended December 31, 2017, the prices for copper, galvanized steel and stainless steel increased approximately 6.2%, 15.8%, 4.4% and 2.4%, respectively, from 2016.

We attempt to limit the impact of price fluctuations on these materials by entering into cancellable and non-cancellable fixed price contracts with our major suppliers for periods of six to 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations.

The following are highlights of our results of operations, cash flows, and financial condition:

• We continue to see growth and improvement in our water-source heat pump line that increased revenues by \$4.7 million.

• Our warranty expense has stabilized and we expect to see continued improvement.

• The Company completed the acquisition of Wattmaster Controls, Inc. for \$6.4 million. This acquisition was strategic in accelerating the development of our own electronic controllers for air distribution.

• The Company struggled to maintain its gross profit due to elevated staffing levels, increasing material prices and changes in personnel.

• We spent \$37.3 million in capital expenditures in 2018, continuing our work on such projects as our new research and development lab, water-source heat pump production line, as well as other internal development projects.

• We increased our cash dividends, paying \$16.7 million in 2018 compared to \$13.7 million in 2017.

Results of Operations

Units sold for years ended December 31:

	2018	2017	2016
Rooftop Units	15,273	16,003	16,764
Condensing Units	2,007	2,252	1,639
Air Handlers	2,500	2,577	2,114
Outdoor Mechanical Rooms	38	64	65
Water Source Heat Pumps	5,334	2,485	316
Total Units	25,152	23,381	20,898

Year Ended December 31, 2018 vs. Year Ended December 31, 2017

Net Sales

	Years Ending December 31,			
	2018	2017	\$	%
			Change	Change
			(in thousands, except unit data)	
Net sales	\$433,947	\$405,232	\$28,715	7.1 %
Total units	25,152	23,381	1,771	7.6 %

Most of the increase in revenues is due to our price increase from November 2017. Additionally, our parts sales and water-source heat pumps sales continue to grow with increases of \$6.4 million and \$4.7 million, respectively.

Cost of Sales

	Years Ending		Percent of	
	December 31,	December 31,	Sales	Sales
	2018	2017	2018	2017
			(in thousands)	
Cost of sales	\$330,414	\$281,835	76.1 %	69.5 %
Gross Profit	\$103,533	\$123,397	23.9 %	30.5 %

The principal components of cost of sales are labor, raw materials, component costs, factory overhead, freight out and engineering expense. The principal high volume raw materials used in our manufacturing processes are steel, copper and aluminum, which are obtained from domestic suppliers. As shown below, our raw material prices increased during the year. Additionally, in January 2018, the Company paid all employees a one-time bonus of \$1,000 per employee as a result of the Tax Cuts and Jobs Act (the "Act") which lowered the federal corporate tax rate from 35% to 21%. This bonus increased cost of sales by \$1.9 million, excluding taxes and benefits. The Company maintained a higher level of workforce through the end of 2017 and beginning of 2018 in anticipation of our growing business. The growth in

order intake during the beginning of 2018 did not occur as quickly as anticipated. The Company has been working and continues to work on managing its staffing levels to improve our efficiency.

Twelve month average raw material cost per pound as of December 31:

	Years Ending December 31,		% Change	
	2018	2017		
Copper	\$3.75	\$3.58	4.7	%
Galvanized Steel	\$0.52	\$0.44	18.2	%
Stainless Steel	\$1.33	\$1.19	11.8	%
Aluminum	\$1.82	\$1.71	6.4	%

Selling, General and Administrative Expenses

	Years Ending December 31,		Percent of Sales	
	2018	2017	2018	2017
	(in thousands)			
Warranty	\$8,807	\$11,233	2.0 %	2.8 %
Profit Sharing	6,215	8,400	1.4 %	2.1 %
Salaries & Benefits	12,638	11,586	2.9 %	2.9 %
Stock Compensation	4,244	4,288	1.0 %	1.1 %
Advertising	762	1,735	0.2 %	0.4 %
Depreciation	950	720	0.2 %	0.2 %
Insurance	1,235	1,005	0.3 %	0.2 %
Professional Fees	2,441	1,888	0.6 %	0.5 %
Donations	933	724	0.2 %	0.2 %
Bad Debt Expense	174	179	— %	— %
Other	9,356	7,491	2.2 %	1.8 %
Total SG&A	\$47,755	\$49,249	11.0%	12.2%

