AAON INC
Form 10-Q
May 10, 2006

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

FORM 10-Q

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from __________________ to __________________.

Commission file number: 0-18953

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

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

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

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

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

Yes |X| No |_|

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer |_| Accelerated filer |X| Non-accelerated filer |_|

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

Yes |_| No |X|

As of May 1, 2006, registrant had outstanding a total of 12,305,883 shares of its $.004 par value Common Stock.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2006	December 31, 2005
	(in thousands, except for share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 3,466	$ 837
Certificate of deposit	-	1,000
Accounts receivable, net	34,265	32,487
Inventories, net	23,458	23,708
Prepaid expenses	1,202	1,041
Deferred tax asset	4,003	3,877
Total current assets	66,394	62,950
Property, plant and equipment, net	54,419	50,581
Notes receivable, long-term	75	75
Total assets	$120,888	$113,606
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt	$ 108	$ 108
Accounts payable	12,836	11,643
Accrued liabilities	19,909	17,827
Total current liabilities	$ 32,853	$ 29,578
Long-term debt, less current maturities	32	59
Deferred tax liability	4,205	4,474
Stockholders' equity:		
Preferred stock, $.001 par value, 5,000,000 shares authorized, no shares issued	-	-
Common stock, $.004 par value, 50,000,000 shares authorized, 12,303,779 and 12,233,558 issued and outstanding at March 31, 2006, and December 31, 2005, respectively	49	49
Additional paid in capital	547	-
Accumulated other comprehensive income, net of tax	526	513
Retained earnings	82,676	78,933
Total stockholders' equity	83,798	79,495
Total liabilities and stockholders' equity	$120,888	$113,606

The accompanying notes are an integral part of these statements.

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

	Three Months Ended Mar. 31, 2006	Mar. 20
	(in thousands, except share and per	
Net sales	$ 53,620	$ 42
Cost of sales	43,236	32
Gross profit	10,384	10
Selling, general and administrative expenses	4,565	4
Income from operations	5,819	5
Interest expense	(12)	
Interest income	9	
Other income (expense), net	126	
Income before income taxes	5,942	5
Income tax provision	2,199	2
Net income	$ 3,743	$ 3
Earnings Per Share:		
Basic	$ 0.30	$
Diluted	$ 0.30	$
Weighted Average Shares Outstanding:		
Basic	12,277	12
Diluted	12,634	12

The accompanying notes are an integral part of these statements.

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

Accumulated

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Other Comprehensive Income
	(in thousands)			
Balance at December 31, 2005	12,234	$ 49	$ -	$ 513
Comprehensive income:				
Net income	-	-	-	-
Foreign currency translation adjustment	-	-	-	13
Total comprehensive income				
Stock options exercised, including tax benefits	107	-	1,165	-
Share based compensation	-	-	129	-
Stock repurchased and retired	(37)	-	(747)	-
Balance at March 31, 2006	12,304	$ 49	$ 547	$ 526

The accompanying notes are an integral part of these statements.

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

	Three Months Ended Mar. 31, 2006
	(in thousa
OPERATING ACTIVITIES	
Net income	$ 3,743
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation	2,206
Provision for losses on accounts receivable	57
Share-based compensation	129
Excess tax benefits from stock options exercised	(612)
Deferred income taxes	(395)
Changes in assets and liabilities:	
Accounts receivable	(1,835)
Inventories	250
Prepaid expenses	(161)
Accounts payable	1,193
Accrued liabilities	2,695
Net cash provided by operating activities	7,270
INVESTING ACTIVITIES	
Proceeds from matured certificate of deposit	1,500
Investment in certificate of deposit	(500)
Notes receivable, long-term	-
Capital expenditures	(6,044)

Net cash used in investing activities	(5,044)
FINANCING ACTIVITIES	
Borrowings under revolving credit facility	8,939
Payments under revolving credit facility	(8,939)
Payments of long-term debt	(27)
Stock options exercised	552
Excess tax benefits from stock options exercised	612
Repurchase of stock	(747)
Net cash provided by financing activities	390
Effect of exchange rate on cash	13
Net increase (decrease) in cash and cash equivalents	2,629
Cash and cash equivalents, beginning of period	837
Cash and cash equivalents, end of period	$ 3,466

The accompanying notes are an integral part of these statements.

