AAON INC
Form 10-Q
November 02, 2009

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

FORM 10-Q

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

For the quarterly period ended September 30, 2009
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 X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No Not Applicable 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.

Large accelerated filer	Accelerated filer X
Non-accelerated filer	Smaller reporting company

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

Yes No X

As of October 22, 2009 registrant had outstanding a total of 17,217,971 shares of its $.004 par value Common Stock.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

		September 30, 2009		December 31, 2008
		(in thousands except share and per share data)		
Assets				
Current assets:				
Cash and cash equivalents	$	17,894	$	269
Accounts receivable, net		35,728		38,804
Inventories, net		31,268		36,382
Prepaid expenses and other		960		428
Derivative assets		806		-
Assets held for sale, net		1,473		-
Deferred tax assets		4,638		4,235
Total current assets		92,767		80,118
Property, plant and equipment:				
Land		1,328		2,153
Buildings		41,171		36,371
Machinery and equipment		90,331		87,219
Furniture and fixtures		7,407		7,076
Total property, plant and equipment		140,237		132,819
Less: Accumulated depreciation		79,008		72,269
Property, plant and equipment, net		61,229		60,550
Derivative assets		199		-
Notes receivable, long-term		75		75
Total assets	$	154,270	$	140,743
Liabilities and Stockholders' Equity				
Current liabilities:				
Revolving credit facility	$	-	$	2,901
Current maturities of long-term debt		91		91
Accounts payable		12,217		14,715
Dividends payable		-		2,773
Accrued liabilities		23,242		19,038
Total current liabilities		35,550		39,518
Long-term debt		8		121
Deferred tax liabilities		3,839		4,582
Commitments and contingencies		-		-
Stockholders' equity:				
Preferred stock, $.0001 par value, 7,500,000 shares authorized, no shares issued		-		-
Common stock, $.004 par value, 75,000,000 shares authorized, 17,178,944 and 17,208,733 issued and outstanding at September 30, 2009 and December 31, 2008, respectively		71		71
Additional paid-in capital		329		538
Accumulated other comprehensive income, net of tax		1,321		778
Retained earnings		113,152		95,135
Total stockholders' equity		114,873		96,522
Total liabilities and stockholders' equity	$	154,270	$	140,743

The accompanying notes are an integral part of these statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
	(in thousands, except per share data)			
Net sales	$ 58,492	$ 79,279	$ 191,054	$ 219,516
Cost of sales	40,764	59,261	138,288	165,856
Gross profit	17,728	20,018	52,766	53,660
Selling, general and administrative expenses	5,313	7,294	18,641	19,325
Income from operations	12,415	12,724	34,125	34,335
Interest expense	-	(39)	(9)	(58)
Interest income	64	-	71	27
Other income (expense), net	(173)	169	1	416
Income before income taxes	12,306	12,854	34,188	34,720
Income tax provision	4,565	4,499	12,622	12,171
Net income	$ 7,741	$ 8,355	$ 21,566	$ 22,549
Earnings per share:				
Basic	$ 0.45	$ 0.49	$ 1.26	$ 1.28
Diluted	$ 0.45	$ 0.47	$ 1.25	$ 1.25
Cash dividends declared per common share:	$ 0.00	$ 0.00	$ 0.18	$ 0.16
Weighted average shares outstanding:				
Basic	17,175	17,264	17,178	17,683
Diluted	17,304	17,484	17,318	18,028

The accompanying notes are an integral part of these statements.

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

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
			(in thousands)			
Balance at December 31, 2008	17,209	$ 71	$ 538	$ 778	$ 95,135	$ 96,522
Comprehensive income:						
Net income	–	–	–	–	21,566	21,566
Foreign currency translation adjustment	–	–	–	543	–	543
Total comprehensive income						22,109
Stock options exercised and restricted stock awards vested, including tax benefits	104	–	1,260	–	–	1,260
Share-based compensation	–	–	631	–	–	631
Stock repurchased and retired	(134)	–	(2,100)	–	(448)	(2,548)
Dividends paid	–	–	–	–	(3,101)	(3,101)
Balance at September 30, 2009	17,179	$ 71	$ 329	$ 1,321	$ 113,152	$ 114,873

The accompanying notes are an integral part of these statements.

