

AAON INC
Form 10-Q
November 08, 2012

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from _____ to _____

Commission file number: 0-18953

AAON, INC.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction
of incorporation or organization)

87-0448736
(IRS Employer
Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No Not Applicable

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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

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

As of October 29, 2012 registrant had outstanding a total of 24,525,572 shares of its \$.004 par value Common Stock.

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AAON, Inc., and Subsidiaries
 Consolidated Balance Sheets
 (Unaudited) (In thousands, except share and per share data)

| | September 30, 2012 | December 31, 2011 |
|--|--------------------|-------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 7,017 | \$ 13 |
| Certificates of deposit | 1,200 | - |
| Investments held to maturity at amortized cost | 2,077 | - |
| Accounts receivable, net | 42,371 | 34,137 |
| Income tax receivable | 2,313 | 10,016 |
| Note receivable | 28 | 27 |
| Inventories, net | 37,650 | 34,948 |
| Prepaid expenses and other | 575 | 723 |
| Deferred tax assets | 4,063 | 4,523 |
| Total current assets | 97,294 | 84,387 |
| Property, plant and equipment: | | |
| Land | 1,340 | 1,340 |
| Buildings | 59,615 | 56,057 |
| Machinery and equipment | 117,648 | 114,256 |
| Furniture and fixtures | 8,415 | 7,784 |
| Total property, plant and equipment | 187,018 | 179,437 |
| Less: Accumulated depreciation | 94,384 | 85,935 |
| Property, plant and equipment, net | 92,634 | 93,502 |
| Certificates of deposit | 2,020 | - |
| Investments held to maturity at amortized cost | 3,195 | - |
| Note receivable, long-term | 1,111 | 1,092 |
| Total assets | \$ 196,254 | \$ 178,981 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Revolving credit facility | - | 4,575 |
| Accounts payable | 13,720 | 14,118 |
| Accrued liabilities— | 29,200 | 19,994 |
| Total current liabilities | 42,920 | 38,687 |
| Deferred tax liabilities | 16,343 | 17,790 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.001 par value, 11,250,000 shares authorized, no shares issued | - | - |
| Common stock, \$.004 par value, 112,500,000 shares authorized, 24,537,657 and 24,618,324 issued and outstanding at September 30, 2012 and December 31, 2011, respectively | 98 | 98 |
| Additional paid-in capital | 249 | - |
| Retained earnings | 136,644 | 122,406 |
| Total stockholders' equity | 136,991 | 122,504 |
| Total liabilities and stockholders' equity | \$ 196,254 | \$ 178,981 |

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries
Consolidated Statements of Income
(Unaudited) (In thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| Net sales | \$ 76,816 | \$ 73,829 | \$ 225,106 | \$ 202,818 |
| Cost of sales | 59,667 | 59,570 | 173,336 | 165,184 |
| Gross profit | 17,149 | 14,259 | 51,770 | 37,634 |
| Selling, general and administrative expenses | 6,747 | 5,451 | 19,627 | 16,699 |
| Gain on disposal of assets | 4 | 6 | 17 | 14 |
| Income from operations | 10,406 | 8,814 | 32,160 | 20,949 |
| Interest expense | (16) | (59) | (43) | (173) |
| Interest income | 40 | 22 | 55 | 87 |
| Other income (expense), net | 53 | (122) | 50 | (690) |
| Income before income taxes | 10,483 | 8,655 | 32,222 | 20,173 |
| Income tax provision | 4,476 | 3,029 | 12,351 | 7,058 |
| Net income | \$ 6,007 | \$ 5,626 | \$ 19,871 | \$ 13,115 |
| Earnings per share | | | | |
| Basic | \$ 0.24 | \$ 0.23 | \$ 0.81 | \$ 0.53 |
| Diluted | \$ 0.24 | \$ 0.23 | \$ 0.80 | \$ 0.53 |
| Cash dividends declared per common share: | \$ 0.00 | \$ 0.00 | \$ 0.12 | \$ 0.12 |
| Weighted average shares outstanding: | | | | |
| Basic | 24,535 | 24,667 | 24,558 | 24,708 |
| Diluted | 24,667 | 24,844 | 24,722 | 24,902 |

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries
Consolidated Statements of Stockholders' Equity
(Unaudited) (In thousands)

| | Common Stock | | Paid-in | Retained | |
|---|--------------|--------|----------|------------|------------|
| | Shares | Amount | Capital | Earnings | Total |
| Balance at December 31, 2011 | 24,618 | \$ 98 | \$ – | \$ 122,406 | \$ 122,504 |
| Net income | – | – | – | 19,871 | 19,871 |
| Stock options exercised and restricted stock awards, including tax benefits | 146 | 1 | 1,319 | – | 1,320 |
| Share-based compensation | – | – | 625 | – | 625 |
| Dividends | – | – | – | (2,950) | (2,950) |
| Stock repurchased and retired | (226) | (1) | (1,695) | (2,683) | (4,379) |
| Balance at September 30, 2012 | 24,538 | \$ 98 | \$ 249 | \$ 136,644 | \$ 136,991 |

The accompanying notes are an integral part of these statements.