The Company experienced a decrease in warranty claims paid of 9% in 2018. Additionally, the Company had a change in estimate in how it calculates its estimated failure rate that is applied to sales to estimate our potential future liability for warranty claims. This change in estimate reduced our accrual, and thus our expense, by \$0.9 million. Our profit sharing expenses are also down due to lower earnings. Our advertising expense decreased due to cost savings on our annual sales show. Professional fees have increased related to additional services and work performed for the Wattmaster acquisition. These fees are not expected to be recurring. Our other expenses have increased due to sales concessions granted to our customers.

Income Taxes

	Years Ending December 31,		Effective Tax Rate	
	2018	2017	2018	2017

(in thousands)

Income tax provision \$13,367 \$19,994 23.9% 26.8%

The Tax Cuts and Jobs Act (the “Act”) was enacted on December 22, 2017. The overall effective tax rate decreased from 26.8% to 23.9% due to the reduced corporate rate of 35% to 21%. Additionally, 2017 is lower than normal due to a \$4.4 million reduction in expense due to the remeasuring of our deferred taxes at the end of 2017 due to the Act.

Year Ended December 31, 2017 vs. Year Ended December 31, 2016

Net Sales

	Years Ending December 31,			
	2017	2016	\$	%
			Change	Change
	(in thousands, except unit data)			
Net sales	\$405,232	\$383,977	\$21,255.5	5.5 %
Total units	23,381	20,898	2,483	11.9 %

While we did see an 11.9% increase in the volume of units sold, most of that increase was in water-source heat pumps which have a lower price per unit than our other products. As such, total net sales did not increase by the same percentage as our volume.

Cost of Sales

	Years Ending		Percent of	
	December 31,	December 31,	Sales	Sales
	2017	2016	2017	2016
	(in thousands)			
Cost of sales	\$281,835	\$265,897	69.5%	69.2%
Gross Profit	\$123,397	\$118,080	30.5%	30.8%

The principal components of cost of sales are labor, raw materials, component costs, factory overhead, freight out and engineering expense. The principal high volume raw materials used in our manufacturing processes are steel, copper and aluminum, which are obtained from domestic suppliers. The Company's gross profit remained stable due to efforts to improve efficiency and absorb overhead.

Twelve month average raw material cost per pound as of December 31:

	Years			
	Ending	Ending		
	December	December		
	31,	31,		
	2017	2016	%	%
			Change	
Copper	\$3.58	\$3.37	6.2	%
Galvanized Steel	\$0.44	\$0.38	15.8	%
Stainless Steel	\$1.19	\$1.14	4.4	%
Aluminum	\$1.71	\$1.67	2.4	%

Selling, General and Administrative Expenses

	Years Ending		Percent of			
	December 31,		Sales			
	2017	2016	2017	2016		
	(in thousands)					
Warranty	\$11,233	\$3,601	2.8 %	0.9 %		
Profit Sharing	8,400	8,991	2.1 %	2.3 %		
Salaries & Benefits	11,586	11,363	2.9 %	3.0 %		
Stock Compensation	4,288	2,914	1.1 %	0.8 %		
Advertising	1,735	1,395	0.4 %	0.4 %		
Depreciation	720	796	0.2 %	0.2 %		
Insurance	1,005	1,072	0.2 %	0.3 %		
Professional Fees	1,888	2,032	0.5 %	0.5 %		
Donations	724	370	0.2 %	0.1 %		
Bad Debt Expense	179	(45)	— %	— %		
Other	7,491	6,017	1.8 %	1.6 %		
Total SG&A	\$49,249	\$38,506	12.2 %	10.0 %		

The overall increase in SG&A was primarily due to increased warranty expenses. The Company's warranty expense increased due to the increase in the failure rate used in calculating our accrual for warranty liability. The failure rate increased due to the approximately \$4.5 million or 110% increase in warranty claims in 2017.

Factors affecting the increase in warranty claims were: (1) changes in personnel that resulted in a less stringent application of the warranty claim policy, (2) allowing our independent sales representatives to submit a one-time clean-up of old warranty claims not previously submitted to the Company increased claims by approximately \$1.0 million, (3) two specific job failures, involving multiple units, increased claims by approximately \$1.1 million, and (4) paint department failures which increased claims by approximately \$0.8 million. Claims related to the specific job and paint department failures may continue into 2018.