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

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(in thousands)	
Operating Activities		
Net income	$ 21,566	$ 22,549
Adjustments to reconcile net income to net cash		
provided by operating activities:		
Depreciation	6,682	7,151
Provision for losses on accounts receivable	603	568
Provision for excess and obsolete inventories	414	-
Share-based compensation	631	603
Excess tax benefits from stock options exercised		
and restricted stock awards vested	(389)	(1,262)
Gain on disposition of assets	4	(11)
Unrealized gain on derivative assets	(1,005)	-
Deferred income taxes	(819)	(832)
Changes in assets and liabilities:		
Accounts receivable	2,551	(9,904)
Inventories	4,742	(2,340)
Prepaid expenses and other	(532)	(75)
Accounts payable	(2,695)	6,687
Accrued liabilities	4,576	6,951
Net cash provided by operating activities	36,329	30,085
Investing Activities		
Proceeds from sale of property, plant, and equipment	-	1
Capital expenditures	(8,644)	(5,475)
Net cash used in investing activities	(8,644)	(5,474)
Financing Activities		
Borrowings under revolving credit facility	9,972	30,090
Payments under revolving credit facility	(12,873)	(27,650)
Payments of long-term debt	(113)	(68)
Stock options exercised	871	1,105
Excess tax benefits from stock options exercised		
and restricted stock awards vested	389	1,262
Repurchases of stock	(2,548)	(24,082)
Cash dividends paid to stockholders	(5,874)	(5,791)
Net cash used in financing activities	(10,176)	(25,134)
Effect of exchange rate on cash	116	(26)
Net increase (decrease) in cash and cash equivalents	17,625	(549)
Cash and cash equivalents, beginning of year	269	879
Cash and cash equivalents, end of period	$ 17,894	$ 330

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries
Notes to the Consolidated Financial Statements
September 30, 2009
(unaudited)

1. Basis of Presentation

AAON, Inc. is a Nevada corporation which was incorporated on August 18, 1987. Our subsidiaries include AAON, Inc., an Oklahoma corporation, AAON Coil Products, Inc., a Texas corporation, AAON Canada, Inc., d/b/a Air Wise, an Ontario corporation and AAON Properties, Inc., an Ontario corporation. AAON Properties is the lessor of property in Burlington, Ontario, Canada to AAON Canada. The Consolidated Financial Statements include our accounts and the accounts of our subsidiaries. Unless the context otherwise requires, references in this Quarterly Report to "AAON," the "Company", "we," "us," "our" or "ours" refer to AAON, Inc., and our subsidiaries.

We have prepared the financial statements included herein without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures made in these financial statements are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in our latest audited financial statements which were included in the Form 10-K Report for the fiscal year ended December 31, 2008, filed with the SEC. In the opinion of management, the accompanying financial statements include all normal, recurring adjustments required for a fair presentation of the results of the periods presented. Operating results for the nine months ended September 30, 2009, are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

Revenue Recognition

We recognize revenues from sales of products when the products are shipped and the title and risk of ownership pass to the customer. Selling prices are fixed based on purchase orders or contractual agreements. Sales allowances and customer incentives are treated as reductions to sales and are provided for based on historical experiences and current estimates. For sales initiated by independent manufacturer representatives, we recognize revenues net of the representatives' commission. Our policy is to record the collection and payment of sales taxes through a liability account.

Currency

Foreign currency transactions and financial statements are translated in accordance with Financial Accounting Standards Board ("FASB") Codification ("FASC") Topic 830, Foreign Currency Matters. We use the U.S. dollar as our functional currency, except for the 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.

Derivatives

We use derivatives to mitigate our exposure to volatility in copper prices. Fluctuations in copper commodity prices impact the value of the derivatives that we hold. We are subject to gains which we record as derivative assets if the forward copper commodity prices increase and losses which we record as derivative liabilities if they decrease. We record the fair value of the derivative position in the Consolidated Balance Sheets. We use COMEX index pricing to support our fair value calculation, which is a Level 2 input per the valuation hierarchy as the pricing is for instruments similar but not identical to the contract we will settle (see Note 16, Fair Value Measurements). We did not designate the derivative as a cash flow hedge. We record changes in the derivative's fair value currently in earnings based on mark-to-market accounting. The change in earnings is recorded to cost of sales in the Consolidated Statements of Income. We do not use derivatives for speculative purposes.

Subsequent Events

We have determined that no subsequent events which require recognition or disclosure in our Consolidated Financial Statements exist as of November 2, 2009, the date of issuance for the financial statements.

New Accounting Pronouncements

In March 2008, the FASB issued FASC Topic 815, Derivatives and Hedging, formerly SFAS No. 161, ("FASC 815"), which requires enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under prior guidance and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. FASC 815 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Adoption of FASC 815 did not have a material impact on our Consolidated Financial Statements (see Note 4, Derivatives).

In May 2009, the FASB issued FASC Topic 855, Subsequent Events, formerly SFAS 165 ("FASC 855"), which requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. FASC 855 is effective for interim and annual periods ending after June 15, 2009. We adopted FASC 855 for reporting in second quarter 2009. Adoption of FASC 855 did not have a material impact on our Consolidated Financial Statements.