AAON, Inc., and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited) (In thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2012 | 2011 |
| Operating Activities | | |
| Net income | \$ 19,871 | \$ 13,115 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 10,079 | 8,174 |
| Amortization of bond premiums | 80 | 155 |
| Provision for losses on accounts receivable, net of adjustments | (7) | (242) |
| Share-based compensation | 625 | 509 |
| Excess tax benefits from stock options exercised and restricted stock awards vested | (267) | (176) |
| Gain on disposition of assets | (17) | (14) |
| Foreign currency transaction gain | (40) | - |
| Deferred income taxes | (987) | (48) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (8,227) | 61 |
| Income tax receivable | 5,801 | - |
| Inventories | (2,702) | (8,654) |
| Prepaid expenses and other | 148 | (194) |
| Accounts payable | 2,681 | (2,281) |
| Accrued liabilities | 11,375 | 870 |
| Net cash provided by operating activities | 38,413 | 11,275 |
| Investing Activities | | |
| Proceeds from sale of property, plant and equipment | 311 | 55 |
| Investment in certificates of deposits | (4,280) | - |
| Maturities of certificates of deposits | 1,060 | 1,503 |
| Purchases of investments held to maturity | (5,624) | - |
| Maturities of investments | - | 8,793 |
| Proceeds from called investment | 270 | - |
| Capital expenditures | (12,582) | (30,638) |
| Principal payments from note receivable | 20 | 21 |
| Net cash used in investing activities | (20,825) | (20,266) |
| Financing Activities | | |
| Borrowings under revolving credit facility | 34,847 | 66,557 |
| Payments under revolving credit facility | (39,422) | (52,592) |
| Stock options exercised | 1,053 | 373 |
| Excess tax benefits from stock options exercised and restricted stock awards vested | 267 | 176 |
| Repurchases of stock | (4,379) | (2,662) |
| Cash dividends paid to stockholders | (2,950) | (2,976) |

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| | | |
|--|-----------|----------|
| Net cash (used) provided by financing activities | (10,584) | 8,876 |
| Net increase (decrease) in cash and cash equivalents | 7,004 | (115) |
| Cash and cash equivalents, beginning of year | 13 | 2,393 |
| Cash and cash equivalents, end of period | \$ 7,017 | \$ 2,278 |

The accompanying notes are an integral part of these statements.

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AAON, Inc., and Subsidiaries
Notes to the Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of AAON, Inc., a Nevada corporation, and our operating subsidiaries, both of which are wholly-owned (collectively, the “Company”) have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and with the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The financial statements reflect all adjustments (all of which are of a normal recurring nature) which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of the results that may be expected for a full year. The accompanying unaudited financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because these estimates and assumptions require significant judgment, actual results could differ from those estimates and could have a significant impact on our results of operations, financial position and cash flows. We reevaluate our estimates and assumptions on an ongoing basis.

Accounting Policies

A comprehensive discussion of our critical accounting policies and management estimates is included in Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2011. There have been no significant changes in our critical accounting policies or management estimates.

2. Revenue Recognition

Revenues are recognized when the products are shipped and the title and risk of ownership pass to the customer. Final sales prices are fixed based on purchase orders. Sales allowances and customer incentives are treated as reductions to sales and are provided for based on historical experiences and current estimates. In addition, the Company presents revenues net of sales taxes, and net of certain payments to our independent manufacturer representatives (“Representatives”).

Representatives are national companies that are in the business of providing HVAC units and other related products and services to customers. The end user customer orders a bundled group of products and services from the Representative and expects the Representative to fulfill the order. Only after the specifications are agreed to by the Representative and the customer, and the decision is made to use an AAON HVAC unit, will we receive notice of the order. We establish the amount we must receive for our HVAC unit (“minimum sales price”), but do not control the total order price which is negotiated by the Representative with the end user customer.

We are responsible for billings and collections resulting from all sales transactions, including those initiated by our Representatives. The Representatives submit the total order price to us for invoicing and collection. The total order price includes our minimum sales price and an additional amount which may include both the Representatives' fee and amounts due for additional products and services required by the customer. These additional products and services may include controls purchased from another manufacturer to operate the unit, start-up services, and curbs for supporting the unit ("Third Party Products"). All are associated with the purchase of a HVAC unit but may be provided by the Representative or another third party. The Company is under no obligation related to Third Party Products.

The Representatives do not provide us with a breakout of the amount of the total order price over the minimum sales price which includes the Representatives' fee and Third Party Product amounts ("Due to Representatives"). The Due to Representatives amount is paid only after all amounts associated with the order are collected from the customer.

3. Certificates of Deposits

We have \$3.2 million invested in certificates of deposits as of September 30, 2012 with maturities of two years or less with interest rates ranging from 0.30% to 0.85% per annum. We had no investments in certificates of deposit at December 31, 2011.

4. Investments Held to Maturity

Our investments held to maturity at September 30, 2012 include \$5.3 million of corporate notes and bonds with contractual maturities of two years or less. We had no investments held to maturity at December 31, 2011. The investments have moderate risk with S&P ratings ranging from A- to BBB-.

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

| | Amortized Cost | Gross Unrealized Gain (Loss) (in thousands) | Fair Value |
|------------------------------|-------------------|---|-----------------|
| Current Assets: | | | |
| Investments held to maturity | \$ 2,077 | \$ (1) | \$ 2,078 |
| Non-current Assets: | | | |
| Investments held to maturity | \$ 3,195 | \$ (10) | \$ 3,205 |
| Total | \$ 5,272 | \$ (11) | \$ 5,283 |

5. Accounts Receivable

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

| | September 30, 2012 | December 31, 2011 |
|---------------------------------------|-----------------------|----------------------|
| | (in thousands) | |
| Accounts receivable | \$ 42,603 | \$ 34,405 |
| Less: Allowance for doubtful accounts | (232) | (268) |
| Total, net | \$ 42,371 | \$ 34,137 |

| | Nine Months Ended September 30, 2012 | September 30, 2011 |
|--|--|-----------------------|
| | (in thousands) | |
| Allowance for doubtful accounts: | | |
| Balance, beginning of period | \$ 268 | \$ 600 |
| Provision for losses on accounts receivable | 576 | 513 |
| Adjustments to provision | (584) | (755) |
| Accounts receivable written off, net of recoveries | (28) | (43) |
| Balance, end of period | \$ 232 | \$ 315 |

6. Inventories

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

Inventory balances are as follows:

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| | (in thousands) | |
| Raw materials | \$ 31,305 | \$ 31,746 |
| Work in process | 3,576 | 1,979 |
| Finished goods | 3,069 | 1,523 |
| | 37,950 | 35,248 |
| Less: Allowance for excess and obsolete inventories | (300) | (300) |
| Total, net | \$ 37,650 | \$ 34,948 |

