

GENERAC HOLDINGS INC.

Form 10-Q

August 13, 2010

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2010

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 001-34627

# GENERAC HOLDINGS INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-5654756**

(IRS Employer  
Identification No.)

**S45 W29290 Hwy. 59, Waukesha, WI**

(Address of principal executive offices)

**53189**

(Zip Code)

**(262) 544-4811**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 10, 2010, there were 67,522,102 shares of the Registrant's common stock outstanding.



Table of Contents

**GENERAC HOLDINGS INC.**

**INDEX**

	<b>Page</b>
<b><u>PART I. Financial Information</u></b>	
<b><u>Item 1.</u></b>	
<u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009</u>	1
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2010 and 2009</u>	2
<u>Condensed Consolidated Statements of Redeemable Stock and Stockholders' Equity (Deficit) for the six months ended June 30, 2010 and the Year Ended December 31, 2009</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2010 and 2009</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
<b><u>Item 2.</u></b>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<b><u>Item 3.</u></b>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	29
<b><u>Item 4.</u></b>	
<u>Controls and Procedures</u>	29
<b><u>PART II. Other Information</u></b>	
<b><u>Item 1.</u></b>	
<u>Legal Proceedings</u>	30
<b><u>Item 1A.</u></b>	
<u>Risk Factors</u>	30
<b><u>Item 6.</u></b>	
<u>Exhibits</u>	30
<u>Signatures</u>	31

---

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

Generac Holdings Inc.

Condensed Consolidated Balance Sheets

*(Dollars in Thousands, Except Share and Per Share Data)*

	June 30, 2010 (Unaudited)	December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 93,109	\$ 161,307
Accounts and notes receivable, less allowance for doubtful accounts	68,410	54,130
Inventories	111,436	123,700
Prepaid expenses and other assets	3,412	5,880
Total current assets	276,367	345,017
Property and equipment, net	72,580	73,374
Customer lists, net	115,700	134,674
Patents, net	88,875	92,753
Other intangible assets, net	7,121	7,791
Deferred financing costs, net	7,589	13,070
Trade names	142,247	144,407
Goodwill	525,875	525,875
Other assets	73	282
Total assets	\$ 1,236,427	\$ 1,337,243
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 42,985	\$ 33,639
Accrued wages and employee benefits	6,041	6,930
Other accrued liabilities	36,948	52,326
Current portion of long-term debt		39,076
Total current liabilities	85,974	131,971
Long-term debt	731,422	1,052,463
Other long-term liabilities	20,829	17,418
Total liabilities	838,225	1,201,852
Class B convertible voting common stock, par value \$0.01, 110,000 shares authorized, 0 and 24,018 shares issued at June 30, 2010 and December 31, 2009, respectively		765,096
Series A convertible non-voting preferred stock, par value \$0.01, 30,000 shares authorized, 0 and 11,311 shares issued at June 30, 2010 and December 31, 2009, respectively		113,109

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Stockholders' equity (deficit):

Common stock (formerly Class A common stock), par value \$0.01, 500,000,000 shares authorized, 67,522,102 and 1,617 shares issued at June 30, 2010 and December 31, 2009, respectively	675	
Additional paid-in capital	1,130,514	2,394
Excess purchase price over predecessor basis	(202,116)	(202,116)
Accumulated deficit	(523,269)	(538,571)
Accumulated other comprehensive loss	(7,602)	(4,492)
Stockholder notes receivable		(29)
Total stockholders' equity (deficit)	398,202	(742,814)
Total liabilities and stockholders' equity	\$ 1,236,427	\$ 1,337,243

See notes to condensed consolidated financial statements.

Table of Contents

## Generac Holdings Inc.

## Condensed Consolidated Statements of Operations

*(Dollars in Thousands, Except Share and Per Share Data)*

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net sales	\$ 140,455	\$ 149,577	\$ 271,173	\$ 290,023
Costs of goods sold	85,710	89,389	165,010	182,308
Gross profit	54,745	60,188	106,163	107,715
Operating expenses:				
Selling and service	13,809	15,853	28,121	30,243
Research and development	3,482	2,625	7,204	5,237
General and administrative	5,679	3,970	10,838	7,867
Amortization of intangibles	12,921	12,954	25,682	25,766
Total operating expenses	35,891	35,402	71,845	69,113
Income from operations	18,854	24,786	34,318	38,602
Other (expense) income:				
Interest expense	(5,720)	(18,482)	(14,212)	(36,448)
Investment income	36	694	110	1,960
Gain on extinguishment of debt		4,414		13,510
Write-off of deferred financing costs related to debt extinguishment			(4,180)	
Other, net	(259)	(308)	(575)	(621)
Total other expense, net	(5,943)	(13,682)	(18,857)	(21,599)
Income before provision for income taxes	12,911	11,104	15,461	17,003
Provision for income taxes	77	107	159	212
Net income	12,834	10,997	15,302	16,791
Preferential distribution to:				
Series A preferred stockholders		(3,320)	(2,042)	(6,112)
Class B common stockholders		(24,731)	(12,133)	(48,859)
Beneficial conversion - see note 1			(140,690)	
Net income (loss) attributable to common stockholders (formerly Class A common stockholders)	\$ 12,834	\$ (17,054)	\$ (139,563)	\$ (38,180)
Net income (loss) per common share - basic:				
Common stock (formerly Class A common stock)	\$ 0.19	\$ (9,824)	\$ (2.71)	\$ (21,993)
Class B common stock	n/a	\$ 1,030	\$ 2,230	\$ 2,034
Net income (loss) per common share - diluted:				
Common stock (formerly Class A common stock)	\$ 0.19	\$ (9,824)	\$ (2.71)	\$ (21,993)
Class B common stock	n/a	\$ 1,030	\$ 2,230	\$ 2,034

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Weighted average common shares outstanding -  
basic:

Common stock (formerly Class A common stock)	67,093,250	1,736	51,507,358	1,736
Class B common stock	n/a	24,018	5,440	24,018

Weighted average common shares outstanding -  
diluted:

Common stock (formerly Class A common stock)	67,200,565	1,736	51,507,358	1,736
Class B common stock	n/a	24,018	5,440	24,018

*See notes to condensed consolidated financial statements.*



Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Table of Contents

Generac Holdings Inc.

Condensed Consolidated Statements of Redeemable Stock and Stockholders' Equity (Deficit)

(Dollars in Thousands, Except Share Data)

	Redeemable		Class B Common Stock		Class A Common Stock (former)		Additional	Excess	Retained	Accumulated	Other	Stockholder	Total	Comprehensive
	Series A Preferred	Shares	Amount	Shares	Amount	Class A Common Stock	Paid-In	Purchase Price	Earnings	Comprehensive	Notes	Stockholders	Income	(Loss)
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Over	(Accumulated)	(Loss)	Receivable	Equity		
<b>Balance at December 31, 2008</b>	7,835	\$ 78,355	24,018	\$ 765,096	1,736	\$	\$ 2,356	\$ (202,116)	\$ (581,626)	\$ (28,650)	\$ (158)	\$ (810,194)		
Amortization of unrealized loss on interest rate swaps										24,222		24,222	\$ 24,222	
Repayment of stockholder notes receivable											129	129		
Cancellation of stock					(118)									
Contribution of capital related to debt extinguishment	1,476	14,754												
Proceeds from shares issued to management and directors	50	497												
Proceeds from shares issued to stockholders	1,950	19,503												
Net income									43,055			43,055	43,055	
Share based compensation							38						38	
Pension liability adjustment										(64)		(64)	(64)	
														\$ 67,213
<b>Balance at December 31, 2009</b>	11,311	\$ 113,109	24,018	\$ 765,096	1,617	\$	\$ 2,394	\$ (202,116)	\$ (538,571)	\$ (4,492)	\$ (29)	\$ (742,814)		
Unrealized loss on interest rate swaps										(3,110)		(3,110)	(3,110)	
Repayment of stockholder notes receivable											29	29		
Corporate reorganization	(11,311)	(113,109)	(24,018)	(765,096)	28,368,587	284	877,921					878,205		
Beneficial conversion related to Class B Common and Series A Preferred stockholders							(140,690)					(140,690)		

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Accumulated accretion related to Class B Common and Series A Preferred stockholders				(303,305)				(303,305)	
Issuance of Common stock (formerly Class A Common stock) resulting from the beneficial conversion and accumulated accretion	18,002,337	180	443,815					443,995	
Proceeds from public stock offering	20,700,500	207	247,424					247,631	
Share based compensation	449,061	4	2,955					2,959	
Net income						15,302		15,302	15,302
									\$ 12,192
<b>Balance at June 30, 2010 (unaudited)</b>	\$	\$	67,522,102	\$ 675	\$ 1,130,514	\$ (202,116)	\$ (523,269)	\$ (7,602)	\$ 398,202

See notes to condensed consolidated financial statements.

Table of Contents

## Generac Holdings Inc.

## Condensed Consolidated Statements of Cash Flows

*(Dollars in Thousands)*

(Unaudited)

	Six Months Ended June 30,	
	2010	2009
<b>Operating activities</b>		
Net income	\$ 15,302	\$ 16,791
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	3,829	3,855
Amortization	25,682	25,766
Gain on extinguishment of debt		(13,510)
Write-off of deferred financing costs related to debt extinguishment	4,180	
Amortization of deferred finance costs	1,301	1,710
Amortization of unrealized loss on interest rate swaps		12,930
Provision for losses on accounts receivable	(69)	31
Loss on disposal of property and equipment		59
Share-based compensation expense	2,959	19
Net changes in operating assets and liabilities:		
Accounts receivable	(14,211)	2,450
Inventories	12,264	5,012
Other assets	1,999	1,155
Accounts payable	9,346	(8,124)
Accrued wages and employee benefits	(860)	526
Other accrued liabilities	(15,077)	(27,849)
Net cash provided by operating activities	46,645	20,821
<b>Investing activities</b>		
Proceeds from sale of property and equipment		56
Expenditures for property and equipment	(3,035)	(1,885)
Collections on receivable notes		105
Net cash used in investing activities	(3,035)	(1,724)
<b>Financing activities</b>		
Proceeds from issuance of common stock	248,309	
Payment of long-term debt	(360,117)	(9,500)
Net cash used in financing activities	(111,808)	(9,500)
Net (decrease) increase in cash and cash equivalents	(68,198)	9,597
Cash and cash equivalents at beginning of period	161,307	81,229
Cash and cash equivalents at end of period	\$ 93,109	\$ 90,826
<b>Supplemental disclosure of noncash financing activities</b>		
Contributions of capital related to debt extinguishment	\$	\$ 13,989

See notes to condensed consolidated financial statements



Table of Contents

**Generac Holdings Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Basis of Presentation**

**Description of Business**

Generac Holdings Inc. (the Company) owns all of the common stock of Generac Acquisition Corp., which in turn, owns all of the common stock of Generac Power Systems, Inc. (the Subsidiary). The Company designs, manufactures, and markets a complete line of backup power generation products for residential, light-commercial, and industrial markets.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany amounts and transactions have been eliminated in consolidation.

The condensed consolidated balance sheet as of June 30, 2010, the condensed consolidated statement of redeemable stock and stockholders equity (deficit) and condensed consolidated statements of cash flows for the six months ended June 30, 2010 and 2009, and the condensed consolidated statements of operations for the three and six months ended June 30, 2010 and 2009 have been prepared by the Company and have not been audited. In the opinion of management, all adjustments, consisting of only normal recurring adjustments necessary for the fair presentation of the financial position, results of operation and cash flows, have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

Expenses are charged to operations in the year incurred. However, for interim reporting purposes certain expenses are charged to operations based on a proportionate share of annual amounts rather than as they are actually incurred.

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009.

### **Initial Public Offering and Conversion of Class B Common Stock and Series A preferred Stock**

On February 17, 2010, the Company completed its initial public offering (IPO) of 18,750,000 shares of its common stock at a price of \$13.00 per share. In addition, the underwriters exercised their over-allotment option outlined in the underwriters agreement, and purchased an additional 1,950,500 shares of the Company's common stock on March 18, 2010. The Company received approximately \$269,100,000 in gross proceeds from the IPO and over-allotment exercise, or approximately \$247,631,000 in net proceeds after deducting the underwriting discount and total expenses related to the offering.

The Company's capitalization prior to the initial public offering consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. Upon closing of the IPO, all shares of convertible Class B Common stock and Series A Preferred stock were automatically converted into 88,476,530 and 19,511,018 Class A Common shares, respectively. The 88,476,530 shares of Class A Common stock were subject to a 3.294 for 1 reverse stock split, resulting in 26,859,906 Class A Common shares related to the Class B Common stock conversion, and the Class A Common stock was re-designated as Common Stock. Subsequent to the IPO, the Company has one class of common stock. The share and per share data used in basic and diluted earnings per share has been retrospectively restated to reflect only the 3.294 for 1 reverse stock split immediately prior to the IPO.

Table of Contents

Capitalization summary upon closing of initial public offering and underwriters option exercise:

Class A Common stock issued and outstanding immediately prior to the IPO after the 3.294 for 1 reverse stock split	1,617
Conversion and 3.294 for 1 reverse stock split of Class B Common stock into Common stock upon closing of IPO	26,859,906
Conversion of Series A Preferred stock into Common stock upon closing of IPO	19,511,018
Sales of Common stock through IPO	18,750,000
Issuance of vested and non-vested Common stock upon closing of IPO	456,249
Common stock issued and outstanding after IPO	65,578,790
Issuance of Common stock to underwriters due to exercise of over-allotment	1,950,500
Total Common stock issued and outstanding as of March 18, 2010	
- Completion of IPO	67,529,290

The Company determined that the conversion features in the Class B Common stock and Series A Preferred stock were in-the-money at the date of issuance and therefore represented a beneficial conversion feature. Since the Class B Common stock and Series A Preferred stock were convertible upon an initial public offering, conversion was contingent upon a future event and therefore the beneficial conversion feature had not been recorded in the consolidated financial statements as of December 31, 2009. The beneficial conversion feature at the IPO date was \$140,690,000 and was recorded at the IPO date as a return to Class B Common and Series A Preferred stockholders analogous to a dividend, which was satisfied through the issuance of Class A Common stock. The beneficial conversion was recorded within additional paid-in-capital, as no retained earnings were available.

The Company used \$221,622,000 of proceeds from the initial closing of the IPO to pay down its second lien credit facility in full and to repay a portion of its first lien credit facility. Additionally, in March 2010, the Company used \$138,495,000 million of cash and cash equivalents on hand to further pay down its first lien term loan principal. Repayments of the first and second lien credit facilities during the six months ended June 30, 2010 totaled \$360,117,000.

The Company adopted an equity incentive plan on February 10, 2010 in connection with the IPO. At the time of the IPO, 4,341,504 stock options and 456,249 shares of restricted stock and other stock awards were granted to employees and Board members of the Company pursuant to the equity incentive plan. The stock options have an exercise price equal to the IPO price and vest in equal installments over five years, subject to the grantee's continued employment or service. The restricted stock awards will vest in full on the third anniversary of the date of grant, subject to the grantee's continued employment. See further discussion in note 11 Share Plans.

As a result of the Corporate Reorganization (see Management's Discussion and Analysis of Financial Condition and Results of Operations Corporate reorganization), IPO, the underwriters' option exercise and subsequent debt pay down, as of March 31, 2010, the Company had \$731,422,000 of outstanding debt under its first lien term loan, the second lien term loan was fully repaid and terminated, and 67,529,290 total shares of Common stock were outstanding.

**Accumulated Other Comprehensive Income (Loss)**

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Accumulated other comprehensive income (loss) (OCI) includes unrealized losses on certain cash flow hedges and the pension liability. The components of OCI at June 30, 2010 and December 31, 2009 were (dollars in thousands):

	<b>June 30, 2010</b>		<b>December 31, 2009</b>
Pension liability	\$	(4,492)	\$ (4,492)
Unrealized losses on cash flow hedges		(3,110)	
Accumulated other comprehensive loss	\$	(7,602)	\$ (4,492)



Table of Contents

**New Accounting Standards to be Adopted**

In August 2009, the FASB issued a clarification on fair value measurements. This clarification provides that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the techniques provided for in this update. This clarification was effective in the first reporting period following issuance (the Company's first quarter of fiscal 2010), and did not have a material impact on the Company's financial statements.

**2. Derivative Instruments and Hedging Activities**

The Company records all derivatives in accordance with ASC 815, *Derivatives and Hedging*, which requires all derivative instruments be reported on the consolidated balance sheets at fair value and establishes criteria for designation and effectiveness of hedging relationships. The Company is exposed to market risk such as changes in commodity prices, foreign currencies, and interest rates. The Company does not hold or issue derivative financial instruments for trading purposes.

*Commodities*

The primary objectives of the commodity risk management activities are to understand and mitigate the impact of potential price fluctuations on the Company's financial results and its economic well-being. While the Company's risk management objectives and strategies will be driven from an economic perspective, the Company attempts, where possible and practical, to ensure that the hedging strategies it engages in can be treated as hedges from an accounting perspective or otherwise result in accounting treatment where the earnings effect of the hedging instrument provides substantial offset (in the same period) to the earnings effect of the hedged item. Generally, these risk management transactions will involve the use of commodity derivatives to protect against exposure resulting from significant price fluctuations.

The Company primarily utilizes commodity contracts with maturities of less than 12 months. These are intended to offset the effect of price fluctuations on actual inventory purchases. There were two outstanding commodity contracts in place to hedge the Company's projected commodity purchases at June 30, 2010. There was one outstanding commodity contract in place to hedge the Company's projected commodity purchases at December 31, 2009. In October 2009, the Company entered into a commodity forward contract to purchase a notional amount of \$1,432,000 of copper. The contract was effective from October 5, 2009, and terminated on March 31, 2010. In May 2010, the Company entered into commodity forward contracts to purchase a notional amount of \$5,082,000 of copper. The contracts were effective from May 1, 2010 and June 1, 2010, and terminate on December 31, 2010. Total gain recognized in the consolidated statements of operations on commodity contracts was a gain of \$0 and \$137,000 for the three and six months ended June 30, 2009, respectively. Total losses recognized in the consolidated statements of operations on commodity contracts were a loss of \$181,000 and \$196,000 for the three and six months ended June 30, 2010, respectively.

*Foreign Currencies*

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

The Company is exposed to foreign currency exchange risk as a result of transactions in other currencies. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with foreign currency purchases in the normal course of business. Contracts typically have maturities of one year or less.

On February 18, 2010, the Company entered into a ten-month foreign currency average rate option transaction for Euros with a total notional amount of \$2,500,000. The primary objective of this transaction is to mitigate the impact of potential currency fluctuations of the Euro on our financial results. The impact on operations for both the three and six months ended June 30, 2010 was a loss of \$209,000. There were no foreign currency hedge contracts outstanding as of December 31, 2009.

### *Interest Rates*

In 2006, the Company entered into various interest rate swap agreements. The Company formally documented all relationships between interest rate hedging instruments and hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions. From inception through December 31, 2008, the Company's interest rate swap

Table of Contents

agreements qualified as cash flow hedges. For derivatives that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the derivatives' change in fair value, if any, is immediately recognized in earnings. The Company assesses on an ongoing basis whether derivatives used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

Effective January 3, 2009, the Company, within the terms of the Credit Agreements (see note 7), changed the interest rate election from three-month LIBOR to one-month LIBOR. Because of this change, the Company concluded that as of January 3, 2009, the Swaps no longer met hedge effectiveness tests and were therefore, no longer highly effective as a hedge against the impact on interest payments of changes in the LIBOR interest rate. In 2009, the effective portion of the swaps prior to the change was amortized as interest expense over the period of the originally designated hedged transactions. During 2009, changes in the fair value of the swaps were immediately recognized in the consolidated statements of operations as interest expense.

The Company's interest rate swap agreements outstanding as of December 31, 2009, totaling \$675,000,000 notional amount of debt, terminated on January 4, 2010. Subsequently, the Company entered into two new interest rate swap agreements during the first half of 2010. The first was entered into on January 21, 2010. The effective date of this swap is July 1, 2010 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of that swap is October 1, 2010 with a notional amount of \$100,000,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. We expect to maintain the swaps as highly effective in accordance with ASC 815 (formerly SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities) and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss).

The following table presents, in thousands, the fair value of the Company's derivatives:

	June 30, 2010	December 31, 2009
Derivatives designated as hedging instruments:		
Interest rate swaps	\$ (3,110)	\$ (3,110)
Derivatives not designated as hedging instruments:		
Commodity and foreign currency contracts	(354)	208
Total derivatives (liability) asset	\$ (3,464)	\$ 208

As of June 30, 2010 all derivatives that are not designated as hedging instruments are included in other accrued liabilities in the consolidated balance sheet. As of December 31, 2009, all derivatives that are not designated as hedging instruments are included in other assets in the consolidated balance sheet. All derivatives designated as hedging instruments are included in other long-term liabilities in the consolidated balance sheet at June 30, 2010. There were no derivatives that were designated as hedging instruments at December 31, 2009.

The fair value of the derivative contracts of a \$3,464,000 liability and a \$208,000 asset takes into account the Company's credit risk as of June 30, 2010 and December 31, 2009, respectively. Excluding the impact of credit risk, the fair value of the derivatives at June 30, 2010 was a \$3,550,000 liability, and represents the amount the Company would need to pay to exit the agreements on that date. The impact of credit risk on the fair value of derivative contracts at December 31, 2009 was not material.



Table of Contents

The following presents the impact of interest rate swaps, commodity contracts and foreign currency contracts on the consolidated statement of operations for the six months ended June 30, 2010 and 2009 (dollars in thousands):

	Amount of loss recognized in AOCI for the six months ended June 30,		Location of gain (loss) reclassified from AOCI into net income (loss)	Amount of loss reclassified from AOCI into net income (loss) for the six months ended June 30,		Amount of gain (loss) recognized in net income (loss) on hedges (ineffective portion) for the six months ended June 30,	
	2010	2009		2010	2009	2010	2009
<b>Derivatives designated as hedging instruments</b>							
Interest rate swaps	\$ (3,110)	\$	Interest expense	\$	\$ (12,929)	\$	\$
<b>Derivatives not designated as hedging instruments</b>							
Commodity and foreign currency contracts	\$	\$	Cost of goods sold	\$	\$	\$ (405)	\$ 137
Interest rate swaps	\$	\$	Interest expense	\$	\$	\$	\$ 10,970

**3. Fair Value Measurements**

ASC 820-10 *Fair Value Measurements and Disclosures* (formerly SFAS No. 157, *Fair Value Measurements*) among other things, defines fair value, establishes a consistent framework for measuring fair value, and expands disclosure for each major asset and liability category measured at fair value on either a recurring basis or nonrecurring basis. ASC 820-10 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the pronouncement establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on the market approach, which uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, notes receivable, accounts payable, and accrued liabilities), excluding long-term debt, approximates the fair value of these instruments based upon their short-term nature. The fair value of long-term debt was approximately \$676,566,000 at June 30, 2010, as calculated based on current quotations.