In June 2009, the FASB issued Accounting Standards Update ("ASU") 2009-01, Topic 105 - Generally Accepted Accounting Principles ("ASU 2009-01"), which superseded all accounting standards in U.S. GAAP, aside from those issued by the SEC. ASU 2009-01 is effective for reporting periods ending after September 15, 2009. We adopted ASU 2009-01 for reporting in third quarter 2009. The codification does not change or alter existing GAAP. Adoption of ASU 2009-01 did not have a material impact on our Consolidated Financial Statements.

In August 2009, the FASB issued ASU 2009-05, Fair Value Measurement and Disclosures: Measuring Liabilities at Fair Value ("ASU 2009-05"), which provides clarification on measuring liabilities at fair value when a quoted price in an active market is not available. ASU 2009-05 is effective for the first reporting period beginning after issuance. We do not expect adoption of ASU 2009-05 to have a material impact on our Consolidated Financial Statements.

2. Accounts Receivable

We grant credit to customers and perform ongoing credit evaluations. We generally do not require collateral or charge interest. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, economic and market conditions and the age of the receivable. Past due accounts are generally written off against the allowance for doubtful accounts only after all collection attempts have been exhausted.

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

	September 30, 2009	December 31, 2008
	(in thousands)	
Accounts receivable	$ 37,110	$ 39,599
Less: Allowance for doubtful accounts	(1,382)	(795)
Total, net	$ 35,728	$ 38,804

	Nine Months Ended	
	September 30, 2009	September 30, 2008
	(in thousands)	
Allowance for doubtful accounts:		
Balance, beginning of period	$ 795	$ 407
Provision for losses on accounts receivable	491	526
Adjustments to provision	112	41
Accounts receivable written off, net of recoveries	(16)	(127)
Balance, end of period	$ 1,382	$ 847

3. Inventories

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

	September 30, 2009	December 31, 2008
	(in thousands)	
Raw materials	$ 28,876	$ 32,212
Work in process	871	2,545
Finished goods	2,285	1,975
	32,032	36,732
Less: Allowance for excess and obsolete inventories	(764)	(350)
Total, net	$ 31,268	$ 36,382

	Nine Months Ended	
	September 30, 2009	September 30, 2008
	(in thousands)	
Allowance for excess and obsolete inventories:		
Balance, beginning of period	$ 350	$ 350
Provision for excess and obsolete inventories	1,264	600
Adjustments to reserve	(850)	(600)
Balance, end of period	$ 764	$ 350

We increased our allowance for excess and obsolete inventories due to materials from our Canadian facility that will not be utilized at either our Tulsa or Longview locations.

4. Derivatives

We entered into a derivative instrument during the third quarter 2009 with a large financial institution. We do not use derivatives for speculative purposes. The derivative mitigates our exposure to volatility in copper prices. The derivative is in the form of a commodity futures contract. The derivative contract settles monthly beginning in January 2010 ending in December 2010. Settlements equal the difference between the market price of copper and the contract price with the financial institution. The contract is for a total of 2,250,000 pounds of copper at $2.383 per pound. The contract is for quantities equal to or less than those expected to be used in our manufacturing operations in 2010.

We are subject to gains which we record as derivative assets if the forward copper commodity prices increase and losses which we record as derivative liabilities if they decrease. At September 30, 2009, the forward copper commodity prices were higher than our contract price resulting in a gain or derivative asset. We recognized the following derivative asset at fair value in the Consolidated Balance Sheets:

Type of Contract	Balance Sheet Location		Fair Value (in thousands)
Derivatives not designated as hedging instruments:			
Commodity futures contract	Derivative asset – Current	$	806
Commodity futures contract	Derivative asset – Non-Current		199
Total Derivatives not designated as hedging instruments		$	1,005

We did not designate the derivative as a cash flow hedge. We recorded changes in the derivative's fair value currently in earnings based on mark-to-market accounting. We recorded the following unrealized gain on derivative assets at fair value in the Consolidated Statements of Income:

Type of Contract	Income Statement Location		Fair Value (in thousands)
Derivatives not designated as hedging instruments:			
Commodity futures contract	Cost of sales	$	1,005
Total Derivatives not designated as hedging instruments		$	1,005

We used COMEX index pricing to support our fair value calculation, which is a Level 2 input per the valuation hierarchy as the pricing is for instruments similar but not identical to the contract we will settle (see Note 16, Fair Value Measurements).