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

| | Nine Months Ended September 30, 2012 | September 30, 2011 |
|--|--|-----------------------|
| | (in thousands) | |
| Allowance for excess and obsolete inventories: | | |

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| | | |
|---|-------|--------|
| Balance, beginning of period | \$300 | \$ 350 |
| Provision for excess and obsolete inventories | - | 205 |
| Adjustments to reserve | - | (250) |
| Inventories written off | - | - |
| Balance, end of period | \$300 | \$ 305 |

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7. Accrued Liabilities

Accrued liabilities are as follows:

| | September 30, 2012 | December 31, 2011 |
|-----------------------------|--------------------|-------------------|
| | (in thousands) | |
| Warranties | \$ 6,668 | \$ 6,093 |
| Due to Representatives | 11,278 | 7,891 |
| Payroll and profit sharing | 3,558 | 1,736 |
| Workers' compensation | 963 | 886 |
| Medical self-insurance | 456 | 326 |
| Employee benefits and other | 6,277 | 3,062 |
| Total | \$ 29,200 | \$ 19,994 |

8. Supplemental Cash Flow Information

Interest payments of approximately \$0.05 million and \$0.2 million were made related to our revolving credit facility during the nine months ended September 30, 2012 and 2011, respectively.

Payments for income taxes of approximately \$11.2 million and \$5.4 million were made during the nine months ended September 30, 2012 and 2011.

Capital expenditures accrued in accounts payable for the nine months ended September 30, 2012 and 2011 were \$0.773 million and \$0.524 million, respectively.

9. Revolving Credit Facility

Our revolving credit facility provides for maximum borrowings of \$30.0 million, which is provided by the Bank of Oklahoma, National Association. Under the line of credit, there is one standby letter of credit totaling \$0.9 million. Borrowings available under the revolving credit facility at September 30, 2012, were \$29.1 million.

There were no borrowings outstanding under the revolving credit facility at September 30, 2012. We had an outstanding balance of \$4.6 million under the revolving credit facility at December 31, 2011. Our weighted average interest rate for intra-period borrowing under the revolving credit facility was approximately 2.8% at September 30, 2012 and 3.4% at December 31, 2011. No fees are associated with the unused portion of the committed amount.

As of September, 2012, we were in compliance with our financial covenants. The covenants are related to our tangible net worth, total liabilities to tangible net worth ratio and working capital. At September 30, 2012, our tangible net worth was \$137.0 million and met the requirement of being at or above \$95.0 million. Our total liabilities to tangible net worth ratio was .43 to 1, and met the requirement of not being above 2 to 1. Our working capital was \$54.0 million and met the requirement of being at or above \$40.0 million.

10. Share-Based Compensation

We have historically maintained a stock option plan for key employees, directors and consultants (the “1992 Plan”). The 1992 Plan provided for 6.6 million shares of common stock to be issued under the plan. Under the terms of the 1992 Plan, the exercise price of shares granted may not be less than 85% of the fair market value at the date of the grant. Options granted to directors prior to May 25, 2004, vest one year from the date of grant and are exercisable for 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 1,125,000 shares that can be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance units and performance awards. Since inception of the LTIP, non-qualified stock options and restricted stock awards have been granted with the same vesting schedule as the previous plan. Under the LTIP, the exercise price of shares granted may not be less than 100% of the fair market value at the date of the grant.

The Company recognizes share-based compensation at fair value in the financial statements. The fair value of each share-based award is estimated at the date of grant using the Black-Scholes pricing model. Total compensation cost, net of estimated forfeitures, is amortized over the requisite service period of the related share-based award.

We recognized approximately \$0.174 million and \$0.088 million for the three months ended, and \$0.383 million and \$0.293 million for the nine months ended, September 30, 2012 and 2011, 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, 2012 is \$2.6 million and is expected to be recognized over a weighted average period of 2.6 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, 2012 | September 30, 2011 |
| Directors and Officers: | | |
| Expected dividend yield | 1.23% | N/A |
| Expected volatility | 47.54% | N/A |
| Risk-free interest rate | 1.19% | N/A |
| Expected life | 7.0 years | N/A |
| Forfeiture rate | 0% | N/A |
| Employees: | | |
| Expected dividend yield | 1.23% | 1.20% |
| Expected volatility | 46.0% | 45.13% |
| Risk-free interest rate | 1.19% | 1.40% |
| Expected life | 8.0 years | 8.0 years |
| Forfeiture rate | 31% | 31% |

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

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A summary of stock options outstanding is as follows:

| Range of Exercise Prices | Number Outstanding at September 30, 2012 | Options Outstanding | | | Options Exercisable | |
|--------------------------|--|---|---------------------------------|---------------------------|--|---------------------------------|
| | | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value | Number Exercisable at September 30, 2012 | Weighted Average Exercise Price |
| 7.21 – 9.71 | 93,350 | 2.90 | \$ 7.93 | \$ 11.76 | 93,350 | \$ 7.93 |
| 10.21 – 12.97 | 253,450 | 5.30 | 11.01 | 8.68 | 184,750 | 11.14 |
| 13.70 – 16.75 | 178,000 | 8.29 | 15.59 | 4.10 | 49,100 | 15.42 |
| 18.30 – 21.57 | 311,075 | 9.59 | 19.48 | 0.21 | 1,500 | 18.30 |
| Total | 835,875 | 7.27 | \$ 14.79 | \$ 8.79 | 328,700 | \$ 10.90 |

A summary of stock option activity is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (\$000) |
|-----------------------------------|------------|---------------------------------|---|-----------------------------------|
| Outstanding at January 1, 2012 | 653,050 | \$ 11.77 | | |
| Granted | 298,575 | 19.45 | | |
| Exercised | (110,250) | 9.55 | | |
| Forfeited or Expired | (5,500) | 14.42 | | |
| Outstanding at September 30, 2012 | 835,875 | 14.79 | 7.27 | \$ 4,094 |
| Exercisable at September 30, 2012 | 328,700 | \$ 10.90 | 4.85 | \$ 2,889 |

The weighted average grant date fair value of options granted during the nine months ended September 30, 2012 and 2011 was \$8.51 and \$6.81, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2012 and 2011 was approximately \$2.1 million and \$0.8 million, respectively. The cash received from options exercised during the nine months ended September 30, 2012 and 2011, was approximately \$1.1 million and \$0.4 million, respectively. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statements of Cash Flows.