Income Taxes

	Years Ending		Effective Tax	
	December 31,		Rate	
	2017	2016	2017	2016
	(in thousands)			
Income tax provision	\$19,994	\$26,615	26.8 %	33.3 %

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. As a result of the changes provided under the Act, the Company adjusted its deferred tax assets and liabilities existing at the date of enactment using the newly enacted rates for the periods when they are expected to be realized. This remeasurement resulted in a benefit to income taxes of \$4.4 million.

Liquidity and Capital Resources

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

Our cash and cash equivalents decreased \$19.5 million from December 31, 2017 to December 31, 2018. As of December 31, 2018, we had \$2.0 million in cash and cash equivalents.

On July 26, 2018 we renewed our \$30.0 million line of credit with BOKF, NA dba Bank of Oklahoma (“Bank of Oklahoma”). Under the line of credit, there was one standby letter of credit of \$1.3 million as of December 31, 2018. At December 31, 2018 we have \$28.7 million of borrowings available under the revolving credit facility. No fees are associated with the unused portion of the committed amount.

As of December 31, 2018 and 2017, there were no outstanding balances under the revolving credit facility. Interest on borrowings is payable monthly at LIBOR plus 2.0%. The weighted average interest rate was 4.2% and 3.5% for the years ended December 31, 2018 and 2017, respectively.

At December 31, 2018, we were in compliance with all of the covenants under the revolving credit facility. We are obligated to comply with certain financial covenants under the revolving credit facility. These covenants require that we meet certain parameters related to our tangible net worth and total liabilities to tangible net worth ratio. At December 31, 2018, our tangible net worth was \$247.5 million, which meets the requirement of being at or above \$175.0 million. Our total liabilities to tangible net worth ratio was 0.2 to 1.0 which meets the requirement of not being above 2 to 1.

The Board has authorized three stock repurchase programs for the Company. The Company may purchase shares on the open market from time to time, up to a total of 5.7 million shares. The Board must authorize the timing and amount of these purchases. Effective May 24, 2016, the Board authorized up to \$25.0 million in open market repurchases and on June 2, 2016, the Company executed a repurchase agreement in accordance with the rules and regulations of the SEC allowing the Company to repurchase an aggregate amount of \$25.0 million or a total of approximately 2.0 million shares from the open market. The repurchase agreement expired on April 15, 2017. In May 2018, the Board authorized up to \$15.0 million in open market repurchases and on May 18, 2018, the Company executed a repurchase agreement in accordance with the rules and regulations of the SEC allowing the Company to repurchase shares from the open market. The agreement expires on March 1, 2019. The Company also has a stock repurchase arrangement by which employee-participants in our 401(k) savings and investment plan are entitled to have shares in AAON, Inc. stock in their accounts sold to the Company. The maximum number of shares to be repurchased is contingent upon the number of shares sold by employee-participants. Lastly, the Company repurchases shares of AAON, Inc. stock from certain of its directors and employees for payment of statutory tax withholdings on stock transactions. All other repurchases from directors or employees are contingent upon Board approval. All repurchases are done at current market prices.

Our repurchase activity is as follows:

Program	2018			2017			2016		
	Shares	Total \$	\$ per share	Shares	Total \$	\$ per share	Shares	Total \$	\$ per share
Open market	252,272	\$8,373,698	\$33.19	198,676	\$283,654	\$32.69	165,598	\$4,440,658	\$26.82
401(k)	497,753	18,472,442	37.11	467,580	16,336,084	34.94	540,501	14,875,850	27.52
Directors and employees	33,751	1,096,625	32.49	45,878	1,614,425	35.19	30,072	823,446	27.38
Total	783,776	\$27,942,765	\$35.65	522,134	\$18,234,163	\$34.92	736,171	\$20,139,954	\$27.36

Program	Inception to Date		
	Shares	Total \$	\$ per share
Open market	4,095,767	\$69,605,813	\$16.99
401(k)	7,047,776	100,541,247	14.27
Directors and employees	1,953,261	18,374,658	9.41
Total	13,096,804	\$188,521,718	\$14.39