5. Accrued Liabilities

Accrued liabilities are as follows:

	September 30, 2009		December 31, 2008	
	(in thousands)			
Warranty	$	6,500	$	6,589
Commissions		9,586		8,816
Payroll		3,269		1,883
Workers' compensation		555		610
Medical self-insurance		1,410		886
Employee benefits and other		1,922		254
Total	$	23,242	$	19,038

6. Supplemental Cash Flow Information

Interest payments of approximately $9,000 and $58,000 were made for the nine months ended September 30, 2009 and 2008, respectively. Payments for income taxes of $9.5 million and $8.8 million were made during the nine months ended September 30, 2009 and 2008, respectively. Dividends payable of $3.1 million and $2.8 million were accrued as of June 30, 2009 and 2008 and paid in July 2009 and 2008, respectively.

7. Revolving Credit Facility

Our 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 $1.0 million. The letter of credit was a requirement of our workers compensation insurance and will expire December 31, 2009. Interest on borrowings is payable monthly at the rate of 4% or LIBOR plus 2.5%, whichever is higher (4.00% at September 30, 2009). No fees are associated with the unused portion of the committed amount.

At September 30, 2009, we did not have an outstanding balance under the revolving credit facility. At December 31, 2008, we had $2.9 million borrowed under the revolving credit facility. Borrowings available under the revolving credit facility at September 30, 2009 were $14.2 million. At September 30, 2009, we were in compliance with our financial ratio covenants. The covenants are related to our tangible net worth, total liabilities to tangible net worth ratio and working capital. At September 30, 2009 our tangible net worth was $114.9 million which meets the requirement of being at or above $75 million. Our total liabilities to tangible net worth ratio was 1 to 3 which meets the requirement of 2 to 1. Our working capital was $57.2 million which meets the requirement of being at or above $30 million. On July 30, 2009, we renewed the line of credit with a maturity date of July 30, 2010 with terms substantially consistent with the previous agreement.

8. Share-Based Compensation

We have historically maintained a stock option plan for key employees, directors and consultants (the “1992 Plan”). The 1992 Plan provided for 4.4 million shares of common stock to be issued under the plan. Under the terms of the 1992 Plan, the exercise price of shares granted may not be less than 85% of the fair market value at the date of the grant. Options granted to directors prior to May 25, 2004, vest one year from the date of grant and are exercisable for nine years thereafter. Options granted to directors on or after May 25, 2004, vest one-third each year, commencing one year after the date of grant. All other options granted vest at a rate of 20% per year, commencing one year after date of grant, and are exercisable during years 2-10.

On May 22, 2007, our stockholders adopted a Long-Term Incentive Plan (“LTIP”) which provides an additional 750,000 shares that can be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance units and performance awards. Since inception of the LTIP, non-qualified stock options and restricted stock awards have been granted with the same vesting schedule as the previous plan. Under the LTIP, the exercise price of shares granted may not be less than 100% of the fair market value at the date of the grant.

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

We recognized approximately $135,000 and $107,000 for the three months ended and approximately $363,000 and $336,000 for the nine months ended September 30, 2009 and 2008, respectively, in pre-tax compensation expense related to stock options in the Consolidated Statements of Income. The total pre-tax compensation cost related to unvested stock options not yet recognized as of September 30, 2009 is $1.1 million and is expected to be recognized over a weighted-average period of 2.2 years.

The following weighted average assumptions were used to determine the fair value of the stock options granted on the original grant date for expense recognition purposes for options:

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Directors and Officers:		
Expected dividend yield	1.86%	1.69%
Expected volatility	47.47%	43.52%
Risk-free interest rate	2.53%	2.84%
Expected life	7.0 years	8.0 years
Forfeiture rate	0%	0%
Employees:		
Expected dividend yield	1.86%	1.69%
Expected volatility	46.94%	42.55%
Risk-free interest rate	2.62%	2.84%
Expected life	8.0 years	6.3 years
Forfeiture rate	31%	28%

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

A summary of stock options outstanding is as follows:

	Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number Outstanding at September 30, 2009	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable at September 30, 2009	Weighted Average Exercise Price
$0.00 – $3.85	57,375	0.03	$ 3.85	$ 16.23	57,375	$ 3.85
$5.73 – $11.29	120,613	3.66	9.12	10.96	104,113	8.84
$11.40 – $12.00	33,900	5.96	11.60	8.48	23,700	11.66
$13.60 – $15.55	131,500	8.47	15.13	4.95	30,900	14.66
$15.99 – $19.46	187,500	7.31	17.26	2.82	77,800	17.44
$21.01 – $21.42	12,500	8.99	21.20	(1.12)	1,800	21.01
Total	543,388	5.97	$ 13.26	$ 9.03	295,688	$ 11.05

A summary of stock option activity is as follows: