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 June 30, 2019

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	(IRS Employer
of incorporation or organization)	Identification No.)

2425 South Yukon Ave., 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 [ü] No [ ]

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ü] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "small reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	[ü]	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.[ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ☐ No [ü]

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	AAON	NASDAQ

As of July 30, 2019, registrant had outstanding a total of 52,107,053 shares of its $.004 par value Common Stock.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	June 30, 2019	December 31, 2018
Assets	*(in thousands, except share and per share data)*	
Current assets:		
Cash and cash equivalents	$ 13,683	$ 1,994
Certificates of deposit	4,000	—
Accounts receivable, net	68,933	54,078
Income tax receivable	3,246	6,104
Note receivable	28	27
Inventories, net	77,044	77,612
Prepaid expenses and other	1,696	1,046
Total current assets	168,630	140,861
Property, plant and equipment:		
Land	3,125	3,114
Buildings	99,193	97,393
Machinery and equipment	219,438	212,779
Furniture and fixtures	17,107	16,597
Total property, plant and equipment	338,863	329,883
Less: Accumulated depreciation	171,232	166,880
Property, plant and equipment, net	167,631	163,003
Intangible assets, net	389	506
Goodwill	3,229	3,229
Right of use assets	1,764	—
Note receivable	608	598
Total assets	$ 342,251	$ 308,197
Liabilities and Stockholders' Equity		
Current liabilities:		
Revolving credit facility	$ —	$ —
Accounts payable	7,885	10,616
Dividends payable	8,355	—
Accrued liabilities	42,713	37,455
Total current liabilities	58,953	48,071
Deferred tax liabilities	14,938	10,826
Other long-term liabilities	3,791	1,801
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value, 5,000,000 shares authorized, no shares issued	—	—
Common stock, $.004 par value, 100,000,000 shares authorized, 52,118,180 and 51,991,242 issued and outstanding at June 30, 2019 and December 31, 2018, respectively	209	208
Additional paid-in capital	1,586	—
Retained earnings	262,774	247,291
Total stockholders' equity	264,569	247,499
Total liabilities and stockholders' equity	$ 342,251	$ 308,197

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	**2018**	**2019**	**2018**
	(in thousands, except share and per share data)			
Net sales	$ 119,437	$ 109,588	$ 233,259	$ 208,670
Cost of sales	89,262	82,003	177,291	165,695
Gross profit	30,175	27,585	55,968	42,975
Selling, general and administrative expenses	13,481	13,086	24,482	23,305
Loss (gain) on disposal of assets	6	(4)	290	(11)
Income from operations	16,688	14,503	31,196	19,681
Interest income, net	31	67	40	135
Other expense, net	17	12	(9)	6
Income before taxes	16,736	14,582	31,227	19,822
Income tax provision	3,775	2,891	7,364	3,871
Net income	$ 12,961	$ 11,691	$ 23,863	$ 15,951
Earnings per share:				
Basic	$ 0.25	$ 0.22	$ 0.46	$ 0.30
Diluted	$ 0.25	$ 0.22	$ 0.45	$ 0.30
Cash dividends declared per common share:	$ 0.16	$ 0.16	$ 0.16	$ 0.16
Weighted average shares outstanding:				
Basic	52,120,272	52,383,842	52,087,626	52,348,912
Diluted	52,747,199	52,717,787	52,589,845	52,754,045

The accompanying notes are an integral part of these consolidated financial statements.

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

	Common Stock		Paid-in	Retained	
	Shares	Amount	Capital	Earnings	Total
			(in thousands)		
Balances at December 31, 2018	51,991	$ 208	$ —	$ 247,291	$ 247,499
Net income	—	—	—	23,863	23,863
Stock options exercised and restricted stock awards granted	384	2	7,683	—	7,685
Share-based compensation	—	—	5,073	—	5,073
Stock repurchased and retired	(257)	(1)	(11,170)	—	(11,171)
Dividends	—	—	—	(8,380)	(8,380)
Balances at June 30, 2019	52,118	$ 209	$ 1,586	$ 262,774	$ 264,569

The accompanying notes are an integral part of these consolidated financial statements.

AAON, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30,	
	2019	**2018**
Operating Activities	*(in thousands)*	
Net income	$ 23,863	$ 15,951
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,760	8,438
Amortization of bond premiums	—	8
Provision for losses on accounts receivable, net of adjustments	128	89
Provision for excess and obsolete inventories	1,153	299
Share-based compensation	5,073	3,699
Loss (gain) on disposition of assets	290	(11)
Foreign currency transaction gain	(13)	15
Interest income on note receivable	(26)	14
Deferred income taxes	4,112	438
Changes in assets and liabilities:		
Accounts receivable	(14,983)	(2,087)
Income taxes	2,858	(3,328)
Inventories	(585)	1,400
Prepaid expenses and other	(650)	(935)
Accounts payable	(2,592)	12,974
Deferred revenue	172	(931)
Accrued liabilities	5,312	213
Net cash provided by operating activities	35,872	36,246
Investing Activities		
Capital expenditures	(16,784)	(25,925)
Cash paid in business combination	—	(6,377)
Proceeds from sale of property, plant and equipment	59	11
Investment in certificates of deposits	(6,000)	(7,200)
Maturities of certificates of deposits	2,000	4,560
Purchases of investments held to maturity	—	(9,001)
Maturities of investments	—	11,620
Proceeds from called investments	—	495
Principal payments from note receivable	28	16
Net cash used in investing activities	(20,697)	(31,801)
Financing Activities		
Stock options exercised	7,685	2,299
Repurchase of stock	(10,191)	(11,539)
Employee taxes paid by withholding shares	(980)	(808)
Net cash used in financing activities	(3,486)	(10,048)
Net increase (decrease) in cash and cash equivalents	11,689	(5,603)
Cash and cash equivalents, beginning of period	1,994	21,457
Cash and cash equivalents, end of period	$ 13,683	$ 15,854

The accompanying notes are an integral part of these consolidated financial statements.