A summary of the unvested stock options is as follows:

| | Shares | Weighted Average Grant Date Fair Value |
|--------------------------------|-----------|--|
| Unvested at January 1, 2012 | 286,900 | \$ 5.97 |
| Granted | 298,575 | 8.51 |
| Vested | (72,800) | 5.57 |
| Forfeited | (5,500) | 6.26 |
| Unvested at September 30, 2012 | 507,175 | \$ 7.52 |

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

These awards are recorded at their fair values on the date of grant and compensation cost is recorded using straight-line vesting over the service period. We recognized approximately \$0.087 million and \$0.075 million for the three months, and \$0.241 million and \$0.216 million for the nine months, ended September 30, 2012 and 2011, respectively in pre-tax compensation expense related to restricted stock awards in the Consolidated Statements of Income. In addition, as of September 30, 2012, unrecognized compensation cost related to unvested restricted stock awards was approximately \$0.807 million which is expected to be recognized over a weighted average period of 2.1 years.

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

| | Shares |
|--------------------------------|-----------|
| Unvested at January 1, 2012 | 37,350 |
| Granted | 35,750 |
| Vested | (18,225) |
| Forfeited | - |
| Unvested at September 30, 2012 | 54,875 |

11. Earnings Per Share

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share assumes the conversion of all potentially dilutive securities and is calculated by dividing net income by the sum of the weighted average number of shares of common stock outstanding plus all potentially dilutive securities. Dilutive common shares consist primarily of stock options and restricted stock awards.

The computations of basic and diluted earnings per share are shown as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|------------|------------------------------------|------------|
| | 2012 | 2011 | 2012 | 2011 |
| | (in thousands, except share and per share data) | | | |
| Numerator: | | | | |
| Net income | \$ 6,007 | \$ 5,626 | \$ 19,871 | \$ 13,115 |
| Denominator: | | | | |
| Denominator for basic earnings per share – | | | | |
| Weighted average shares | 24,535,490 | 24,666,775 | 24,558,457 | 24,708,391 |
| Effect of dilutive employee stock options and restricted stock awards | 131,928 | 177,114 | 164,006 | 193,158 |

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| | | | | |
|--|------------|------------|------------|------------|
| Denominator for diluted earnings per share – | | | | |
| Weighted average shares | 24,667,418 | 24,843,889 | 24,722,463 | 24,901,549 |
| Earnings per share: | | | | |
| Basic | \$ 0.24 | \$ 0.23 | \$ 0.81 | \$ 0.53 |
| Diluted | \$ 0.24 | \$ 0.23 | \$ 0.80 | \$ 0.53 |
| Anti-dilutive shares | | | | |
| | 497,575 | 178,750 | 497,575 | 178,750 |
| Weighted average exercise price | | | | |
| | \$ 18.42 | \$ 16.03 | \$ 18.42 | \$ 16.03 |

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12. Income Taxes

For the nine months ended September 30, 2012, our effective tax rate was 38% compared to 35% for the same period in 2011. Our effective rate differs from the statutory federal rate of 35% for certain items, such as state and local taxes, certain State and Federal income tax credits, and certain return to provision adjustments. The change in our effective tax rate from 2011 reflects the loss of certain tax credits.

As of September 30, 2012, we have no unrecognized tax benefits that if recognized would affect the effective tax rate. We do not expect to record any unrecognized tax benefits during the next twelve months.

We recognize accrued interest and penalties related to income tax balances in income tax expense. For the quarter ended September 30, 2012, we did not have any accruals for the potential payment of interest or penalties.

We made payments of approximately \$7.4 million for income taxes during the quarter ended September 30, 2012 and paid \$2.2 million for income taxes in the same period a year ago.

We are subject to examination for tax years 2010, 2011, and to non-U.S. income tax examinations for the tax years of 2007 through 2010. In addition, we are subject to state and local income tax examinations for the tax years 2006 through 2011. We believe our recorded tax liabilities as of September 30, 2012 sufficiently reflect the anticipated outcome of these examinations.

13. Stock Repurchase

On July 1, 2005, we entered into a stock repurchase arrangement by which employee participants in our 401(k) savings and investment plan are entitled to have shares of AAON stock in their accounts sold to us to provide diversification of their investments. Through September 30, 2012, we have repurchased 1.8 million shares for an aggregate price of \$24.3 million, or an average price of \$13.24 per share. We purchased the shares at current market prices.

On November 7, 2006, the Board of Directors authorized us to repurchase shares from certain directors and officers following their exercise of stock options. Since the inception of the program and as of September 30, 2012, we have repurchased a total of approximately 0.664 million shares for an aggregate price of approximately \$9.7 million, or an average price of \$14.64 per share. These shares are purchased at current market prices.

On May 17, 2010, the Board authorized a stock buyback program, targeting repurchases of up to approximately 5% (approximately 1.3 million shares) of our outstanding stock from time to time in open market transactions. Since the inception of the program and as of September 30, 2012, we have repurchased a total of approximately 0.718 million shares for an aggregate price of \$11.5 million, or an average price of \$16.04 per share. We purchased the shares at current market prices. We did not repurchase any shares under this stock buyback program during the nine months ended September 30, 2012.

14. Commitments and Contingencies

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

We are a party to several short-term, cancelable and non-cancelable, fixed and variable price contracts with major suppliers for the purchase of raw material and component parts. We expect to receive delivery of raw materials for use in our manufacturing operations under these contracts. These contracts are not accounted for as derivatives instruments because they meet the normal purchases and sales exemption.

15. Subsequent Events

On November 7, 2012, the Board of Directors declared a regular semi-annual cash dividend of \$0.12 per share. In addition, in view of our strong financial position, the Board also declared a one-time special cash dividend of \$0.12 per share. Both dividends will be paid to the holders of the outstanding Common Stock of the Company as of the close of business on December 3, 2012, the record date, payable December 24, 2012.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes thereto, which are included in this report, and our audited consolidated financial statements and the notes thereto, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. This discussion contains or incorporates by reference "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts, but rather are based on expectations, estimates, assumptions and projections about our industry, business and future financial results, based on information available at the time this report is filed with the Securities and Exchange Commission or, with respect to any document incorporated by reference, available at the time that such document was prepared. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those identified in the section entitled "Forward-Looking Statements" in this Item 2 of this Quarterly Report on Form 10-Q and in the section entitled "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. We do not assume any obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, new information or circumstances or otherwise, except as required by law.

Overview

We engineer, manufacture and market air-conditioning and heating equipment consisting of rooftop units, chillers, air-handling units, make-up air units, heat recovery units, condensing units, commercial self-contained units and coils. These products are marketed and sold to retail, manufacturing, educational, medical and other commercial industries. We market units to all 50 states in the United States and certain provinces in Canada. For the quarter just ended, foreign sales were approximately 6% of our total net sales.

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 state of the economy has negatively impacted the commercial and industrial new construction markets. If there is a further decline in the economic activity in the U.S. or further deterioration in the capital markets it could affect the level of activity in the markets in which we operate and therefore could result in a decrease of 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. Demand for our products is influenced by national and regional economic and demographic factors. The commercial and industrial new construction market is subject to cyclical fluctuations in that it is generally tied to housing starts, but has a lag factor of 6 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 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, which are obtained from domestic suppliers.

The price levels of our raw materials have moderated from the high prices we experienced a year ago, but the market continues to be volatile and unpredictable as a result of the uncertainty related to the U.S. economy, a weakening global economy, and November 2012's presidential election. For the nine months ended September 30, 2012, the price for steel increased by approximately 1% and the cost for aluminum decreased approximately 10%, while the

price of copper remained relatively unchanged from a year ago.

We attempt to limit the impact of price fluctuations on these materials by entering into cancelable and non-cancelable fixed price contracts with our major suppliers for periods of 6 to 18 months. We expect to receive delivery of raw materials from our fixed price contracts for use in our manufacturing operations. In addition, from time to time we use derivative contracts to partially mitigate the volatility in the prices for some of these commodities. We did not enter into a derivative contract for any of our key raw materials during the quarters ended September 30, 2012 and 2011.

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Key financial highlights impacting our financial condition, results of operations and cash position for the quarter ended September 30, 2012 are as follows:

- Net sales for the third quarter of 2012 increased to \$76.8 million compared to \$73.8 million in 2011, or a 4% increase. Year-to-date net sales increased 11% to \$225.1 million compared to \$202.8 million in 2011.
- Income from operations for the third quarter of 2012 increased to \$10.4 million, or 18.1% compared to \$8.8 million in 2011. Income from operations for the nine months ended September 30 in 2012 increased 53.5% to \$32.2 million compared to \$20.9 million for the same period in 2011.
- Working capital was \$54 million in the third quarter of 2012 – an improvement of \$12 million, or 30% from the same period a year ago.
- Cash provided by operations was \$38.4 million compared to \$11.3 million in the third quarter of 2011. Cash used in investing activities was \$20.8 million versus \$20.3 million for the same period in 2011.
- Net income for the third quarter of 2012 increased to \$6.0 million or 6.8% compared to \$5.6 million in 2011.
- Diluted earnings per share were \$0.24 and \$0.80 for the three months and nine months ended on September 30, 2012 compared to \$0.23 and \$0.53 for the same periods in 2011.

Results of Operations

Three Months Ended September 30, 2012 vs. Three Months Ended September 30, 2011

The following table provides a summary of our financial results, including information presented as a percentage of net sales (dollars in thousands):

| | Three Months Ended September 30, | | | | Percent of sales | |
|--|----------------------------------|-----------|---------------------------|---------|------------------|--------|
| | 2012 | 2011 | Increase (Decrease) \$ | % | 2012 | 2011 |
| Net sales | \$ 76,816 | \$ 73,829 | 2,987 | 4.0 | 100.0 | 100.0 |
| Cost of sales | 59,667 | 59,570 | 97 | 0.2 | 77.7 | 80.7 |
| Gross profit | 17,149 | 14,259 | 2,890 | 20.3 | 22.3 | 19.3 |
| Selling, general and administrative expenses | 6,747 | 5,451 | 1,296 | 23.8 | 8.8 | 7.4 |
| Gain on disposal of assets | 4 | 6 | (2) | (33.3) | 0.0 | 0.0 |
| Income from continuing operations | 10,406 | 8,814 | 1,592 | 18.1 | 13.5 | 11.9 |
| Interest expense | (16) | (59) | (43) | (72.9) | 0.0 | (0.1) |
| Interest income | 40 | 22 | 18 | 81.8 | 0.1 | 0.0 |
| Other income (expense), net | 53 | (122) | 175 | 143.4 | 0.1 | (0.2) |
| Income before income taxes | 10,483 | 8,655 | 1,828 | 21.1 | 13.7 | 11.6 |
| Income tax provision | 4,476 | 3,029 | 1,447 | 47.8 | 5.9 | 4.0 |
| Net income | \$ 6,007 | \$ 5,626 | 381 | 6.8 | 7.8 | 7.6 |

Net Sales

Net sales in the third quarter of 2012 increased \$3.0 million, or 4%, to \$76.8 million from \$73.8 million compared to the same period in 2011. The increase in net sales can be attributed to gains in market share in the non-residential and replacement markets along with price increases introduced earlier in the year. Market conditions remain tight as HVAC industry players compete for the same customers who are cautious about spending funds in new projects because of the uncertainty surrounding the pending tax increases and government spending cuts that could take effect in January.

Gross Profit

Gross profit increased \$2.9 million, or 20.3% to \$17.1 million, in the third quarter of 2012 from \$14.2 million in 2011. As a percentage of sales, gross margins were 22.3% in the quarter just ended compared to 19.3% in 2011. The improvement in gross margins can be attributed to cost savings in raw materials, increased product prices and product mix, and improved productivity.

Selling, General and Administrative Expenses

Selling, General and Administrative (“SG&A”) expenses increased by \$1.2 million, or 23.8% to \$6.7 million for the quarter just ended compared to \$5.5 million in 2011. As a percentage of net sales, SG&A was 8.8% of total sales in the third quarter of 2012 and 7.4% in 2011. The increase in SG&A is primarily due to higher profit sharing expense of approximately \$0.258 million a result of higher operating income before income taxes, higher warranty charges of \$0.285 million and bad debt expense of \$0.008 million as a result of increased sales in the quarter just ended compared to 2011, higher employee salaries of \$0.649 million as a result of salary pay increases and management discretionary bonus incentive plan, and insurance expense of approximately \$0.026 million.

Interest Expense

Interest expense for the three months ended September 30, 2012 decreased \$0.043 million to \$0.016 million compared to \$0.059 million in 2011 primarily as a result of higher net borrowings for the three months ended September 30, 2011.

Other Income (Expense), net

Other income, net was \$0.053 million in the third quarter of 2012 compared to an expense of \$0.122 million in 2011. For the quarter just ended, other income is primarily driven by foreign currency exchange rate gain of approximately \$0.048 million, and miscellaneous non-operating charges of approximately \$0.005 million.

Income Tax Expense

Income tax expense was \$4.5 million in the third quarter of 2012 compared to \$3.0 million in 2011. The effective tax rate was 43% for the third quarter of 2012 and 35% for the third quarter of 2011. Our effective rate differs from the statutory federal rate of 35% for certain items, such as state and local taxes, certain State and Federal income tax credits, and certain return to provision adjustments. The change in our effective tax rate from 2011 reflects the loss of certain tax credits.

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Nine Months Ended September 30, 2012 vs. Nine Months Ended September 30, 2011

The following table provides a summary of our financial results, including information presented as a percentage of net sales (dollars in thousands):

| | Nine Months Ended September 30, | | | | Percent of sales | |
|--|---------------------------------|------------|---------------------|---------|------------------|--------|
| | 2012 | 2011 | Increase (Decrease) | | 2012 | 2011 |
| | | | \$ | % | | |
| Net sales | \$ 225,106 | \$ 202,818 | 22,288 | 11.0 | 100.0 | 100.0 |
| Cost of sales | 173,336 | 165,184 | 8,152 | 4.9 | 77.0 | 81.4 |
| Gross profit | 51,770 | 37,634 | 14,136 | 37.6 | 23.0 | 18.6 |
| Selling, general and administrative expenses | 19,627 | 16,699 | 2,928 | 17.5 | 8.7 | 8.2 |
| Gain on disposal of assets | 17 | 14 | 3 | 21.4 | 0.0 | 0.0 |
| Income from continuing operations | 32,160 | 20,949 | 11,211 | 53.5 | 14.3 | 10.4 |
| Interest expense | (43) | (173) | (130) | (75.1) | 0.0 | (0.1) |
| Interest income | 55 | 87 | (32) | (36.8) | 0.0 | 0.0 |
| Other income (expense), net | 50 | (690) | 740 | 107.2 | 0.0 | (0.3) |
| Income before income taxes | 32,222 | 20,173 | 12,049 | 59.7 | 14.3 | 10.0 |
| Income tax provision | 12,351 | 7,058 | 5,293 | 75.0 | 5.5 | 3.5 |
| Net income | \$ 19,871 | \$ 13,115 | 6,756 | 51.5 | 8.8 | 6.5 |

Net Sales

Net sales increased \$22.3 million or 11.0 % to \$225.1 million for the nine months ended September 30, 2012 compared to \$202.8 million in the same period in 2011. The overall increase in net sales is the result of gain in market share from new non-residential construction and replacement markets in addition to product price increases introduced earlier in the year.

Gross Profit

Gross profit increased \$14.1 million or 37.6% to \$51.8 million for the first nine months of 2012 from \$37.6 million in 2011. As a percentage of sales, gross margins were 23.0% for the nine months ended September 30, 2012 compared to 18.6% for the same period in 2011. The improvement in gross margins can be attributed to raw material cost savings as a result of commodity prices declining due to the uncertainty in the U.S. economy, and improved productivity due to our new sheet metal fabrication equipment put in service during the fourth quarter of 2011 and revamped production lines that resulted in the favorable absorption of fixed overhead costs due to higher production volume and greater manufacturing efficiencies.

For the same period in 2011, gross profit was impacted by increased labor costs and labor inefficiencies associated with a severe snowstorm that caused some damages to one of our Tulsa production facilities that affected three production lines resulting in lost production days. Also, gross margin was impacted by our inability to pass on to our customers escalating costs of part components and raw material in the form of price increases.

Selling, General and Administrative Expenses

Selling, General and Administrative (“SG&A”) expenses increased by \$2.9 million, or 17.5% to \$19.6 million for the first nine months just ended compared to \$16.7 million incurred in the same period a year ago. As a percentage of net sales, SG&A was 8.7% of total sales in 2012 and 8.2% in 2011. The increase in SG&A is primarily due to higher profit sharing expense of approximately \$1.23 million a result of higher operating income before income taxes, higher warranty charges of \$0.683 million and bad debt expense of \$0.063 million as a result of increased sales for the first nine months of 2012 compared to 2011, higher employee salaries of \$0.769 million as a result of salary pay increases and management discretionary bonus incentive plan, and insurance expense of approximately \$0.177 million.

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Interest Expense

Interest expense for the nine months ended September 30, 2012 decreased \$0.13 million compared with the same period of 2011 primarily as a result of lower net borrowing for the nine months ended September 30, 2012.

Other Income (Expense), net

Other income, net was \$0.05 million for the first nine months of 2012 compared to an expense of \$0.69 million in 2011. Other expense, net was higher in 2011 as the Company incurred repair expenses to repair damages to the roof of one of our manufacturing facilities in Tulsa caused by a severe snowstorm in February 2011.

Income Tax Expense

The income tax expense was \$12.3 million in the first nine months of 2012 compared to \$7.0 million in 2011. The effective tax rate was 38% for 2012 and 35% in 2011. Our effective rate differs from the statutory federal rate of 35% for certain items, such as state and local taxes, certain State and Federal income tax credits, and certain return to provision adjustments. The change in our effective tax rate from 2011 reflects the loss of certain tax credits.

Liquidity and Capital Resources

Our primary sources of liquidity are cash flows generated from our operating activities and the borrowing capacity under the revolving line of credit provided by the Bank of Oklahoma, National Association. Our primary uses of cash are working capital, capital expenditures, contractual obligations, stock repurchases, and dividend payments.

General

At September 30, 2012 our revolving credit facility provided for maximum borrowings of \$30.0 million. We have a standby letter of credit that expires on December 31, 2012 of approximately \$0.9 million, which meets the requirement for our worker's compensation insurance program. There are no fees associated with the unused portion of the committed amount.

During the quarter just ended September 30, 2012, we borrowed \$7.7 million and made payments of \$14.9 million under the revolving credit facility. Interest on borrowings is payable monthly at LIBOR plus 2.5%. We paid interest at a weighted average rate of 2.8% during the nine months just ended, and 3.4% for the year ended December 31, 2011.

We had no outstanding balance under the revolving credit facility at September 30, 2012 and \$4.6 million at December 31, 2011. Borrowings available under the revolving credit facility at September 30, 2012 were \$29.1 million.

As of September 30, 2012, we were in compliance with the financial covenants in the revolving credit facility and anticipate our compliance will continue during the remainder of 2012. These covenants require us to meet certain parameters related to our tangible net worth, total liabilities to tangible net worth ratio and working capital. At September 30, 2012, our tangible net worth was \$137.0 million, which meets the requirement of being at or above \$95.0 million. Our total liabilities to tangible net worth ratio was .43 to 1, which meets the requirement of not being above 2 to 1. Our working capital was \$54.0 million which meets the requirement of being at or above \$40.0 million.

On July 29, 2012, we renewed our \$30 million line of credit with a new maturity date of July 28, 2013. We expect to renew our revolving credit agreement in July 2013.

On November 7, 2012, the Board of Directors declared a regular semi-annual cash dividend of \$0.12 per share. In addition, in view of our strong financial position, the Board also declared a one-time special cash dividend of \$0.12 per share. Both dividends will be paid to the holders of the outstanding Common Stock of the Company as of the close of business on December 3, 2012, the record date, payable December 24, 2012.

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For the nine months just ended, we repurchased shares of stock from our employees' 401(k) savings and investment plan in the amount of \$2.8 million for approximately 0.142 million shares, as compared to \$2.7 million for approximately 0.133 million shares for the same period in 2011.

Management believes that our projected cash flows from operations and the revolving credit facility, or comparable financing, will provide the necessary liquidity and capital resources for fiscal year 2012 and the foreseeable future. This expectation is based upon, among other things, our knowledge of the heating, ventilation, and air conditioning ("HVAC") industry and our leadership in the industry, our sales volumes, market prices for our products, our ability to limit the growth of our business if necessary, our ability to adjust dividend cash payments, our relationship with the existing bank lender, and general industry and economic conditions.

Statement of Cash Flows

The following table reflects the major categories of cash flows for the nine months ended September 30, 2012 and 2011. For additional details, see the Condensed Consolidated Statements of Cash Flows in the condensed consolidated financial statements.

| | 2012 (in millions) | 2011 |
|--|-----------------------|---------|
| Net cash provided by operating activities | \$ 38.4 | \$ 11.3 |
| Net cash (used) in investing activities | (20.8) | (20.3) |
| Net cash (used) provided by financing activities | (10.6) | 8.9 |

Cash Flows Provided by Operating Activities

For the first nine months of 2012, cash provided by operations amounted to \$38.4 million as compared to \$11.3 million in the same period in 2011. The increase in cash flows is due to higher net income of \$19.9 million in 2012 and favorable change in working capital. Significant fluctuations in working capital were as follows:

- Inventory levels resulted in a use of cash of \$2.7 million for the first nine months of 2012 compared to a use of cash of \$8.7 million for the same period in 2011 primarily as a result of increased sales and backlog.
- Increased accounts receivable was a use of cash of \$8.2 million during the first nine months primarily as a result of increased sales.
- Payables and accrued expenses increased cash by approximately \$14.1 million, mainly as a result of increased purchases of inventories and accrued liabilities for payroll, employee benefits and commissions due to our representatives.

Cash Flows Used in Investing Activities

Net cash used in investing activities was \$20.8 million for the first nine months of 2012 as compared to cash used of \$20.3 million for the same period of 2011. For the quarter just ended cash used in investing activities includes investments of \$9.9 million in certificate of deposits and corporate bonds and notes, and capital expenditures of \$12.6 million, offset by proceeds from the sale of assets of approximately \$0.311 million and proceeds from the maturities of certificates of deposits of \$1.1 million. For the same period in 2011, we invested \$30.6 million in capital expenditures offset by proceeds of approximately \$10.3 million from investments.

Cash Flows (Used) Provided by Financing Activities

Net cash used by financing activities was \$10.6 million for the first nine months of 2012 compared to net cash provided of \$8.9 million for the same period in 2011. The most significant items affecting the comparison of our financing cash flows for these periods primarily relate to a decrease in net borrowings activity from our revolving line of credit of approximately \$18.5 million and an increase in repurchases of stock of \$1.7 million under the share repurchase program, offset by an overall net increase in stock options and restricted stock awards exercised of \$0.771 million.

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Off-Balance Sheet Arrangements

We are not a 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.

Contractual Obligations

As of September 30, 2012, there were no material changes outside the ordinary course of business in the contractual obligations disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011 under the caption “Contractual Obligations.”

Critical Accounting Policies

There has been no material changes in the Company’s critical accounting policies during the nine months ended September 30, 2012.

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “expects”, “anticipates”, “intends”, “plans”, “believes”, “seeks”, “estimates”, “should”, and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Important factors that could cause results to differ materially from those in the forward-looking statements include (1) the timing and extent of changes in raw material and component prices, (2) the effects of fluctuations in the commercial/industrial new construction market, (3) the timing and extent of changes in interest rates, as well as other competitive factors during the year, and (4) general economic, market or business conditions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

We are subject to interest rate risk on the revolving credit facility which bears variable interest based upon a rate of LIBOR plus 2.5%. At September 30, 2012, the available balance under the revolving credit facility was \$29.1 million.

Commodity Price Risk

Our exposure to commodity cost risk is related primarily to the price of copper, steel, and aluminum, as these are major components of our product cost. We are exposed to volatility in the prices of these commodities and occasionally we use fixed price cancellable and non-cancellable contracts with our major suppliers for periods of 6 to 18 months to manage this exposure.

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures

Under the direction and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) as of the end of the period covered by this quarterly report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that due to a material weakness in the review procedures associated with key financial statement elements related to intercompany activities, income taxes and inventory, disclosure controls and procedures were not effective as of September 30, 2012.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

In light of the material weakness, the Company performed additional analysis and other post-closing procedures to ensure that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles and accurately reflect the results for the quarter ended September 30, 2012. As a result, notwithstanding the material weakness as described above, management concluded that the consolidated financial statements included in this Form 10-Q fairly present in all material respects the Company's financial position, results of operations and cash flows for the periods presented.

Changes in internal controls

In response to the material weakness in internal control over financial reporting encountered during the third quarter of 2012, we are undertaking efforts to remediate the material weakness. The material weakness will be fully remediated when, in the opinion of management, the revised control processes have been operating for a sufficient period of time to provide reasonable assurance as to their effectiveness. The remediation and ultimate resolution of our material weakness will be reviewed with the Audit Committee of our Board of Directors.

During the quarter ended September 30, 2012, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011. The risk factors described in our Annual Report could materially adversely affect our business, financial condition or future results. There have been no other material changes to the risk factors included in our 2011 Annual Report, other than the risk described below.

During the first and third quarters of 2012 we identified material weaknesses in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act. As previously disclosed in Item 4 of Part I of this report, during the quarter ended March 31, 2012, management identified a material weakness in our internal control over financial reporting related to our valuation of inventory. During the quarter ended September 30, 2012 management identified a material weakness in the review procedures associated with key financial statement elements related to intercompany activities, income taxes and inventory, and concluded that disclosure controls and procedures were not effective. As a result of this weakness, our management concluded that our internal control over financial reporting was not effective as of the last day of the period covered by this report. We are actively engaged in developing a remediation plan designed to address the material weaknesses. See Item 4 “Controls and Procedures.” If our remedial measures are insufficient to address the material weaknesses or if additional material weaknesses or significant deficiencies in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results.

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

On July 1, 2005, we entered into a stock repurchase arrangement by which employee participants in our 401(k) savings and investment plan are entitled to have shares of AAON stock in their accounts sold to us to provide diversification of their investments. Through September 30, 2012, we have repurchased 1.8 million shares for an aggregate price of \$24.3 million, or an average price of \$13.24 per share. We purchased the shares at current market prices.

On November 7, 2006, the Board of Directors authorized us to repurchase shares from certain directors and officers following their exercise of stock options. Since the inception of the program and as of September 30, 2012, we have repurchased a total of approximately 0.664 million shares for an aggregate price of approximately \$9.7 million, or an average price of \$14.64 per share. These shares are purchased at current market prices.

On May 17, 2010, the Board authorized a stock buyback program, targeting repurchases of up to approximately 5% (approximately 1.3 million shares) of our outstanding stock from time to time in open market transactions. Since the inception of the program and as of September 30, 2012, we have repurchased a total of approximately 0.718 million shares for an aggregate price of \$11.5 million, or an average price of \$16.04 per share. We purchased the shares at current market prices. We did not repurchase any shares under this stock buyback program during the nine months ended September 30, 2012.

Repurchases during the third quarter of 2012 were as follows:

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid Per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|----------------|---|--|---|---|
| July 2012 | 19,407 | \$ 19.68 | 19,407 | - |
| August 2012 | 18,378 | \$ 18.76 | 18,378 | - |
| September 2012 | 6,919 | \$ 19.88 | 6,919 | - |
| Total | 44,704 | \$ 19.34 | 44,704 | - |

Item 4. Mine Safety Disclosures

Not applicable

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

None

Item 5. Other Information.

None

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Item 6. Exhibits.

(a) Exhibits

- | | | |
|-------|---------------------|-----------------------------------|
| (i) | <u>Exhibit 31.1</u> | Section 302 Certification of CEO |
| (ii) | <u>Exhibit 31.2</u> | Section 302 Certification of CFO |
| (iii) | <u>Exhibit 32.1</u> | Section 1350 Certification of CEO |
| (iv) | <u>Exhibit 32.2</u> | Section 1350 Certification of CFO |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AAON, INC.

Dated: November 8, 2012

By:

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

Dated: November 8, 2012

By:

/s/ Scott M. Asbjornson
Scott M. Asbjornson
Vice President/CFO