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AAON, Inc., and Subsidiaries
Notes to the Consolidated Financial Statements
March 31, 2006
(unaudited)

1. BASIS OF PRESENTATION

The financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The Company believes that the disclosures made in these financial statements are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in the Company's latest audited financial statements which were included in the Form 10-K Report for the fiscal year ended December 31, 2005, filed by AAON, Inc. with the SEC. In the opinion of management, the accompanying financial statements include all normal, recurring adjustments required for a fair presentation of the results of the periods presented. Operating results for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

Currency

Foreign currency transactions and financial statements are translated in accordance with Statement of Financial Standards No. 52, Foreign Currency Translations. The Company uses the U.S. dollar as its functional currency, except for the Company's Canadian subsidiaries, which use the Canadian dollar. Adjustments arising from translation of the Canadian subsidiaries' financial statements are reflected in the Consolidated Statement of Stockholders' Equity. Transaction gains or losses that arise from exchange rate fluctuations applicable to transactions are denominated in Canadian currency and are included in the results of operations as incurred.

New Accounting Pronouncements

FASB (Financial Accounting Standards Board) Statement 123 (R) replaces FASB Statement No.123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The Statement requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The compensation cost will be recognized over the period of time during which an employee is required to provide service in exchange for the award. The Statement applies to all awards granted and any unvested awards at December 31, 2005. Effective January 1, 2006, the Company adopted the fair value recognition method of Statement of Financial Accounting Standards No. 123(R) Accounting for Stock Based Compensation (SFAS 123R), using the modified-prospective-transition method.

FASB Statement 151, Inventory Costs, replaces Accounting Research Bulletin No. 43, Chapter 4, Inventory Pricing. The Statement requires that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead as an inventory cost. The new statement also requires that allocation of fixed production overhead costs should be based on normal capacity of the production facilities. The Statement is effective January 1, 2006. The adoption of this statement did not have a material impact on the Company's Consolidated Financial Statements.

2. STOCK COMPENSATION

The Company maintains a stock option plan for key employees, directors and consultants. The Company's stock option plan provided for 2,925,000 shares of common stock to be issued under the plan. Under the terms of the 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 after 1-3 years. 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.

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Prior to January 1, 2006, the Company accounted for its nonqualified stock options under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under APB 25, no stock-based employee compensation cost was reflected in net income, as all options granted under the plan qualified for "fixed" plan accounting and had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company had adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS 123). No stock based compensation cost was recognized in the Consolidated Statements of Income for the three months ended March 31, 2005. Effective January 1, 2006, the Company adopted the fair value recognition method of Statement of Financial Accounting Standards No. 123(R) Share-Based Payment (SFAS 123R), using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the first three months of 2006 includes all share-based payments granted prior to, but not yet vested as of January 1, 2006, and compensation cost for all share-based payments granted subsequent to January 1, 2006. The compensation cost is based on the grant date fair value calculated using a Black-Scholes-Merton Option Pricing Model in accordance with provisions of Statement 123(R).

For the three months ended March 31, 2006, the Company recognized approximately $129,000 in pre-tax compensation expense in the Consolidated Statement of Income related to the stock option plan. The total pre-tax compensation cost related to nonvested stock options not yet recognized as of March 31, 2006, is $1.2 million and is expected to be recognized over a weighted-average period of 2.4 years.

The effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation is as follows:

	Three Months Ended March 31, 2005
	(in thousands, except per share data)
Net income as reported	$3,287
Deduct compensation expense determined under fair value method for all awards, net of related tax effects	(83)
Pro forma net income	$3,204
Earnings per share:	
Basic, as reported	$ 0.27
Basic, pro forma	$ 0.26
Diluted, as reported	$ 0.26
Diluted, pro forma	$ 0.25

The following assumptions were used to determine the fair value of the unvested stock options on the original grant date for expense recognition purposes for options granted for the three months ended March 31, 2006 and for pro forma disclosure purposes for the three months ended March 31, 2005:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Expected dividend yield	0%	0%
Expected volatility	32.32%	33.81%
Risk-free interest rate	4.86%	4.50%
Expected life	8 yrs	8 yrs

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of bank deposits and highly liquid, interest-bearing money market funds with initial maturities of three months or less.

4. ACCOUNTS RECEIVABLE

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

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

	March 31, 2006
	(in thousa
Accounts receivable	$ 34,840
Less: allowance for doubtful accounts	(575)
Total, net	$ 34,265

	Three Months March 31, 2006
	(in thousa
Allowance for doubtful accounts:	
Balance, beginning of period	$ 685
Provision for losses on accounts receivable	57
Accounts receivable written off, net of recoveries	(167)
Balance, end of period	$ 575

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5. INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method. The Company establishes 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. At March 31, 2006, and December 31, 2005, inventory balances and the related changes in the allowance for excess and obsolete inventories account are as follows:

	March 31, 2006	December 2005
	(in thousands)	
Raw materials	$ 18,424	$ 18,2

Work in process	2,454	1,9
Finished goods	2,930	3,8
	23,808	24,0
Less: Inventory reserve	(350)	(3
Total, net	$ 23,458	$ 23,7

	Three Months Ended	
	March 31, 2006	March 2005
	(in thousands)	
Allowance for excess and obsolete inventories:		
Balance, beginning of period	$ 350	$ 1,0
Provision for excess and obsolete inventories	-	
Adjustments to reserve	-	
Balance, end of period	$ 350	$ 1,0

At March 31, 2006, the Company had prepaid $908,000 for copper, at 2005 pricing, for 2006 material requirements. This amount is included as prepaid expenses in the Company's Consolidated Balance Sheet at March 31, 2006.

6. ACCRUED LIABILITIES

At March 31, 2006, and December 31, 2005, accrued liabilities were comprised of the following:

	March 31, 2006	December 2005
	(in thousands)	
Warranty	$ 6,606	$ 6,2
Commissions	7,779	8,0
Payroll	1,245	1,2
Income taxes	1,638	6
Workers' compensation	751	5
Medical self-insurance	896	6
Other	994	4
Total	$ 19,909	$ 17,8

7. WARRANTIES

A provision is made for the estimated cost of warranty obligations 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 Company's warranty liability during the three months ended March 31, 2006, and 2005, are as follows:

	Three Months Ended	
	March 31, 2006	March 2005
	(in thousands)	
Balance, beginning of period	$ 6,282	$ 6,3
Warranties accrued during the period	939	1,1
Warranties settled during the period	(615)	(6
Balance, end of period	$ 6,606	$ 6,7

8. REVOLVING CREDIT FACILITY

The Company's revolving credit facility provides for maximum borrowings of $15.2 million. Interest on borrowings is payable monthly at the Wall Street Journal prime rate less .5% or LIBOR plus 1.6%, at the election of the Company. At March 31, 2006, the Company had no borrowings under the revolving credit facility compared to $1.3 million at March 31, 2005. The Company had no borrowings under the revolving credit facility at December 31, 2005. Borrowings available under the revolving credit facility at March 31, 2006, were $14.6 million. In addition, the Company has a $600,000 letter of credit that expires December 31, 2006. The credit facility requires that the Company maintain a certain financial ratio and prohibits the declaration of cash dividends. On February 14, 2006, the board of Directors voted to initiate a semi-annual cash dividend of $0.20 per share to the holders of the outstanding Common Stock of the Company as of the close of business on June 12, 2006, the record date, payable on July 3, 2006. The restriction of payments of dividends has been waived by the lender. At March 31, 2006, the Company was in compliance with its financial ratio covenants.

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9. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended	
	March 31, 2006	March 2005
	(in thousands, except for share and per s	
Numerator:		
Net income	$ 3,743	$ 3,

Denominator:		
Denominator for basic earnings per share - Weighted average shares	12,277,155	12,386,
Effect of dilutive employee stock options	356,642	408,
Denominator for diluted earnings per share - Weighted average shares	12,633,797	12,795,
Basic earnings per share	$ .30	$ 0
Diluted earnings per share	$ .30	$ 0
Anti-dilutive shares	79,500	92,
Weighted Average Exercise Price	$ 18.45	$ 18

10. STOCK REPURCHASE

Following repurchases of approximately 12% of its outstanding Common Stock between September 1999 and September 2001, the Company announced and began its current stock repurchase program on October 17, 2002, targeting repurchases of up to an additional 10% (1,325,000 shares) of its outstanding stock. Through March 31, 2006, the Company had repurchased a total of 1,257,864 shares under the current program for an aggregate price of $22,034,568, or an average of $17.52 per share. On February 14, 2006, the Board of Directors approved the suspension of the Company's repurchase program.

On July 1, 2005, the Company entered into a stock repurchase arrangement by which employee-participants in AAON's 401K Savings and Investment Plan are entitled to have shares of AAON stock in their accounts sold to the Company to provide diversification of their investments. Through March 31, 2006, the Company repurchased 132,054 shares for an aggregate price of $2,452,476 or an average price of $18.57 per share.

11. CONTINGENCIES

The Company is subject to claims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability, if any, will not have a material effect on the Company's results of operations or financial position.

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

AAON engineers, manufactures and markets air-conditioning and heating equipment consisting of standardized and custom rooftop units, chillers, air-handling units, make-up units, heat recovery units, condensing units and coils.

AAON sells its products to property owners and contractors through a network of manufacturers' representatives and its internal sales force. Demand for the Company's 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 6-18 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, the Company emphasizes 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 raw materials used in AAON's manufacturing processes are steel, copper and aluminum. The major component costs include compressors, electric motors and electronic controls.

Selling, general, and administrative ("SG&A") costs include the Company's internal sales force, warranty costs, profit sharing and administrative expense. Warranty expense is estimated based on historical trends and other factors. The Company's warranty on its products is: for parts only, the earlier of one year from the date of first use or 14 months from date of shipment; compressors (if applicable), an additional four years, on gas-fired heat exchangers (if applicable), 15 years, and on stainless steel heat exchangers (if applicable), 25 years.

The Company's operations in Burlington, Ontario, Canada, are located at 279 Sumach Drive, consisting of an 82,000 sq. ft. office/manufacturing facility on a 5.6 acre tract of land.

The office facilities of AAON, Inc. consist of a 337,000 square foot building (322,000 sq. ft. of manufacturing/warehouse space and 15,000 sq. ft. of office space) located at 2425 S. Yukon Avenue, Tulsa, Oklahoma (the "original facility"), and a 563,000 square foot manufacturing/warehouse building and a 22,000 square foot office building (the "expansion facility") located across the street from the original facility at 2440 S. Yukon Avenue. The Company utilizes 39% of the expansion facility and the remaining 61% is leased to a third party. The operations of AAON Coil Products, Inc. are conducted in a plant/office building at 203-207 Gum Springs Road in Longview, Texas, containing 258,000 square feet (251,000 sq. ft. of manufacturing/warehouse and 7,000 sq. ft. of office space). In 2004 and 2005, AAON Coil Products purchased an additional 15 acres of land for future expansion.

Set forth below is unaudited income statement information with respect to the Company for the periods ended March 31, 2006, and 2005:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(in thousands)	
Net sales	$ 53,620	$ 42,780
Cost of sales	43,236	32,730
Gross profit	10,384	10,050
Selling, general and administrative Expenses	4,565	4,763
Income from operations	5,819	5,368
Interest expense	(12)	(2)

Interest income	9	78
Other income (expense), net	126	72
Income before income taxes	5,942	5,435
Income tax provision	2,199	2,148
Net income	$ 3,743	$ 3,287

Results of Operations

Net sales increased $10.8 million (25.3%) to $53.6 million from $42.8 million for the three months ended March 31, 2006, compared to the same period in 2005. Increased sales were attributable to an increase in volume of product sold related to an improvement of the commercial and industrial construction industry, the Company's new and redesigned products being favorably received by its customers, and price increases.

Gross margins were 19.4% compared to 23.5% for the three months ended March 31, 2006 and March 31, 2005, respectively. The decrease in gross margins was due primarily to continuing increases in copper prices, an increase in manufacturing expense, and low margin jobs and labor inefficiencies at the Canadian subsidiary which resulted in a pre-tax loss at Canada of $423,000. Gross profit increased $334,000 (3.2%) to $10.4 million from $10.0 million for the three months ended March 31, 2006, compared to the same period in 2005. The increase in gross profits was due primarily to increased volume of product sold and price increases.

Steel, copper and aluminum are high volume materials used in the manufacturing of the Company's products, which are obtained from domestic suppliers. The Company also purchases from other domestic manufacturers certain components, including compressors, electric motors and electrical controls used in its products. The suppliers of these components are significantly affected by the rising raw material costs as steel, copper and aluminum are used in the manufacturing of their products. The Company is experiencing price increases from component part suppliers. The Company attempts to limit the impact of price increases on these materials by entering into cancelable fixed price contracts with its major suppliers for periods of 6-12 months.

Selling, general and administrative expenses decreased $117,000 (2.50%) to $4.6 million from $4.8 million for the three months ended March 31, 2006 compared to the same period in 2005, due primarily to a decrease in warranty expense.

The decrease in the income tax provision effective tax rate to 37% from 39.5% was related to the impact of state and foreign taxes.

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Financial Condition and Liquidity

Net accounts receivable increased $1.8 million from $32.5 million at December 31, 2005, to $34.3 million at March 31, 2006, due to the increase in sales.

Inventories decreased $250,000 to $23.5 million at March 31, 2006, compared to $23.7 million at December 31, 2005, due to lower inventory levels related to increased sales.

Accounts payable and accrued liabilities increased $3.3 million to $32.7 million at March 31, 2006, compared to $29.5 million at December 31, 2005, due primarily to timing of payments to vendors.

The Company generated $7.3 million and $1.6 million cash from operating activities during the three months ended March 31, 2006, and March 31, 2005, respectively. The increase in 2006 related primarily to an increase in net income and accounts payable and a decrease in inventory. The increase in 2005 related primarily to an increase in net income.

Cash flows used in investing activities were $5.0 million for the three months ended March 31, 2006, and $3.3 million for the three months ended March 31, 2005. Cash flows used in investing activities in 2006 and in 2005 were related primarily to capital expenditures for additions of machinery and equipment. All capital expenditures were financed out of cash generated from operations.

Cash flows provided by financing activities were $394,000 and $1.1 million during the three months ended March 31, 2006, and March 31, 2005, respectively. The cash flows provided by financing activities in 2006 were related primarily to stock options exercised and the related respective excess tax benefits. The cash provided by financing activities in 2005 was related primarily to net borrowings under the revolving credit agreement. The Company's revolving credit facility provides for maximum borrowings of $15.15 million. Interest on borrowings is payable monthly at the Wall Street Journal prime rate less .5% or LIBOR plus 1.6%, at the election of the Company. At March 31, 2006, the Company had no borrowings under the revolving credit facility compared to $1.3 million at March 31, 2005. Borrowings available under the revolving credit facility at March 31, 2006, were $14.6 million. In addition, the Company has a $600,000 letter of credit that expires December 31, 2006. The credit facility requires that the Company maintain a certain financial ratio and prohibits the declaration of cash dividends. On February 14, 2006, the board of Directors voted to initiate a semi-annual cash dividend of $0.20 per share to the holders of the outstanding Common Stock of the Company as of the close of business on June 12, 2006, the record date, payable on July 3, 2006. The restriction of payments of dividends has been waived by the lender. At March 31, 2006, the Company was in compliance with its financial ratio covenants.

Management believes the Company's bank revolving credit facility (or comparable financing), and projected cash flows from operations will provide the necessary liquidity and capital resources to the Company for a minimum of the next twelve months. The Company's belief that it will have the necessary liquidity and capital resources is based upon its knowledge of the HVAC industry and its place in that industry, its ability to limit the growth of its business if necessary, and its relationship with its existing bank lender. For information concerning the Company's revolving credit facility at March 31, 2006, see Note 8 to the financial statements included in this report.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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, future actual results could differ from those estimates and could have a significant impact on the Company's results of operations, financial position and cash flows. The Company reevaluates its estimates and assumptions on a monthly basis.

The following accounting policies may involve a higher degree of estimation or assumption:

Allowance for Doubtful Accounts - The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific

customers, historical trends in collections and write-offs, current customer status, the age of the receivable, economic conditions and other information. Aged receivables are reviewed on a monthly basis to determine if the reserve is adequate and adjusted accordingly at that time.

Inventory Reserves - The Company establishes a reserve for inventories based on the change in inventory requirements due to product line changes, the feasibility of using obsolete parts for upgraded part substitutions, the required parts needed for part supply sales, replacement parts and for estimated shrinkage.

Warranty - A provision is made for estimated warranty costs at the time the product is shipped and revenue is recognized. The warranty period is: for parts only, the earlier of one year from the date of first use or 14 months from date of shipment; compressors (if applicable), an additional four years; on gas-fired heat exchangers (if applicable), 15 years; and on stainless steel heat exchangers (if applicable), 25 years. Warranty expense is estimated based on the Company's warranty period, historical warranty trends and associated costs, and any known identifiable warranty issue. Due to the absence of warranty history on new products, an additional provision may be made for such products.

Medical Insurance - A provision is made for medical costs associated with the Company's Medical Employee Benefit Plan, which is primarily a self-funded plan. A provision is made for estimated medical costs based on historical claims paid and any known potential of significant future claims. The plan is supplemented by employee contributions and an excess policy for claims over $100,000 each.

Historically, reserves have been within management's expectations.

New Accounting Pronouncements

FASB (Financial Accounting Standards Board) Statement 123(R), Accounting for Stock-Based Compensation replaces FASB Statement No.123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. The Statement requires measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The compensation cost will be recognized over the period of time during which an employee is required to provide service in exchange for the award, which will be the vesting period. The Statement applies to all awards granted and any unvested awards at December 31, 2005. Effective January 1, 2006, the Company adopted the fair value recognition method of Statement of Financial Accounting Standards No. 123(R) Share-Based Payments (SFAS 123R), using the modified-prospective-transition method.

FASB Statement 151, Inventory Costs, replaces Accounting Research Bulletin No. 43, Chapter 4, Inventory Pricing. The Statement requires that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead as an inventory cost. The new statement also requires that allocation of fixed production overhead costs should be based on normal capacity of the production facilities. The Statement is effective January 1, 2006. The adoption of this statement did not have a material impact on the Company's consolidated financial statements.

Forward-Looking Statements

This Annual Report 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", 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. The Company undertakes no obligations 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.

The Company is subject to interest rate risk on its revolving credit facility which bears variable interest based upon a prime or LIBOR rate. The Company had no outstanding balance as of March 31, 2006.

Foreign sales accounted for less than 4% of the Company's sales in 2005 and the Company accepts payment for such sales in U.S. and Canadian dollars; therefore, the Company believes it is not exposed to significant foreign currency exchange rate risk on these sales. Foreign currency transactions and financial statements are translated in accordance with Statement of Financial Standards No. 52, Foreign Currency Translation. The Company uses the U.S. dollar as its functional currency, except for the Company's Canadian subsidiaries, which use the Canadian dollar. Adjustments arising from translation of the Canadian subsidiaries' financial statements are reflected in Consolidated Statements of Stockholders' Equity. Transaction gains or losses that arise from exchange rate fluctuations applicable to transactions are denominated in Canadian currency and are included in the results of operations as incurred.

Important raw materials purchased by the Company are steel, copper and aluminum, which are subject to price fluctuations. The Company attempts to limit the impact of price increases on these materials by entering cancelable fixed price contracts with its major suppliers for periods of 6 -12 months. However, in 2005 cost increases in basic commodities, such as steel, copper and aluminum, severely impacted profit margins.

The Company does not utilize derivative financial instruments to hedge its interest rate or raw materials price risks.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

At the end of the period covered by this Quarterly Report on Form 10-Q, the Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer believe that:

- o The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and

- o The Company's disclosure controls and procedures operate such that important information flows to appropriate collection and disclosure points in a timely manner and are effective to ensure that such information is accumulated and communicated to the Company's management, and made known to the Company's Chief Executive Officer and Chief Financial Officer, particularly during the period when this Quarterly Report was prepared, as appropriate to allow timely decisions regarding the required disclosure.

AAON's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures and concluded that these controls and procedures were effective as of March 31, 2006.

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(b) Management's Quarterly Report on Internal Control over Financial Reporting

The management of AAON, Inc. and its subsidiaries (AAON), is responsible for establishing and maintaining adequate internal control over financial reporting. AAON's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

In making its assessment of internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control--Integrated Framework. Based on our assessment, we believe that, as of March 31, 2006, the Company's internal control over financial reporting is effective based on those criteria.

(c) Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the first quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1A. Risk Factors.

There have been no material changes from risk factors as previously disclosed in registrant's Form 10-K in response to Item 1A, to Part I of Form 10-K.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.

Following repurchases of approximately 12% of its outstanding Common Stock between September 1999 and September 2001, the Company announced and began its current stock repurchase program on October 17, 2002, targeting repurchases of up to an additional 10% (1,325,000 shares) of its outstanding stock. Through December 31, 2005, the Company had repurchased a total of 1,257,864 shares under the current program for an aggregate price of $22,034,568, or an average of $17.52 per share. On February 14, 2006, the Board of Directors approved the suspension of the Company's repurchase program.

On July 1, 2005, the Company entered into a stock repurchase arrangement by which employee-participants in AAON's 401K Savings and Investment Plan are entitled to have shares of AAON stock in their accounts sold to the Company to provide diversification of their investments. Through March 31, 2006, the Company repurchased 132,054 shares for an aggregate price of $2,452,476 or an average price of $18.57 per share.

Item 5. Other Information.

Although the Company has paid no cash dividends from inception to date, on February 14, 2006, the Board of Directors voted to initiate a semi-annual cash dividend of $0.20 per share to the holders of the outstanding Common Stock of the Company as of the close of business on June 12, 2006, the record date, payable on July 3, 2006.

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: May 4, 2006

By: /s/ Norman H. Asbjornson

Norman H. Asbjornson
President/CEO

Dated: May 4, 2006

By: /s/ Kathy I. Sheffield

Kathy I. Sheffield
Treasurer

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