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

1. General

Basis of Presentation

The accompanying unaudited consolidated financial statements of AAON, Inc., a Nevada corporation, and our operating subsidiaries, all 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"). These financial statements have not been audited by the Company's independent registered public accounting firm, except that the consolidated balance sheet at December 31, 2018 is derived from audited consolidated financial statements. 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. Certain disclosures have been condensed in or omitted from these consolidated financial statements. 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, 2018. All intercompany balances and transactions have been eliminated in consolidation.

We are engaged in the engineering, manufacturing, marketing and sale of 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, coils and controls.

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 and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because these estimates and assumptions require significant judgment, 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 as needed, but at a minimum on a quarterly basis. The most significant estimates include, but are not limited to, the fair-value of acquisitions, inventory reserves, warranty accrual, worker's compensation accrual, medical insurance accrual, income taxes and share-based compensation. Actual results could differ materially from those estimates.

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, 2018.

Business Combinations

We record the assets acquired and liabilities assumed in a business combination at their acquisition date fair values.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value is based upon assumptions that market participants would use when pricing an asset or liability. We use the following fair value hierarchy, which prioritizes valuation technique inputs used to measure fair value into three broad levels:

- Level 1: Quoted prices in active markets for identical assets and liabilities that we have the ability to access at the measurement date.
- Level 2: Inputs (other than quoted prices included within Level 1) that are either directly or indirectly observable for the asset or liability, including (i) quoted prices for similar assets or liabilities in active markets, (ii) quoted prices for identical or similar assets or liabilities in inactive markets, (iii) inputs other than quoted prices that are observable for the asset or liability, and (iv) inputs that are derived from observable market data by correlation or other means.

- Level 3: Unobservable inputs for the asset or liability including situations where there is little, if any, market activity for the asset or liability. Items categorized in Level 3 include the estimated business combination fair values of property, plant and equipment, intangible assets and goodwill.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall into different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to a fair value measurement requires judgment, considering factors specific to the asset or liability.

Investments

We held approximately $4 million in certificates of deposit at June 30, 2019. The certificates of deposit bear interest ranging from 2.25% to 2.30% per annum and have maturities of less than one month.

Intangible Assets

Our intangible assets include various trademarks, service marks and technical knowledge acquired in our February 2018 business combination (see Note 3). We amortize our intangible assets on a straight-line basis over the estimated useful lives of the assets. We evaluate the carrying value of our amortizable intangible assets for potential impairment when events and circumstances warrant such a review.

Goodwill

Goodwill represents the excess of the consideration paid for the acquired businesses over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill at June 30, 2019 is deductible for income tax purposes. Goodwill is not amortized, but instead is evaluated for impairment at least annually. We perform our annual assessment of impairment during the fourth quarter of our fiscal year, and more frequently if circumstances warrant.

Recent 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 ("ASC").

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 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.

2. Revenue Recognition

On January 1, 2018, we adopted the new accounting standard FASB ASC 606, *Revenue from Contracts with Customers*, and all the related amendments to all contracts using the retrospective method. The impact at adoption was not material to the consolidated financial statements. The new accounting policy provides results substantially consistent with prior revenue recognition policies.

Disaggregated net sales by major source:

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Rooftop Units	$ 88,757	$ 83,665	$ 177,100	$ 158,480
Condensing Units	5,156	4,855	9,206	9,136
Air Handlers	6,033	6,553	11,627	11,793
Outdoor Mechanical Rooms	825	894	1,307	1,867
Water Source Heat Pumps	6,822	2,741	12,666	7,128
Part Sales	8,799	6,702	15,289	12,662
Other	3,045	4,178	6,064	7,604
Net Sales	$ 119,437	$ 109,588	$ 233,259	$ 208,670

Disaggregated units sold by major source:

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Rooftop Units	3,797	4,175	7,559	7,643
Condensing Units	479	625	873	1,036
Air Handlers	537	818	1,117	1,354
Outdoor Mechanical Rooms	10	13	21	27
Water Source Heat Pumps	2,377	1,004	4,666	2,618
Total Units	7,200	6,635	14,236	12,678

The Company recognizes revenue when it satisfies the performance obligation in its contracts. Most of the Company's products are highly customized, cannot be resold to other customers and the cost of rework to be resold is not economical. The Company has a formal cancellation policy and generally does not accept returns on these units. As a result, many of the Company's products do not have an alternative use and therefore, for these products we recognize revenue over the time it takes to produce the unit. For all other products that are part sales or standardized units, we satisfy the performance obligation when the title and risk of ownership pass to the customer, generally at time of shipment. 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. Sales of our products are moderately seasonal with the peak period being July - November of each year.

In addition, the Company presents revenues net of sales tax 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 that 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' fee and Third Party Products amounts ("Due to Representatives") are paid only after all amounts associated with the order are collected from the customer. The amount of payments to our Representatives were $10.2 million and $13.3 million for the three months ended June 30, 2019 and 2018, respectively and $21.7 million and $24.9 million for the six months ended June 30, 2019 and 2018, respectively.

The Company also sells extended warranties on parts for various lengths of time ranging from six months to 10 years. Revenue for these separately priced warranties is deferred and recognized on a straight-line basis over the separately priced warranty period.

3. Business Combination

On February 28, 2018, we closed on the purchase of substantially all of the assets of WattMaster Controls, Inc., ("WattMaster"). The assets acquired consisted primarily of intellectual property, receivables, inventory and fixed assets. The Company also hired substantially all of the WattMaster employees. These assets and workforce have allowed us to accelerate the development of our own electronic controllers for air distribution systems. We funded the business combination with available cash of $6.0 million. We paid the final working capital settlement of $0.4 million with available cash in May 2018. We have included the results of WattMaster's operations in our consolidated financial statements beginning March 1, 2018.

The following table presents the allocation of the consideration paid to the assets acquired and liabilities assumed, based on their fair values, in the acquisition of WattMaster described above:

		(in thousands)
Accounts receivable	$	1,082
Inventories		1,380
Property, plant and equipment		340
Intellectual property		700
Goodwill		3,229
Assumed current liabilities		(354)
Consideration paid	$	6,377

Goodwill represents the excess of the consideration paid for the acquired businesses over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill represents a premium paid to acquire the skilled workforce of the business acquired and is deductible for federal income tax purposes.

4. Leases

We adopted ASU No. 2016-02, *Leases (Topic 842)*, as amended, as of January 1, 2019, using the transition method, which becomes effective upon the date of adoption. 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. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to carry forward the historical lease classification. We have also elected the short-term lease measurement and recognition exemption which does not require balance sheet presentation for short-term leases. The Company historically does not enter into numerous or material lease agreements to support its manufacturing operations. Furthermore, any lease agreements entered into are usually less than a year and for leases on non material assets such as warehouse vehicles and office equipment.

Adoption of the new standard resulted in the recording of additional lease right of use assets and lease liabilities of approximately $1.8 million as of January 1, 2019, which mostly relates to the multi-year facility lease assumed in the 2018 WattMaster acquisition. The cumulative-effect adjustments to the opening balance was immaterial to the consolidated financial statements as a whole. The standard did not materially impact our consolidated net earnings or cash flows.

5. Accounts Receivable

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

	June 30, 2019	December 31, 2018
	(in thousands)	
Accounts receivable	$ 69,325	$ 54,342
Less: Allowance for doubtful accounts	(392)	(264)
Total, net	$ 68,933	$ 54,078

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Allowance for doubtful accounts:	*(in thousands)*			
Balance, beginning of period	$ 379	$ 108	$ 264	$ 119
Provisions for losses on accounts receivables, net of adjustments	13	109	128	98
Accounts receivable written off, net of recoveries	—	(9)	—	(9)
Balance, end of period	$ 392	$ 208	$ 392	$ 208

6. Inventories

Inventories are valued at the lower of cost or net realizable value. 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.

The components of inventories are as follows:

	June 30, 2019	December 31, 2018
	(in thousands)	
Raw materials	$ 71,348	$ 67,995
Work in process	3,133	4,060
Finished goods	4,913	6,767
	79,394	78,822
Less: Allowance for excess and obsolete inventories	(2,350)	(1,210)
Total, net	$ 77,044	$ 77,612

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

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Allowance for excess and obsolete inventories:	*(in thousands)*			
Balance, beginning of period	$ 1,567	$ 1,209	$ 1,210	$ 1,118
Provisions for excess and obsolete inventories	796	217	1,153	318
Inventories written off	(13)	(19)	(13)	(29)
Balance, end of period	$ 2,350	$ 1,407	$ 2,350	$ 1,407

7. Intangible Assets

Our intangible assets consist of the following:

	June 30, 2019	December 31, 2018
	(in thousands)	
Intellectual property	$ 700	$ 700
Less: Accumulated amortization	(311)	(194)
Total, net	$ 389	$ 506

Amortization expense recorded in cost of sales is as follows:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
	(in thousands)			
Amortization expense	$ 58	$ 78	$ 117	$ 78

8. Supplemental Cash Flow Information

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Supplemental disclosures:	*(in thousands)*			
Interest paid	$ —	$ —	$ —	$ 5
Income taxes paid	$ 41	$ 451	$ 394	$ 6,683
Non-cash investing and financing activities:				
Non-cash capital expenditures	$ (1,232)	$ (1,604)	$ (164)	$ (871)
Dividends declared	8,355	$ 8,400	$ 8,355	$ 8,400

9. Warranties

The Company has warranties with various terms ranging from 18 months for parts to 25 years for certain heat exchangers. The Company has an obligation to replace parts if conditions under the warranty are met. A provision is made for estimated warranty costs at the time the related products are sold based upon the warranty period, historical trends, new products and any known identifiable warranty issues.

Changes in the warranty accrual are as follows:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Warranty accrual:	*(in thousands)*			
Balance, beginning of period	$ 11,424	$ 10,788	$ 11,421	$ 10,483
Payments made	(2,071)	(2,504)	(3,177)	(3,723)
Provisions	2,313	3,174	3,422	4,698
Balance, end of period	$ 11,666	$ 11,458	$ 11,666	$ 11,458
Warranty expense:	$ 2,313	$ 3,174	$ 3,422	$ 4,698

10. Accrued Liabilities

Accrued liabilities were comprised of the following:

	June 30, 2019	December 31, 2018
	(in thousands)	
Warranty	$ 11,666	$ 11,421
Due to representatives	12,561	11,024
Payroll	6,333	4,182
Profit sharing	1,892	1,835
Worker's compensation	552	567
Medical self-insurance	876	1,207
Customer prepayments	2,273	2,367
Employee vacation time	3,701	3,173
Other	2,859	1,679
Total	$ 42,713	$ 37,455

11. Revolving Credit Facility

Our revolving credit facility, as amended, provides for maximum borrowings of $30.0 million, which is provided by BOKF, NA dba Bank of Oklahoma ("Bank of Oklahoma"). Under the line of credit, there is one standby letter of credit totaling $1.3 million. Borrowings available under the revolving credit facility at June 30, 2019 were $28.7 million. Interest on borrowings is payable monthly at LIBOR plus 2.0%. No fees are associated with the unused portion of the committed amount. We had no outstanding balance under the revolving credit facility at June 30, 2019 and December 31, 2018. The revolving credit facility expires on July 26, 2021.