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

Our recent dividends are as follows:

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Declaration Date	Record Date	Payment Date	Dividend per Share
May 24, 2016	June 10, 2016	July 1, 2016	\$0.11
November 9, 2016	December 2, 2016	December 23, 2016	\$0.13
May 16, 2017	June 9, 2017	July 7, 2017	\$0.13
November 7, 2017	November 30, 2017	December 21, 2017	\$0.13
May 18, 2018	June 8, 2018	July 6, 2018	\$0.16
November 8, 2018	November 29, 2018	December 20, 2018	\$0.16

Based on historical performance and current expectations, we believe our cash and cash equivalents balance, the projected cash flows generated from our operations, our existing committed revolving credit facility (or comparable financing) and our expected ability to access capital markets will satisfy our working capital needs, capital expenditures and other liquidity requirements associated with our operations in 2019 and the foreseeable future.

Statement of Cash Flows

The table below reflects a summary of our net cash flows provided by operating activities, net cash flows used in investing activities, and net cash flows used in financing activities for the years indicated.

	2018	2017	2016
	(in thousands)		
Operating Activities			
Net Income	\$42,572	\$54,498	\$53,376
Income statement adjustments, net	28,233	20,362	18,996
Changes in assets and liabilities:			
Accounts receivable	(2,832)	(7,516)	7,048
Income tax receivable	(4,461)	4,596	(1,537)
Inventories	(5,598)	(23,698)	(9,478)
Prepaid expenses and other	(528)	98	(83)
Accounts payable	(1,176)	3,043	654
Deferred revenue	412	258	417
Accrued liabilities	(1,766)	6,353	(5,470)
Net cash provided by operating activities	54,856	57,994	63,923
Investing Activities			
Capital expenditures	(37,268)	(41,713)	(26,604)
Cash paid for business combination	(6,377)	—	—
Purchases of investments	(16,201)	(18,521)	(14,496)
Maturities of investments and proceeds from called investments	25,145	29,112	24,095
Other	66	70	80
Net cash used in investing activities	(34,635)	(31,052)	(16,925)
Financing Activities			
Stock options exercised	4,987	2,259	2,063
Repurchase of stock	(26,846)	(16,620)	(19,317)
Employee taxes paid by withholding shares	(1,097)	(1,614)	(823)
Cash dividends paid to stockholders	(16,728)	(13,663)	(12,676)
Net cash used in financing activities	\$(39,684)	\$(29,638)	\$(30,753)

Cash Flows from Operating Activities

Cash flows from operating activities decreased in 2017 primarily due to increased purchases of raw material during the year arising from stocking of parts needed for the water-source heat pump line. Additionally, the Company began stocking water-source heat pump units which resulted in larger amounts of finished goods on hand at the end of the year. In 2018, the Company increased purchases of metals where lower prices could be obtained in an effort to help manage our material costs.

Cash Flows from Investing Activities

Cash flows used in investing activities increased primarily due our February 2018 business combination.

The capital expenditure program for 2019 is estimated to be approximately \$40.0 million. The capital expenditures for 2019 relate to the completion of our R&D lab and water-source heat pump lines, along with expansion of our Tulsa facility. Many of these projects are subject to review and cancellation at the discretion of our CEO and Board of Directors without incurring substantial charges.

Cash Flows from Financing Activities

Cash flows used in financing activities increased due to open market buybacks following the May 2018 repurchase agreement.

Off-Balance Sheet Arrangements

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

Commitments and Contractual Agreements

We had no material contractual purchase agreements as of December 31, 2018, except for one contractual purchase obligation for approximately \$2.2 million that expires in December 2019.

Contingencies

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

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("US GAAP") requires management to make estimates and assumptions about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenue and expenses in our consolidated financial statements and related notes. We base our estimates, assumptions and judgments on historical experience, current trends and other factors believed to be relevant at the time our consolidated financial statements are prepared. However, because future events and their effects cannot be determined with certainty, actual results could differ from our estimates and assumptions, and such differences could be material. We believe the following critical accounting policies affect our more significant estimates, assumptions and judgments used in the preparation of our consolidated financial statements.