As of June 30, 2019, we were in compliance with our financial covenants. These covenants require that we meet certain parameters related to our tangible net worth and total liabilities to tangible net worth ratio. At June 30, 2019, our tangible net worth was $264.6 million and met the requirement of being at or above $175.0 million. Our total liabilities to tangible net worth ratio was 0.3 to 1, and met the requirement of not being above 2 to 1.

12. Income Taxes

The provision (benefit) for income taxes consists of the following:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
	(in thousands)			
Current	$ 1,550	$ 2,873	$ 3,252	$ 3,433
Deferred	2,225	18	4,112	438
	$ 3,775	$ 2,891	$ 7,364	$ 3,871

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate before the provision for income taxes.

The reconciliation of the Federal statutory income tax rate to the effective income tax rate is as follows:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
Federal statutory rate	21.0 %	21.0 %	21.0 %	21.0 %
State income taxes, net of Federal benefit	5.2	6.8	5.6	6.8
Indian Depreciation	—	(4.4)	—	(3.2)
Excess tax benefits	(4.7)	(2.4)	(3.8)	(4.1)
Other	1.1	(1.2)	0.8	(1.0)
Effective tax rate	22.6 %	19.8 %	23.6 %	19.5 %

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. Major changes under the Act include the following:

- Reducing the corporate rate to 21 percent
- Doubling bonus depreciation to 100 percent for five years
- Further limitations on executive compensation deductions
- Eliminating the domestic manufacturing deduction

As a result of these changes, the Company adjusted its deferred tax assets and liabilities in the forth quarter of 2017 using the newly enacted rates for the periods when they are expected to be realized.

In February 2018, the Bipartisan Budget Act of 2018 extended accelerated depreciation for business property on an Indian reservation. As a result, the Company has approximately $5.0 million in additional depreciation it can take as a tax deduction in 2017. Because the Company had remeasured its deferred tax liability related to property, plant and equipment to the new lower

tax rate at December 31, 2017 and because this additional depreciation became a current tax expense with the passing of this bill in 2018, the Company received a benefit of approximately $0.6 million as the deduction will be taken in 2017 at the higher federal tax rate of 35.0%.

The Company's estimated annual 2019 effective tax rate, excluding discrete events, is approximately 27%. We file income tax returns in the U.S., state and foreign income tax returns jurisdictions. We are subject to U.S. examinations for tax years 2014 to present, and to non-U.S. income tax examinations for the tax years of 2014 to present. In addition, we are subject to state and local income tax examinations for the tax years 2014 to present. The Company continues to evaluate its need to file returns in various state jurisdictions. Any interest or penalties would be recognized as a component of income tax expense.

13. Share-Based Compensation

On May 22, 2007, our stockholders adopted a Long-Term Incentive Plan (“LTIP”) which provided an additional 3.3 million shares that could be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance units and performance awards, in addition to the shares from the previous plan, the 1992 Plan. Since inception of the LTIP, non-qualified stock options and restricted stock awards have been granted with a five years vesting schedule. Under the LTIP, the exercise price of shares granted could not be less than 100% of the fair market value at the date of the grant.

On May 24, 2016, our stockholders adopted the 2016 Long-Term Incentive Plan ("2016 Plan") which provides for approximately 6.4 million shares, comprised of 3.4 million new shares provided for under the 2016 Plan, approximately 0.4 million shares that were available for issuance under the previous LTIP that are now authorized for issuance under the 2016 Plan, and an additional 2.6 million shares that were approved by the stockholders on May 15, 2018. Under the 2016 Plan, shares can be granted in the form of stock options, stock appreciation rights, restricted stock awards, performance awards, dividend equivalent rights, and other awards. Under the 2016 Plan, the exercise price of shares granted may not be less than 100% of the fair market value at the date of the grant. The 2016 Plan will be administered by the Compensation Committee of the Board of Directors or such other committee of the Board of Directors as is designated by the Board of Directors (the “Committee”). Membership on the Committee shall be limited to independent directors. The Committee may delegate certain duties to one or more officers of the Company as provided in the 2016 Plan. The Committee will determine the persons to whom awards are to be made, determine the type, size and terms of awards, interpret the 2016 Plan, establish and revise rules and regulations relating to the 2016 Plan and make any other determinations that it believes necessary for the administration of the 2016 Plan.

Options - The total pre-tax compensation cost related to unvested stock options not yet recognized as of June 30, 2019 is $29.1 million and is expected to be recognized over a weighted average period of 4.00 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 granted during the six months ended June 30, 2019 and 2018 using a Black Scholes-Merton Model:

	Six months ended June 30, 2019	Six months ended June 30, 2018
Directors and Officers:		
Expected dividend rate	$ 0.32	$ 0.26
Expected volatility	29.54%	29.73%
Risk-free interest rate	2.40%	2.20%
Expected life (in years)	5.0	5.0
Employees:		
Expected dividend rate	$ 0.32	$ 0.26
Expected volatility	29.54%	29.82%
Risk-free interest rate	2.40%	2.48%
Expected life (in years)	5.0	5.0

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

The following is a summary of stock options vested and exercisable as of June 30, 2019:

Range of Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Intrinsic Value (*in thousands*)
$ 7.18 - $ 33.20	386,282	5.57	$ 21.63	$ 11,028
$ 33.40 - $ 40.87	190,504	7.43	35.57	2,784
$ 41.37 - $ 50.18	6,070	0.87	41.37	53
Total	582,856	6.13	$ 26.39	$ 13,865

The following is a summary of stock options vested and exercisable as of June 30, 2018:

Range of Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Intrinsic Value (*in thousands*)
$ 4.54 - $ 32.80	425,351	5.59	$ 17.47	$ 6,711
$ 32.85 - $ 34.10	67,654	5.18	34.02	1
$ 34.15 - $ 39.00	21,607	8.73	35.10	—
Total	514,612	5.67	$ 20.39	$ 6,712

A summary of option activity under the plans is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2018	2,445,849	$ 30.77
Granted	1,944,820	41.39
Exercised	(282,735)	27.18
Forfeited or Expired	(225,525)	36.37
Outstanding at June 30, 2019	3,882,409	$ 36.02
Exercisable at June 30, 2019	582,856	$ 26.39

The total intrinsic value of options exercised during the six months ended June 30, 2019 and 2018 was $5.0 million and $3.2 million, respectively. The cash received from options exercised during the six months ended June 30, 2019 and 2018 was $7.7 million and $2.3 million, respectively. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statements of Cash Flows.

Restricted Stock - Since 2007, as part of the LTIP and since May 2016 as part of the 2016 Plan, the Compensation Committee of the Board of Directors has authorized and issued restricted stock awards to directors and key employees. Restricted stock awards granted to directors vest one-third each year. All other restricted stock awards vest at a rate of 20% per year. The fair value of restricted stock awards is based on the fair market value of AAON, Inc. common stock on the respective grant dates, reduced for the present value of dividends.

These awards are recorded at their fair value on the date of grant and compensation cost is recorded using straight-line vesting over the service period. At June 30, 2019, unrecognized compensation cost related to unvested restricted stock awards was approximately $8.5 million, which is expected to be recognized over a weighted average period of 3.00 years.

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

	Shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2018	292,450	$ 28.54
Granted	112,018	40.92
Vested	(106,644)	27.21
Forfeited	(11,243)	33.52
Unvested at June 30, 2019	286,581	$ 33.68

A summary of share-based compensation is as follows:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
	(in thousands)			
Grant date fair value of awards during the period:				
Options	$ 127	$ 53	$ 20,071	$ 12,580
Restricted stock	876	1,247	4,584	3,361
Total	$ 1,003	$ 1,300	$ 24,655	$ 15,941
Share-based compensation expense:				
Options	$ 2,057	$ 1,368	$ 3,282	$ 2,126
Restricted stock	986	607	1,791	1,573
Total	$ 3,043	$ 1,975	$ 5,073	$ 3,699
Income tax benefit/(deficiency) related to share-based compensation:				
Options	$ 488	$ 300	$ 731	$ 601
Restricted stock	304	57	455	219
Total	$ 792	$ 357	$ 1,186	$ 820

14. Earnings Per Share

Basic net income per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income 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 following table sets forth the computation of basic and diluted earnings per share:

	Three months ended		Six months ended	
	June 30, 2019	June 30, 2018	June 30, 2019	June 30, 2018
	(in thousands, except share and per share data)			
Numerator:				
Net income	$ 12,961	$ 11,691	$ 23,863	$ 15,951
Denominator:				
Basic weighted average shares	52,120,272	52,383,842	52,087,626	52,348,912
Effect of dilutive stock options and restricted stock	626,927	333,945	502,219	405,133
Diluted weighted average shares	52,747,199	52,717,787	52,589,845	52,754,045
Earnings per share:				
Basic	$ 0.25	$ 0.22	$ 0.46	$ 0.30
Diluted	$ 0.25	$ 0.22	$ 0.45	$ 0.30
Anti-dilutive shares:				
Shares	1,898,078	2,161,244	1,912,902	1,919,008

15. Stockholders' Equity

Stock Repurchase - The Board has authorized three stock repurchase programs for the Company. Al1 other repurchases from directors or employees are contingent upon Board approval. All repurchases are done at current market prices.

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. 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 expired on March 1, 2019. In February 2019, the Board authorized up to $20.0 million in open market repurchases and on March 5, 2019, 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 will expire on March 4, 2020.

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.

Our repurchase activity is as follows:

	Six months ended June 30,					
	2019			2018		
	(in thousands, except share and per share data)					
Program	**Shares**	**Total $**	**$ per share**	**Shares**	**Total $**	**$ per share**
Open market	5,799	$ 200	$ 34.46	104,155	$ 3,428	$ 32.91
401(k)	226,708	9,991	44.07	231,387	8,108	35.04
Directors and employees	24,065	980	40.73	23,140	811	35.03
Total	256,572	$ 11,171	$ 43.54	358,682	$ 12,347	$ 34.42

	Inception to date		
	(in thousands, except share and per share data)		
Program	**Shares**	**Total $**	**$ per share**
Open market	4,101,566	$ 69,806	$ 17.02
401(k)	7,274,484	110,532	15.19
Directors and employees	1,977,326	19,355	9.79
Total	13,353,376	$ 199,693	$ 14.95

Subsequent to June 30, 2019 and through July 30, 2019, the Company repurchased 29,437 shares for $1.5 million from our 401(k) savings and investment plan.

Dividends - At the discretion of the Board, 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 18, 2018	June 8, 2018	July 6, 2018	$0.16
November 8, 2018	November 29, 2018	December 20, 2018	$0.16
May 20, 2019	June 3, 2019	July 1, 2019	$0.16

16. Commitments and 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 and/or cash flows.

We are occasionally party to short-term, cancellable and occasionally non-cancellable, fixed 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. These contracts are not accounted for as derivative instruments because they meet the normal purchase and normal sales exemption. At June 30, 2019, we had one material contractual purchase obligation for approximately $1.1 million that expires in December 2019.

17. Related Parties

The Company purchases some supplies from an entity controlled by the Company’s CEO. The Company sometimes makes sales to the CEO for parts. Additionally, the Company sells units to an entity owned by a member of the President's immediate family. This entity is also one of the Company’s Representatives and as such, the Company makes payments to the entity for third party products. All related party transactions are made on standard Company terms.

The following is a summary of transactions and balance with affiliates:

	Three months ended		Six months ended	
	June 30, 2019	**June 30, 2018**	**June 30, 2019**	**June 30, 2018**
	(in thousands)			
Sales to affiliates	$ 318	$ 447	$ 368	$ 592
Payments to affiliates	66	101	193	111

	June 30, 2019	**December 31, 2018**
	(in thousands)	
Due from affiliates	$ 75	$ 79
Due to affiliates	—	—

18. Segments

The following table summarizes certain financial data related to our segments. Transactions between segments are recorded based on prices negotiated between the segments. Sales of units represents the selling price of our units plus freight and other miscellaneous charges less any returns and allowances. Parts include sales of purchased and fabricated parts including our coils along with the related freight and less any returns and allowances. The “Other” category in the table below includes certain sales cost and expenses that are not allocated to the reportable segments.

Asset information by segment is not easily identifiable or reviewed by the chief operating decision maker. As such, this information is not included below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
	(in thousands)			
Sales				
Units	110,253	102,691	217,321	195,666
Parts - External	9,348	7,092	16,259	13,379
Parts - Inter-segment	7,295	6,353	15,217	13,637
Other	(164)	(195)	(321)	(375)
Eliminations	(7,295)	(6,353)	(15,217)	(13,637)
Net sales	119,437	109,588	233,259	208,670
Gross Profit				
Units	30,742	29,379	57,285	45,919
Parts - External	4,487	2,958	8,171	5,987
Parts - Inter-segment	168	(431)	845	364
Other	(5,054)	(4,752)	(9,488)	(8,931)
Eliminations	(168)	431	(845)	(364)
Net gross profit	30,175	27,585	55,968	42,975

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, 2018. 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 SEC 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, 2018. 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 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, coils and controls. 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 all provinces in Canada. Foreign sales were approximately $7.8 million of our total net sales for the six months just ended and $6.3 million of our sales during the same period of 2018.

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 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. Our sales strategy is currently balanced between new construction and replacement applications. The new construction market in 2018 and through the second quarter of 2019 has been robust, but showing signs of uncertainty. Thus, we continue to emphasize 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 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 have remained relatively consistent the past few years, but the market has become volatile and unpredictable as a result of the uncertainty related to the U.S. economy and a weakening global economy. For the six months ended June 30, 2019, the price (twelve month trailing average) for galvanized steel, stainless steel and aluminum increased by approximately 10.6%, 4.8% and 1.7%, respectively, and copper decreased by 2.9%, as compared to the six months ended June 30, 2018.

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 continued construction of our three-story 134,000 square foot laboratory building with ten testing cells contained within it. This unique laboratory will have capabilities beyond anything known to exist in the world and will elevate AAON's research and design capabilities accordingly. Completion of this lab in 2019 will be a significant event.

The following are recent highlights and items that impacted our results of operations, cash flows and financial condition:

- We saw improvement in our gross margin during the first quarter.
- Overall units sold increased approximately 8.5% and 12.3% for the three and six months ended, respectively, as compared to the same period last year.
- We invested $16.8 million in capital expenditures, continuing our work on projects such as our new research and development lab, water-source heat pump production line, as well as other internal development projects.
- Our order intake level continued to support our high backlog.

Backlog

The following table shows our historical backlog levels:

6/30/2019	12/31/2018	6/30/2018
	(in thousands)	
$ 179,647	$ 151,767	$ 156,565

Results of Operations

Three Months Ended June 30, 2019 vs. Three Months Ended June 30, 2018

Units Sold

	Three months ended June 30,	
	2019	2018
Rooftop Units	3,797	4,175
Condensing Units	479	625
Air Handlers	537	818
Outdoor Mechanical Rooms	10	13
Water Source Heat Pumps	2,377	1,004
Total Units	7,200	6,635

Net Sales

	Three months ended June 30,			
	2019	2018	Change	% Change
	(in thousands, except unit data)			
Net sales	$ 119,437	$ 109,588	$ 9,849	9.0%
Total units	7,200	6,635	565	8.5%

Our part sales account for 1.9% of the increase in net sales while our water source heat pumps account for 3.7% of the increase in net sales. The remaining increase comes from the price increases we implemented in 2018 and 2019.

Cost of Sales

	Three months ended June 30,		Percent of Sales	
	2019	2018	2019	2018
	(in thousands)			
Cost of sales	$ 89,262	$ 82,003	74.7%	74.8%
Gross profit	30,175	27,585	25.3%	25.2%

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. While the cost of some raw materials continue to increase, we are still maintaining our material cost due to prior purchases made when prices were lower.

Twelve-month average raw material cost per pound as of June 30:

	2019	2018	% Change
Copper	$ 3.71	$ 3.82	(2.9)%
Galvanized Steel	$ 0.52	$ 0.47	10.6 %
Stainless Steel	$ 1.32	$ 1.26	4.8 %
Aluminum	$ 1.82	$ 1.79	1.7 %

Selling, General and Administrative Expenses

	Three months ended June 30, 2019	Three months ended June 30, 2018	Percent of Sales 2019	Percent of Sales 2018
	(in thousands)			
Warranty	$ 2,313	$ 3,174	1.9%	2.9%
Profit Sharing	1,892	1,607	1.6%	1.5%
Salaries & Benefits	3,630	3,166	3.0%	2.9%
Stock Compensation	1,711	1,071	1.4%	1.0%
Advertising	130	212	0.1%	0.2%
Depreciation	381	216	0.3%	0.2%
Insurance	217	247	0.2%	0.2%
Professional Fees	300	591	0.3%	0.5%
Donations	749	205	0.6%	0.2%
Bad Debt Expense	13	110	—%	0.1%
Other	2,145	2,487	1.8%	2.3%
Total SG&A	$ 13,481	$ 13,086	11.3%	11.9%

Income Taxes

	Three months ended June 30, 2019	Three months ended June 30, 2018	Effective Tax Rate 2019	Effective Tax Rate 2018
	(in thousands)			
Income tax provision	$ 3,775	$ 2,891	22.6%	19.8%

The Company's estimated annual 2019 effective tax rate, excluding discrete events, is expected to be approximately 27%.
In February 2018, the Bipartisan Budget Act of 2018 extended accelerated depreciation for business property on an Indian reservation. As a result, this additional depreciation became a current tax expense with the passing of this bill in 2018 and the Company received a benefit of approximately $0.6 million.

Results of Operations

Six Months Ended June 30, 2019 vs. Six Months Ended June 30, 2018

Units Sold

	Six months ended June 30, 2019	Six months ended June 30, 2018
Rooftop Units	7,559	7,643
Condensing Units	873	1,036
Air Handlers	1,117	1,354
Outdoor Mechanical Rooms	21	27
Water Source Heat Pumps	4,666	2,618
Total Units	14,236	12,678

Net Sales

	Six months ended June 30, 2019	Six months ended June 30, 2018	Change	% Change
	(in thousands, except unit data)			
Net sales	$ 233,259	$ 208,670	$ 24,589	11.8%
Total units	14,236	12,678	1,558	12.3%

Our part sales account for 1.3% of the increase in net sales while our water source heat pumps account for 2.7% of the increase in net sales. The remaining increase comes from the price increases we implemented in 2018 and 2019.

Cost of Sales

	Six months ended June 30,		Percent of Sales	
	2019	2018	2019	2018
	(in thousands)			
Cost of sales	$ 177,291	$ 165,695	76.0%	79.4%
Gross profit	55,968	42,975	24.0%	20.6%

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 saw improvement in its gross profit in the six months ended June 30, 2019 compared to 2018. Material costs have maintained while the Company continues to improve its labor and overhead efficiencies.

Twelve-month average raw material cost per pound as of June 30:

	2019	2018	% Change
Copper	$ 3.71	$ 3.82	(2.9)%
Galvanized Steel	$ 0.52	$ 0.47	10.6 %
Stainless Steel	$ 1.32	$ 1.26	4.8 %
Aluminum	$ 1.82	$ 1.79	1.7 %

Selling, General and Administrative Expenses

	Six months ended June 30, 2019		Percent of Sales 2019	2018
	2019	2018	2019	2018
	(in thousands)			
Warranty	$ 3,422	$ 4,698	1.5%	2.3%
Profit Sharing	3,536	2,229	1.5%	1.1%
Salaries & Benefits	7,165	6,442	3.1%	3.1%
Stock Compensation	2,843	2,068	1.2%	1.0%
Advertising	350	434	0.2%	0.2%
Depreciation	692	434	0.3%	0.2%
Insurance	376	605	0.2%	0.3%
Professional Fees	1,030	1,373	0.4%	0.7%
Donations	864	703	0.4%	0.3%
Bad Debt Expense	128	99	0.1%	—%
Other	4,076	4,220	1.7%	2.0%
Total SG&A	$ 24,482	$ 23,305	10.5%	11.2%

The Company's warranty expense continues to improve after making significant quality control improvements in the past two years.

Income Taxes

	Six months ended June 30,		Effective Tax Rate	
	2019	2018	2019	2018
	(in thousands)			
Income tax provision	$ 7,364	$ 3,871	23.6%	19.5%

The Company’s estimated annual 2019 effective tax rate, excluding discrete events, is expected to be approximately 27%.
In February 2018, the Bipartisan Budget Act of 2018 extended accelerated depreciation for business property on an Indian reservation. As a result, this additional depreciation became a current tax expense with the passing of this bill in 2018 and the Company received a benefit of approximately $0.6 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 our revolving credit facility.

Our cash increased $15.7 million from December 31, 2018 to June 30, 2019 and totaled $17.7 million at June 30, 2019.

Under the line of credit with Bank of Oklahoma, there was one standby letter of credit of $1.3 million as of June 30, 2019. At June 30, 2019, 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.

We had no outstanding balance under the revolving credit facility at June 30, 2019 and December 31, 2018. Interest on borrowings is payable monthly at LIBOR plus 2.0%. The termination date of the revolving credit facility is July 26, 2021.

At June 30, 2019, 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 June 30, 2019, our tangible net worth was $264.6 million, which meets the requirement of being at or above $175.0 million. Our total liabilities to tangible net worth ratio was 0.3 to 1.0 which meets the requirement of not being above 2 to 1.

Authorizations - The Board has authorized three stock repurchase programs for the Company. Any other repurchases from directors or employees are contingent upon Board approval. All repurchases are done at current market prices.

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. 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 expired on March 1, 2019. In February 2019, the Board authorized up to $20.0 million in open market repurchases and on March 5, 2019, 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 will expire on March 4, 2020.

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.

Repurchase Activity

	Six months ended June 30,					
	2019			2018		
	(in thousands, except share and per share data)					
Program	**Shares**	**Total $**	**$ per share**	**Shares**	**Total $**	**$ per share**
Open market	5,799	$ 200	$ 34.46	104,155	$ 3,428	$ 32.91
401(k)	226,708	9,991	44.07	231,387	8,108	35.04
Directors and employees	24,065	980	40.73	23,140	811	35.03
Total	256,572	$ 11,171	$ 43.54	358,682	$ 12,347	$ 34.42

	Inception to date		
	(in thousands, except share and per share data)		
Program	**Shares**	**Total $**	**$ per share**
Open market	4,101,566	$ 69,806	$ 17.02
401(k)	7,274,484	110,532	15.19
Directors and employees	1,977,326	19,355	9.79
Total	13,353,376	$ 199,693	$ 14.95

Dividends - At the discretion of the Board, 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 18, 2018	June 8, 2018	July 6, 2018	$0.16
November 8, 2018	November 29, 2018	December 20, 2018	$0.16
May 20, 2019	June 3, 2019	July 1, 2019	$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 following table reflects the major categories of cash flows for the six months ended June 30, 2019 and 2018. For additional details, see the consolidated financial statements.

	Six months ended June 30, 2019	Six months ended June 30, 2018
	(in thousands)	
Operating Activities		
Net Income	$ 23,863	$ 15,951
Income statement adjustments, net	22,477	12,989
Changes in assets and liabilities:		
Accounts receivable	(14,983)	(2,087)
Income taxes	2,858	(3,328)
Inventories	(585)	1,400
Prepaid expenses and other	(650)	(935)
Accounts payable	(2,592)	12,974
Deferred revenue	172	(931)
Accrued liabilities & donations	5,312	213
Net cash provided by operating activities	35,872	36,246
Investing Activities		
Capital expenditures	(16,784)	(25,925)
Cash paid in business combination	—	(6,377)
Purchases of investments	(6,000)	(16,201)
Maturities of investments and proceeds from called investments	2,000	16,675
Other	87	27
Net cash used in investing activities	(20,697)	(31,801)
Financing Activities		
Stock options exercised	7,685	2,299
Repurchase of stock	(10,191)	(11,539)
Employee taxes paid by withholding shares	(980)	(808)
Net cash used in financing activities	$ (3,486)	$ (10,048)

Cash Flows Provided by Operating Activities

The Company manages cash needs through working capital rather than drawing on its line of credit. In 2018, the Company slowed vendor payments and benefited from more rapid customer payments to fund its Wattmaster acquisition and large equipment purchases. In 2019, the Company's cash needs have lessened while collections and payments cycles have resumed a more normal pattern.

Cash Flows Used in Investing Activities

The capital expenditure program for 2019 is estimated to be approximately $48.3 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.

The Company invested excess cash flows in 2018 in investments along with completing a strategic business combination that allowed us to quickly develop our own electronic controllers for air distribution systems.

Cash Flows Used in Financing Activities

Stock options exercised increased due to the timing of employee exercises and increases in our stock price.

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.

Contractual Obligations

We had one material contractual purchase obligation as of June 30, 2019 for approximately $1.1 million that expires in December 2019.

Critical Accounting Policies

There have been no material changes in the Company's critical accounting policies during the six months ended June 30, 2019.

Recent Accounting Pronouncements

See Note 1 of the Notes to the Consolidated Financial Statements for a discussion of recent accounting pronouncements.

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", "will", "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.

Commodity Price Risk

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

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer with the oversight of the Audit Committee, regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded, as of the end of the period covered by this Quarterly Report, that our disclosure controls and procedures were effective.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

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.

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, 2018. The risk factors described in our Annual Report could materially adversely affect our business, financial condition or future results. There have been no material changes to the risk factors included in our 2018 Annual Report.

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

In May 2018, the Board authorized up to $15.0 million in open market repurchases and on May 18, 2018, 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 expired on March 1, 2019. In February 2019, the Board authorized up to $20.0 million in open market repurchases and on March 5, 2019, 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 will expire on March 4, 2020. We have repurchased a total of approximately 4.1 million shares under the stock buyback programs for an aggregate price of $69.8 million, or an average price of $17.02 per share. We purchased the shares at current market prices.

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, 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 employees. From inception through June 30, 2019, we repurchased approximately 7.3 million shares for an aggregate price of $110.5 million, or an average price of $15.19 per share. We purchased the shares at current market prices.

Periodically, the Company repurchases shares of AAON, Inc. stock from certain of its directors and employees. The number of shares to be repurchased is contingent upon Board approval. From inception through June 30, 2019, we repurchased approximately 2.0 million shares for an aggregate price of $19.4 million, or an average price of $9.79 per share. We purchased the shares at current market prices.

Repurchases during the second quarter of 2019 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
April 2019	62,751	$ 47.15	62,751	—
May 2019	32,168	47.33	32,168	—
June 2019	33,149	48.33	33,149	—
Total	128,068	$ 47.50	128,068	—

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

(a) Exhibits

(i)	Exhibit 31.1	Section 302 Certification of CEO
(ii)	Exhibit 31.2	Section 302 Certification of CFO
(iii)	Exhibit 32.1	Section 1350 Certification of CEO
(iv)	Exhibit 32.2	Section 1350 Certification of CFO

SIGNATURES

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

AAON, INC.

Dated: 8/1/2019 By: /s/ Norman H. Asbjornson

Norman H. Asbjornson
Chief Executive Officer

Dated: 8/1/2019 By: /s/ Scott M. Asbjornson

Scott M. Asbjornson
Chief Financial Officer

Exhibit 31.1

CERTIFICATION

I, Norman H. Asbjornson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AAON, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2019

/s/ Norman H. Asbjornson

Norman H. Asbjornson
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Scott M. Asbjornson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AAON, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

    b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

    c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2019

/s/ Scott M. Asbjornson

Scott M. Asbjornson
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of AAON, Inc. (the “Company”), on Form 10-Q for the quarter ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Norman H. Asbjornson, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

August 1, 2019

/s/ Norman H. Asbjornson

Norman H. Asbjornson
Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AAON, Inc. (the “Company”), on Form 10-Q for the quarter ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Scott M. Asbjornson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

August 1, 2019

/s/ Scott M. Asbjornson

Scott M. Asbjornson
Chief Financial Officer