Inventory Reserves – We establish a reserve for inventories based on the change in inventory requirements due to product line changes, the feasibility of using obsolete parts for upgraded part substitutions, the required parts needed

for part supply sales, replacement parts and for estimated shrinkage.

Warranty – A provision is made for estimated warranty costs at the time the product is shipped and revenue is recognized. 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 for compressors (if applicable); 15 years on aluminized steel gas-fired heat exchangers (if applicable); 25 years on stainless steel heat exchangers (if applicable); and ten years on gas-fired heat exchangers in RL products (if applicable). Our warranty policy for the RQ series covers parts for two years from date of unit shipment. Our warranty policy for the WH and WV Series geothermal/water-source heat pumps covers parts for five years from the date of manufacture. Warranty expense is estimated based on the warranty period, historical warranty trends and associated costs, and any known identifiable warranty issue.

Due to the absence of warranty history on new products, an additional provision may be made for such products. Our estimated future warranty cost is subject to adjustment from time to time depending on changes in actual warranty trends and cost experience. Should actual claim rates differ from our estimates, revisions to the estimated product warranty liability would be required.

Stock Compensation – We measure and recognize compensation expense for all share-based payment awards made to our employees and directors, including stock options and restricted stock awards, based on their fair values at the time of grant. Compensation expense is recognized on a straight-line basis during the service period of the related share-based compensation award. Forfeitures are accounted for as they occur. The fair value of each option award and restricted stock award is estimated on the date of grant using the Black-Scholes-Merton option pricing model. The use of the Black-Scholes-Merton option valuation model requires the input of subjective assumptions such as: the expected volatility, the expected term of the options granted, expected dividend yield, and the risk-free rate.

New Accounting Pronouncements

Changes to U.S. GAAP are established by the Financial Accounting Standards Board (“FASB”) in the form of accounting standards updates (“ASUs”) to the FASB’s Accounting Standards Codification.

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

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The ASU will replace previous lease accounting guidance in U.S. GAAP. The ASU requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. The ASU retains a distinction between finance leases and operating leases. The ASU is effective for the Company beginning January 1, 2019.

The following ASUs have been issued in 2018 with the same effective dates and transition requirements:

• ASU 2018-01, Land Easement Practical Expedient, which provides a relief from certain land easements held before the effective date.

• ASU 2018-10, Leases: Codification Improvements, which provides clarification for various areas of Topic 842.

• ASU 2018-11, Leases: Targeted Improvements, which provides clarification for several areas of Topic 842:

• comparative reporting requirements, an optional method of adoption (the transition method) and separating lease and non lease component for lessors.

• ASU 2018-20, Leases: Narrow-Scope Improvement for Lessors, which provided clarification to lessors for sales taxes, variable payments and other costs.

The Company historically does not enter into numerous or material lease agreements to support its manufacturing operations. The Company typically enters into lease agreements that are less than a year and for leases on assets such as warehouse vehicles and office equipment. The Company assumed a multi-year facility lease in the WattMaster

acquisition. The Company has completed the process of determining our contracts to which this new guidance applies. The Company does not expect this new guidance to have a significant impact on the consolidated financial statements due the non-material monetary amount of the total leased assets under the new applicable guidance. Furthermore, we have elected to apply the short-term lease accounting policy election to all short-term leases under the applicable guidance. Under the policy election the lessee does not recognize a short-term lease liability or right-of-use asset on its balance sheet.

The Company will elect the transition method, which becomes effective upon the date of adoption of ASU 2016-02 discussed above. The transition method allows entities to initially apply the new leases standard at the adoption date

(January 1, 2019) and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We expect the cumulative-effect adjustments to the opening balance to be immaterial to the financial statements as a whole.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurements: Changes to the Disclosure Requirement for Fair Value Measurements. The ASU includes additional disclosure requirements for unrealized gains and losses for Level 3 fair value measurement and significant observable inputs used to develop Level 3 fair value measurements. The ASU is effective for the Company beginning after December 15, 2019. We do not expect ASU 2018-13 will have a material effect on our consolidated financial statements and notes thereto.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Commodity Price Risk

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

Item 8. Financial Statements and Supplementary Data.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
AAON, Inc.

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of AAON, Inc. (a Nevada corporation) and subsidiaries (the “Company”) as of December 31, 2018 and 2017, and the related consol