Assets and (liabilities) measured at fair value on a recurring basis are as follows (dollars in thousands):

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Fair Value Measurement Using

	<b>Total June 30, 2010</b>	<b>Quoted Prices in Active Markets for Identical Contracts (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>
Net derivative contracts	\$ (3,464)	\$	\$ (3,464)

Table of Contents

The fair value of derivative contracts above takes into account the Company's credit risk in accordance with ASC 820-10. Excluding the impact of credit risk, the fair value of derivatives at June 30, 2010 was a \$3,550,000 liability, and this represents the amount the Company would need to pay to exit the agreements on this date.

**4. Segment Reporting**

The Company operates in and reports as a single operating segment, which is the manufacture and sale of power products. Net sales are generated through the sale of generators and service parts to distributors and retailers. The Company manages and evaluates its operations as one segment primarily due to similarities in the nature of the products, production processes and methods of distribution. All of the Company's identifiable assets are located in the United States. The Company's sales outside North America represent approximately 2% of net sales.

The Company's product offerings consist primarily of power products with a range of power output. Residential products and industrial/commercial products are each a similar class of products based on similar power output and customer usage. The breakout of net sales between residential, industrial/commercial, and other products is as follows (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Residential products	\$ 87,867	\$ 90,874	\$ 171,866	\$ 179,350
Industrial/Commercial products	43,308	51,392	81,626	96,473
Other	9,280	7,311	17,681	14,200
Total	\$ 140,455	\$ 149,577	\$ 271,173	\$ 290,023

**5. Balance Sheet Details**

Inventories consist of the following (dollars in thousands):

	June 30,	December 31,
	2010	2009
Raw material	\$ 74,376	\$ 74,136
Work-in-process	599	775
Finished goods	40,633	52,726
Reserves for excess and obsolescence	(4,172)	(3,937)
	\$ 111,436	\$ 123,700

Property and equipment consists of the following (dollars in thousands):

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

	June 30, 2010		December 31, 2009
Land and improvements	\$ 3,913	\$	3,913
Buildings and improvements	48,579		48,521
Machinery and equipment	28,115		26,500
Dies and tools	10,501		9,631
Vehicles	944		857
Office equipment	6,117		5,712
Gross property and equipment	98,169		95,134
Less accumulated depreciation	(25,589)		(21,760)
Property and equipment, net	\$ 72,580	\$	73,374



Table of Contents

Other accrued liabilities consist of the following (dollars in thousands):

	June 30, 2010	December 31, 2009
Accrued commissions	\$ 4,668	\$ 4,211
Accrued interest	5,063	17,062
Accrued warranties - short term	17,478	17,029
Other accrued liabilities	9,739	14,024
	\$ 36,948	\$ 52,326

**6. Product Warranty Obligations**

The Company records a liability for product warranty obligations at the time of sale to a customer based upon historical warranty experience. The Company also records a liability for specific warranty matters when they become known and are reasonably estimable. The Company's product warranty obligations are included in other accrued liabilities and other long-term liabilities in the balance sheets.

Changes in product warranty obligations are as follows (dollars in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2010	2009	2010	2009
Balance at beginning of period	\$ 20,774	\$ 17,204	\$ 20,729	\$ 17,539
Payments	(3,007)	(3,081)	(6,333)	(6,854)
Charged to operations	3,411	4,641	6,782	8,079
Balance at end of period	\$ 21,178	\$ 18,764	\$ 21,178	\$ 18,764

The product warranty obligations are included in the balance sheets as follows (dollars in thousands):

	June 30, 2010	December 31, 2009
Other accrued liabilities	\$ 17,478	\$ 17,029
Other long-term liabilities	3,700	3,700
Balance at end of period	\$ 21,178	\$ 20,729

**7. Credit Agreements**

Long-term debt consists of the following (dollars in thousands):

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

	June 30, 2010	December 31, 2009
First lien term loan	\$ 739,371	\$ 920,604
Second lien term loan		430,000
	739,371	1,350,604
Less treasury debt first lien	7,949	9,898
Less treasury debt second lien		249,167
Less current portion		39,076
	\$ 731,422	\$ 1,052,463

Table of Contents

On February 17, 2010, the Company completed its initial public offering. \$221,622,000 of proceeds from the initial closing were used to pay down the second lien credit facility in full and to repay a portion of the first lien credit facility. Additionally, in March 2010, the Company used \$138,495,000 of cash and cash equivalents on hand to further pay down the first lien term loan principal. Repayments of the first and second lien credit facilities during the three and six months ended June 30, 2010 totaled \$0 and \$360,117,000, respectively.

At June 30, 2010, the Company had a credit agreement which provided for borrowings under a revolving credit facility (the Revolving Credit Facility) and a first lien term loan (collectively, the Credit Agreement). The Credit Agreement requires the Company, among other things, to meet certain financial and nonfinancial covenants and maintain financial ratios in such amounts and for such periods as set forth therein. The Company is required to maintain a leverage ratio (net debt divided by EBITDA, as defined in the Credit Agreement) of 6.50 as of June 30, 2010. The leverage ratio decreases quarterly, and for 2010, the Company will be required to maintain a leverage ratio of 6.75, 6.50, 6.25, and 5.75 for the first, second, third, and fourth quarters, respectively. The Company was in compliance with all requirements as of June 30, 2010 and December 31, 2009.

The Credit Agreement restricts the circumstances in which distributions and dividends can be paid by its Subsidiary. Payments can be made to the Company for certain expenses, and dividends can be used to repurchase equity interests, subject to an annual limitation. Additionally, the Credit Agreement restricts the aggregate amount of dividends and distributions that can be paid.

During the three and six months ended June 30, 2009, affiliates of CCMP Capital Advisors, LLC (CCMP), majority shareholder of the Company, acquired \$11,898,000 and \$27,898,000 par value of first and second lien term loans for approximately \$7,327,000 and \$13,989,000, respectively. CCMP exchanged this debt for additional shares of Series A Preferred stock issued by the Company. The Company subsequently contributed this debt to its Subsidiary. The fair value of the shares exchanged was \$7,327,000 and \$13,989,000 for the three and six months ending June 30, 2009, respectively. These shares had beneficial conversion features which were contingent upon a future event (see note 1). The Company recorded this transaction as Series A Preferred stock of \$7,327,000 and \$13,989,000 for the three and six months ended June 30, 2009, respectively, based on the fair value of the debt contributed by CCMP which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, the Company recorded a gain on extinguishment of debt of \$4,414,000 and \$13,510,000, which includes the write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the three and six months ended June 30, 2009, respectively.

In previous periods, the Company entered into various interest rate swap agreements (the Swaps) with certain banks. The Swaps, which were effective January 2, 2007, October 3, 2007, and January 3, 2008, had notional amounts totaling \$825,000,000, \$100,000,000, and \$275,000,000, respectively. The total notional amount of \$1,200,000,000 declined to \$1,100,000,000 at October 3, 2008, further declined to \$675,000,000 at January 3, 2009, and terminated January 4, 2010. The Company swapped floating three-month LIBOR interest rates for fixed rates with an aggregate weighted-average interest rate of 5.041% as of December 31, 2009.

The Company entered into two new interest rate swap agreements during the six month period ending June 30, 2010. The first was entered into on January 21, 2010. The effective date of the swap is July 1, 2010 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of the swap is October 1, 2010 with a notional amount of \$100,000,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. We expect to maintain the swaps as highly effective in accordance with ASC 815 (formerly SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities) and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss).

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

The fair value of the interest rate swap agreements, including the impact of credit risk, was a liability of \$3,110,000 and \$0 at June 30, 2010 and December 31, 2009, respectively.

### 8. Earnings Per Share

The Company's capitalization prior to the initial public offering consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. Upon closing of the IPO, all shares of convertible Class B Common stock and Series A preferred stock were automatically converted into 88,476,530 and 19,511,018 Class A Common shares, respectively. The 88,476,530 shares of Class A Common stock were subject to a 3.294 for 1 reverse stock split, resulting in 26,859,906 Class A Common shares relative to the Class B Common stock conversion, and the Class A Common stock was re-designated as Common Stock. Subsequent to the IPO, the Company has one class of common stock. The share and per share data used in basic and diluted earnings per share has been retrospectively restated to reflect only the 3.294 for 1 reverse stock split immediately prior to the IPO.

Table of Contents

The Class B Common stock was considered a participating stock security requiring use of the two-class method for the computation of basic net income (loss) per share in accordance with provision of ASC 260-10 *Earnings per share*. Losses were not allocated to the Class B Common stock in the computation of basic earnings per share as the Class B Common stock was not obligated to share in losses.

Basic earnings per share excludes the effect of common stock equivalents and is computed using the two-class computation method, which subtracts earnings attributable to the Class B preference from total earnings. In addition, earnings attributable to the Series A Preferred preference and the Class B and Series A Preferred beneficial conversion are subtracted from total earnings. Any remaining loss is attributed to the Class A Common shares.

For the six month period ended June 30, 2010, diluted earnings per share are identical to basic earnings per share because the impact of common stock equivalents on earnings per share is anti-dilutive.

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income	\$ 12,834	\$ 10,997	\$ 15,302	\$ 16,791
Less: accretion of Series A Preferred stock		(3,320)	(2,042)	(6,112)
Less: accretion of Class B Common stock		(24,731)	(12,133)	(48,859)
Less: beneficial conversion			(140,690)	
Net income (loss) attributable to Common stock (formerly Class A Common stock)	12,834	(17,054)	(139,563)	(38,180)
Income attributable to Class B Common stock		24,731	12,133	48,859
Net income (loss) per common share - basic:				
Common stock (formerly Class A Common stock)	\$ 0.19	\$ (9,824)	\$ (2.71)	\$ (21,993)
Class B Common stock	n/a	\$ 1,030	\$ 2,230	\$ 2,034
Net income (loss) per common share - diluted:				
Common stock (formerly Class A Common stock)	\$ 0.19	\$ (9,824)	\$ (2.71)	\$ (21,993)
Class B Common stock	n/a	\$ 1,030	\$ 2,230	\$ 2,034
Weighted average number of shares outstanding Common Stock (formerly Class A Common stock):				
Basic	67,093,250	1,736	51,507,358	1,736
Dilutive effect of stock compensation awards	107,315			
Diluted	67,200,565	1,736	51,507,358	1,736
Weighted average number of shares outstanding Class B Common stock	n/a	24,018	5,440	24,018

basic and diluted:

The Series A Preferred and Class B Common stock were only convertible to Class A Common stock immediately prior to an initial public offering. The impact of the conversion of Series A Preferred and Class B Common stock are excluded from the diluted earnings per share calculation for the three and six month periods ended June 30, 2009, as this contingent event had not yet occurred as of June 30, 2009. The number of shares of Class A Common stock that were issued upon conversion of the Series A Preferred and Class B Common stock was dependent upon the initial public offering price of the Class A Common stock on the date of conversion of February 10, 2010 as well as the unpaid priority return.

## **9. Income Taxes**

The Company is the taxpaying entity and files a consolidated federal income tax return. Currently, the Company is not under examination by any major taxing jurisdiction to which the Company is subject, except for an open audit by Michigan Department of Treasury, which began in March 2010. The Company believes the results of this audit will not have a significant impact on its financial position or results of operations. The statute of limitation for tax years 2009, 2008, 2007 and 2006 is open for federal and state income taxes. Additionally, tax year 2005 remains open for examination by certain state taxing authorities.

Table of Contents

At December 31, 2009, the Company had federal net operating loss carry forwards of approximately \$161,800,000, which expire between 2026 and 2029, and various state net operating loss carry forwards, which expire between 2016 and 2029.

As a result of ownership changes, Section 382 of the Internal Revenue Code of 1986, as amended, and similar state provisions can limit the annual deductions of net operating loss and tax credit carry forwards. Such annual limitations could result in the expiration of net operating loss and tax credit carry forwards before utilization. The Company had no such limitation as of June 30, 2010; no limitation was triggered by our initial public offering which was completed on February 17, 2010. Future ownership changes may result in such a limitation.

**10. Benefit Plans**

Additional information related to the Pension Plans is as follows (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Components of net periodic pension expense:				
Service cost	\$	\$	\$	\$
Interest cost		590	584	1,169
Expected return on plan assets		(501)	(451)	(902)
Amortization of net loss		62	60	120
Net periodic pension expense	\$	151	\$	387

**11. Share Plans**

On November 10, 2006, the Company adopted the 2006 Management Equity Incentive Plan (2006 Equity Incentive Plan). The 2006 Equity Incentive Plan provided for awards with respect to a maximum of 9,350,0098 shares of Common stock (formerly Class A Common stock) and 5,000 Class B Common shares, subject to certain adjustments. On November 10, 2006, and from time to time thereafter, certain members of management purchased restricted shares of Class A Common stock under the 2006 Equity Incentive Plan for \$341 per share and pursuant to restricted stock agreements. One half of the restricted shares vest over time (Time Vesting Shares), with 25% vesting on November 10, 2007 and on the next three anniversaries thereafter, so long as the participant was still employed by the Company or one of its subsidiaries on the applicable vesting date. Upon the occurrence of a change of control of the Company, any unvested Time Vesting Shares immediately vested in full, so long as the participant was still employed by the Company or one of its subsidiaries. The remaining restricted shares immediately vested (performance-based vesting) in full, provided the participant was still then employed by the Company or one of its subsidiaries, upon the occurrence of either: (i) a change of control of the Company that provides CCMP with a certain rate of return with respect to net proceeds received by CCMP from their investment in the Company; or (ii) from and after the date of an IPO, the achievement with respect to shares of the Common stock (formerly Class A Common stock) of an average closing trading price exceeding, in any 60 consecutive trading day period starting prior to the later of (a) the fifth year anniversary of the date of grant of the restricted shares, and (b) one year after the IPO, a certain threshold with respect to net proceeds received by CCMP from their investment in the Company. As a condition to the purchase of restricted shares, members of management executed confidentiality, non-competition and intellectual property agreements.

The fair value of the Class A common stock on the date of issuance was estimated to be \$390 per share. As a result of the IPO, the remaining unvested performance-based Restricted Shares became fully vested. As a result, the Company has recorded \$0 and \$159,000 of stock-based

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

compensation expense related to the accelerated vesting during the three and six months ended June 30, 2010. The stock-based compensation expense related to the time-based vesting prior to the IPO was \$0 and \$6,000 for the three and six months ended June 30, 2010.

The Company adopted an equity incentive plan on February 10, 2010 in connection with the IPO. At the time of the IPO, 4,341,504 stock options and 456,249 shares of restricted stock and other stock awards were granted to employees and Board members of the Company pursuant to the equity incentive plan. Total share-based compensation cost related to the equity incentive plan recognized in the consolidated statement of operations for the three and six months ended June 30, 2010 was



Table of Contents

\$1,713,000 and \$2,794,000, respectively, which is recorded in operating expenses in the condensed consolidated statement of operations.

*Stock Options* - The stock options have an exercise price equal to the IPO price of \$13.00 per share, and vest in equal installments over five years, subject to the grantee's continued employment or service. The options expire 10 years after the date of grant.

The grant-date fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model. The fair value is then amortized on a straight-line basis over the requisite service period of the awards, which is generally the vesting period. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Since there was no history for the Company's stock, expected volatility was calculated based on an analysis of historic and implied volatility measures for a set of peer companies. The average expected life was based on the contractual term of the option using the simplified method. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. The compensation expense recognized is net of estimated forfeitures. Forfeitures are estimated based on voluntary termination behavior, as there is no history of actual share option forfeitures at this time. The weighted-average assumptions used in the Black-Scholes-Merton option pricing model for 2010 are as follows:

<b>2010</b>	
Expected stock price volatility	50%
Risk free interest rate	2.94%
Expected annual dividend per share	\$
Expected life of options (years)	6.5

The weighted-average grant-date fair value of options granted during 2010 was \$6.84 per option. There have been no options exercised during 2010.

A summary of option activity as of June 30, 2010 and changes during the six months then ended is presented below:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (\$ in thousands)
Outstanding as of December 31, 2009		\$		
Granted	4,341,504		13.00	
Exercised				
Expired				

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Forfeited	(130,245)	(13.00)		
Outstanding as of June 30, 2010	4,211,259	13.00	9.6	\$ 4,253
Exercisable as of June 30, 2010				

As of June 30, 2010, there was \$23,613,000 of total unrecognized compensation cost, net of expected forfeitures, related to un-vested options. The cost is expected to be recognized over the remaining service period, having a weighted-average period of 4.6 years. Total share-based compensation cost related to the stock options for the three and six month periods ended June 30,

Table of Contents

2010 was \$1,277,000 and \$1,915,000, respectively, which is recorded in operating expenses in the condensed consolidated statement of operations.

*Restricted Stock* - The restricted stock awards will vest in full on the third anniversary of the date of grant, subject to the grantee's continued employment. The fair market value of the award at the time of the grant is amortized to expense over the period of vesting. The fair value of restricted share awards is determined based on the market value of the Company's shares on the grant date. The compensation expense recognized for restricted share awards is net of estimated forfeitures.

A summary of the status of the Company's restricted share awards as of June 30, 2010 and changes during the six months then ended is presented in the table below:

<b>Restricted Stock Awards</b>	<b>Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Non-vested as of December 31, 2009		\$
Granted	437,499	13.00
Vested		
Forfeited	(9,844)	(13.00)
Non-vested as of June 30, 2010	427,655	13.00

The weighted-average grant-date fair value of restricted share awards granted during the six months ended June 30, 2010 was \$13.00 per share. No restricted share awards vested during the six months ended June 30, 2010.

As of June 30, 2010, there was \$4,185,000 of total unrecognized compensation cost, net of expected forfeitures, related to non-vested restricted share awards. That cost is expected to be recognized over the remaining service period, having a weighted-average period of 2.6 years. Total share-based compensation cost related to the restricted stock for the three and six month periods ended June 30, 2010 was \$399,000 and \$598,000, which is recorded in operating expenses in the condensed consolidated statement of operations.

During the three and six months ended June 30, 2010, 2,656 and 21,406 shares of fully vested stock were granted to certain members of the Company's board of directors in exchange for their service on the board. Total compensation cost for these share grants was \$37,500 and \$281,000 for the three and six months ended June 30, 2010, respectively, which is recorded in operating expenses in the condensed consolidated statement of operations.

**12. Commitments and Contingencies**

The Company had a previous arrangement with a finance company to provide floor plan financing for selected dealers. The Company received payment from the finance company within a few days of shipment of product to the dealer. The Company participated in the cost of dealer financing up to certain limits. The Company has agreed to repurchase products repossessed by the finance company. The Company's financial

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

exposure when repurchasing product is limited to the difference between the outstanding balance due and the amount received on the resale of the repossessed product. Under the previous arrangement, in the event of default, the Company is liable for up to 50% of the financed balance. Effective February 27, 2009, the previous arrangement between the Company and the finance company was terminated. The amount financed by dealers which remained outstanding under this previous arrangement at June 30, 2010 and December 31, 2009 was approximately \$179,000 and \$427,000, respectively. Minimal losses have been incurred under this agreement, and a minimal reserve for future losses has been recorded.

Effective May 29, 2009, the Company entered into a new arrangement with a different finance company. This arrangement is similar to the previous arrangement, however, the Company does not indemnify the finance company for any credit losses it incurs. The amount financed by dealers which remained outstanding under this new arrangement at June 30, 2010 and December 31, 2009 was approximately \$8,890,000 and \$6,966,000, respectively.

In the normal course of business, the Company is named as a defendant in various lawsuits in which claims are asserted against the Company. In the opinion of management, the liabilities, if any, which may result from such lawsuits are not expected to have a material adverse effect on the financial position, results of operations, or cash flows of the Company.

Table of Contents

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

This report contains forward-looking statements that are subject to risks and uncertainties. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as anticipate, estimate, expect, project, plan, intend, believe, may, should, can have, likely, future and other similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events.

The forward-looking statements contained in this report are based on assumptions that we have made in light of our industry experience and on our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate under the circumstances. As you read and consider this report, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties (some of which are beyond our control) and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual financial results and cause them to differ materially from those anticipated in the forward-looking statements. The forward-looking statements contained in this report include estimates regarding:

- our business, financial and operating results and future economic performance;
- proposed new product and service offerings; and
- management's goals, expectations and objectives and other similar expressions concerning matters that are not historical facts.

Factors that could affect our actual financial results and cause them to differ materially from those anticipated in the forward-looking statements include:

- demand for our products;
- frequency of major power outages;
- availability of raw materials and key components used producing our products;

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

- competitive factors in the industry in which we operate;
- our dependence on our distribution network;
- our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;
- our ability to adjust to operating as a public company;
- loss of our key management and employees;
- increase in liability claims; and
- changes in environmental, health and safety laws and regulations.

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in these forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in Generac's filings with the Securities and Exchange Commission, including in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Any forward-looking statement made by us in this report speaks only as of the date on which we make it. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

### Overview

We are a leading designer and manufacturer of a wide range of standby generators for the residential, industrial and light-commercial markets. As the only significant market participant focused exclusively on these products, we have one of the leading market positions in the standby generator market in the United States and Canada. We design, engineer and manufacture generators with an output of between 800W and 9mW of power. We design, manufacture, source and modify engines, alternators, automatic transfer switches and other components necessary for our products. Our generators are fueled by natural gas, liquid

Table of Contents

propane, gasoline, diesel and Bi-Fuel . Our products are available through a broad network of independent dealers, retailers and wholesalers.

**Business drivers and measures**

In operating our business and monitoring its performance, we pay attention to a number of industry trends, performance measures and operational factors. The statements in this section are based on our current expectations.

*Industry trends*

Our performance is affected by the demand for reliable back-up power solutions by our customer base. This demand is influenced by several important trends affecting our industry, including the following:

*Increasing penetration opportunity.* Although there have been recent increases in costs of installed standby generators in the residential and light-commercial markets (driven in the last two years by raw material costs), these costs have declined overall over the last decade, and many potential customers are not aware of the costs and benefits of backup power solutions. We estimate that penetration rates for installed standby residential products are approximately 2% of U.S. single-family detached, owner-occupied households with a home value of over \$100,000, as defined by the U.S. Census Bureau's 2007 American Housing Survey for the United States, and penetration rates of many light-commercial outlets such as restaurants, drug stores, and gas stations are significantly lower than penetration of hospitals and industrial locations. We believe that by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby generators.

*Effect of large scale power disruptions.* Power disruptions are an important driver of consumer awareness and have historically influenced demand for generators. Disruptions in the aging U.S. power grid and tropical and winter storm activity increase product awareness and may drive consumers to accelerate their purchase of a standby or portable generator during the immediate and subsequent periods following a power disruption, which we believe may last for six to twelve months for standby generators. While there are power outages every year across all regions of the country, major outage activity is unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period.

*Impact of business capital investment cycle.* The market for commercial and industrial generators is affected by the capital investment cycle and overall durable goods spending, as businesses either add new locations or make investments to upgrade existing locations. These trends can have a material impact on demand for industrial and commercial generators. However the capital investment cycle may differ for the various industrial and commercial end markets (including industrial, telecommunications, distribution, retail health care facilities and municipal infrastructure, among others). The market for generators is also affected by general economic conditions, credit availability and trends in durable goods spending by consumers and businesses.

*Operational factors*

We are subject to various factors that can affect our results of operations, which we attempt to mitigate through factors we can control, including continued product development, expanded distribution, pricing and cost control. The operational factors that affect our business include the following:

*New product start-up costs.* When we launch new products, we generally experience an increase in start-up costs, including engineering expenses, air freight expenses, testing expenses and marketing expenses, resulting in lower gross margins during the initial launch of a new product. Margins on new product introductions generally increase over the life of the product as these start-up costs decline and we focus our engineering efforts on product cost reduction.

*Effect of commodity and component price fluctuations.* Industry-wide price fluctuations of key commodities, such as steel, copper and aluminum and other components we use in our products, can have a material impact on our results of operations. We have historically attempted to mitigate the impact of commodity and component prices through improved product design, price increases and select hedging transactions. Our results are also influenced by changes in fuel prices in the form of freight rates, which in some cases are borne by our customers and in other cases are paid by us.

***Other factors***

Other factors that affect our results of operations include the following:



Table of Contents

*Factors influencing interest expense.* We anticipate that interest expense will decrease in 2010 versus 2009 because, during the six months ended June 30, 2010, we used the net proceeds from our initial public offering and available cash on hand, to repay a substantial portion of outstanding indebtedness. The expiration of certain interest rate swap agreements in January 2010, together with reduced Libor rates versus 2009, will also decrease interest expense in 2010. In addition, new interest rate swaps entered into in January and June 2010, which are described further under the Liquidity and Financial Condition section, will mitigate the risk of interest rate volatility on a portion of our debt.

*Factors influencing provision for income taxes.* Because we made a Section 338(h)(10) election in connection with the 2006 CCMP transactions described below, we have \$1.4 billion of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2009 that we expect to generate cash tax savings of \$557 million through 2021, assuming continued profitability and a 38.5% tax rate. The amortization of these assets for tax purposes is expected to be \$122 million annually through 2020 and \$102 million in 2021, which generates annual cash tax savings of \$47 million through 2020 and \$39 million in 2021, assuming profitability and a 38.5% tax rate. Additionally, we have federal net operating loss, or NOL, carry forwards of \$161.8 million as of December 31, 2009, which we expect to generate an additional \$57 million of federal cash tax savings at a 35% rate when and if utilized. Based on current business plans, we believe that our cash tax obligations through 2021 will be significantly reduced by these tax attributes. However, any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and/or defer our ability to utilize our net operating loss carry forwards to offset future federal income tax liabilities.

*Seasonality.* Although there is demand for our products throughout the year, in each of the past three years approximately 20% to 25% of our net sales occurred in the first quarter, 22% to 25% in the second quarter, 25% to 29% in the third quarter and 25% to 30% in the fourth quarter, with different seasonality depending on the timing of major outage activity in each year. We maintain a flexible production schedule in order to respond to outage-driven peak demand, but typically increase production levels in the second and third quarters of each year.

**Transactions with CCMP**

In November 2006, affiliates of CCMP Capital Advisors, LLC, or CCMP, together with affiliates of Unitas Capital Ltd., (Unitas), and members of our management, purchased an aggregate of \$689 million of our equity capital. In addition, on November 10, 2006, Generac Power Systems borrowed an aggregate of \$1,380 million, consisting of an initial drawdown of \$950 million under a \$1.1 billion first lien secured credit facility and \$430 million under a \$430 million second lien secured credit facility. With the proceeds from these equity and debt financings, together with cash on hand at Generac Power Systems, we (1) acquired all of the capital stock of Generac Power Systems and repaid certain pre-transaction indebtedness of Generac Power Systems for \$2.0 billion, (2) paid \$66 million in transaction costs related to the transaction and (3) retained \$3 million for general corporate purposes. For additional information concerning these and other historical transactions with CCMP, see Item 1 Business History CCMP transactions in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

During the three and six months ended June 30, 2009, affiliates of CCMP Capital Advisors, LLC (CCMP), majority shareholder of the Company, acquired \$11,898,000 and \$27,898,000 par value of first and second lien term loans for approximately \$7,327,000 and \$13,989,000, respectively. CCMP exchanged this debt for additional shares of Series A Preferred stock issued by the Company. The Company subsequently contributed this debt to its Subsidiary. The fair value of the shares exchanged was \$7,327,000 and \$13,989,000, respectively, for the three and six months ending June 30, 2009. These shares had beneficial conversion features which were contingent upon a future event (see note 1). The Company recorded this transaction as Series A Preferred stock of \$7,327,000 and \$13,989,000, respectively, for the three and six months ended June 30, 2009, based on the fair value of the debt contributed by CCMP which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, the Company recorded a gain on extinguishment of debt of \$4,414,000 and \$13,510,000 respectively, which includes the write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the three and six months ended June 30, 2009, respectively.

**Corporate reorganization**

Our capitalization prior to the initial public offering consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. Our Series A Preferred Stock was entitled to a priority return preference equal to a 14% annual return on the amount originally paid for such shares and equity participation equal to 24.3% of the remaining equity value of the Company. Our Class B Common Stock was entitled to a priority return preference equal to a 10% annual return on the amount originally paid for such shares. In connection with the initial public offering, we undertook a corporate reorganization which gave effect to the conversion of our Series A Preferred Stock and Class B Common Stock into the same class of our common stock that was sold in our initial public offering while taking into account the rights and preference of those shares, including the priority returns of our

Table of Contents

Series A Preferred Stock and our Class B Common Stock and the equity participation rights of the Series A Preferred Stock. A reverse stock split was needed to reduce the number of shares to be issued to holders of our Class A and Class B Common Stock to the number that correctly reflected the proportionate interest of such stockholders in the Company, taking into account the number of shares of common stock to be issued upon the conversion of our Series A Preferred Stock and the number and value of shares of common stock to be issued and sold to new investors in the initial public offering. We refer to these transactions as the Corporate Reorganization. For additional information about the Corporate Reorganization, see Item 7 Managements Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K filed for the fiscal year ended December 31, 2009.

**Initial public offering**

On February 17, 2010, we completed our initial public offering of 18,750,000 shares of our common stock at a price of \$13.00 per share. In addition, the underwriters exercised their option and purchased an additional 1,950,500 shares of our common stock from us on March 18, 2010. We received a total of approximately \$247.6 million in net proceeds from the initial public offering and underwriters option exercise, after deducting the underwriting discounts and expenses.

The Company adopted an equity incentive plan on February 10, 2010 in connection with the IPO. A registration statement on Form S-8 was filed registering the 6,637,835 shares of common stock issuable under the equity incentive plan. At the time of the IPO, 4,341,504 stock options and 456,249 shares of restricted stock and other stock awards were granted to employees and Board members of the Company pursuant to the equity incentive plan. The stock options have an exercise price equal to the IPO price and vest in equal installments over five years, subject to the grantee s continued employment or service. The restricted stock awards will vest in full on the third anniversary of the date of grant, subject to the grantee s continued employment.

Immediately following the Corporate Reorganization, the IPO and underwriters option exercise, we had 67,529,290 shares of common stock outstanding.

**Subsequent repayment of debt**

In February 2010, we used \$221.6 million in net proceeds from the initial closing of the IPO to pay down our second lien term loan in full and to pay down a portion of our first lien term loan. In addition, in March 2010, we used \$138.5 million of cash and cash equivalents on hand to further pay down our first lien term loan. As a result of these pay downs, at March 19, 2010, the outstanding balance on the first lien credit facility had been reduced to \$731.4 million, and our second lien credit facility had been repaid in full and terminated. This reduction in debt will have a significant impact on cash flows as a result of lower debt service costs in future periods, based on current LIBOR rates. There were no further pay downs on our first lien credit facility during the three months ended June 30, 2010.

Table of Contents**Results of operations***Quarter and six months ended June 30, 2010 compared to quarter and six months ended June 30, 2009*

The following table sets forth our consolidated statement of operations data for the periods indicated:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net Sales	\$ 140,455	\$ 149,577	\$ 271,173	\$ 290,023
Cost of Goods Sold	85,710	89,389	165,010	182,308
Gross profit	54,745	60,188	106,163	107,715
Operating Expenses:				
Selling and service	13,809	15,853	28,121	30,243
Research and development	3,482	2,625	7,204	5,237
General and administrative	5,679	3,970	10,838	7,867
Amortization of intangibles	12,921	12,954	25,682	25,766
Total operating expenses	35,891	35,402	71,845	69,113
Income from operations	18,854	24,786	34,318	38,602
Total other expense, net	(5,943)	(13,682)	(18,857)	(21,599)
Income before provision for income taxes	12,911	11,104	15,461	17,003
Provision for income taxes	77	107	159	212
Net income	\$ 12,834	\$ 10,997	\$ 15,302	\$ 16,791
Residential products	\$ 87,867	\$ 90,874	\$ 171,866	\$ 179,350
Industrial & Commercial products	43,308	51,392	81,626	96,473
Other	9,280	7,311	17,681	14,200
Net sales	\$ 140,455	\$ 149,577	\$ 271,173	\$ 290,023

*Net sales.* Net sales decreased \$9.1 million, or 6.1%, to \$140.5 million for the three months ended June 30, 2010 from \$149.6 million for the three months ended June 30, 2009. This decrease was driven by a \$3.0 million, or 3.3%, decrease in sales of residential products due to the continued weakness in residential investment coupled with a reduced benefit from power outages. This residential product sales decline was offset by our initiatives to expand product offerings, increase distribution and increase awareness for standby power products. In addition, industrial and commercial product sales declined \$8.1 million, or 15.7%, due to continued weakness in U.S. non-residential construction activity together with declines in sales to industrial and commercial national account customers.

Net sales decreased \$18.9 million, or 6.5%, to \$271.2 million for the six months ended June 30, 2010 from \$290.0 million for the six months ended June 30, 2009. This decrease was driven by a \$7.5 million, or 4.2%, decrease in sales of residential products for the same reasons described in the second quarter above. In addition, industrial and commercial product sales declined \$14.8 million, or 15.4%, for the same reasons described above.

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

*Costs of goods sold.* Costs of goods sold decreased \$3.7 million, or 4.1%, to \$85.7 million for the three months ended June 30, 2010 from \$89.4 million for the three months ended June 30, 2009. Raw material costs decreased \$3.4 million year-over-year due to a decrease in sales volume, offset by higher commodity costs, primarily steel, copper and aluminum, as we started to see an increase in commodity costs during the three months ended June 30, 2010 versus the prior year quarter. Direct labor and overhead costs also decreased \$0.3 million, year over year.

Costs of goods sold decreased \$17.3 million, or 9.5%, to \$165.0 million for the six months ended June 30, 2010 from \$182.3 million for the six months ended June 30, 2009. Raw material costs decreased \$14.8 million year-over-year due to a decrease in sales volume, lower commodity costs, primarily steel, copper and aluminum, as well as engineering and sourcing cost

Table of Contents

reductions implemented during 2009. Inbound freight costs, direct labor and variable overhead costs also decreased \$2.5 million year over year.

*Gross profit.* Gross profit decreased \$5.4 million, or 9.0%, to \$54.7 million for the three months ended June 30, 2010 from \$60.2 million for the three months ended June 30, 2009, primarily due to a decrease in sales volume, coupled with a residential sales mix change to lower kilowatt products. In addition, we started to see an increase in commodity costs during the three months ended June 30, 2010 versus the prior year quarter. As a percentage of net sales, gross profit decreased to 39.0% for the three months ended June 30, 2010 from 40.2% for the three months ended June 30, 2009.

Gross profit decreased \$1.6 million, or 1.4%, to \$106.2 million for the six months ended June 30, 2010 from \$107.7 million for the six months ended June 30, 2009, primarily due to the factors affecting cost of goods sold described above. As a percentage of net sales, gross profit increased to 39.1% for the six months ended June 30, 2010 from 37.1% for the six months ended June 30, 2009.

*Operating expenses.* Operating expenses increased \$0.5 million, or 1.4%, to \$35.9 million for the three months ended June 30, 2010 from \$35.4 million for the three months ended June 30, 2009. Selling and service expenses decreased \$2.0 million due to lower variable selling expenses related to our decrease in net sales. Research and development expenses increased year over year by \$0.9 million from increased product development and engineering resource investment. General and administrative expenses increased \$1.7 million mainly due to \$1.7 million of share based compensation expense recorded during the three months ended June 30, 2010 for the time vesting of stock option, restricted stock and other stock awards issued in connection with our IPO. General and administrative expenses also include additional administrative costs incurred as a result of becoming a public company in the first quarter of 2010.

Operating expenses increased \$2.7 million, or 4.0%, to \$71.8 million for the six months ended June 30, 2010 from \$69.1 million for the six months ended June 30, 2009. Selling and service expenses decreased \$2.1 million due to lower variable expenses related to our decrease in net sales. Research and development expenses increased year over year \$2.0 million from increased product development and engineering resource investment. General and administrative expenses increased \$3.0 million mainly due to \$3.0 million of share based compensation expense recorded during the six months ended June 30, 2010 for the time vesting of stock option, restricted stock and other stock awards issued in connection with our IPO.

*Other expense.* Other expense decreased \$7.7 million, or 56.6%, to \$5.9 million for the three months ended June 30, 2010 from \$13.7 million for the three months ended June 30, 2009. This decrease was caused by the following factors. As a result of the previously discussed CCMP debt buy-backs during the three months ended June 30, 2009, we recognized a \$4.4 million gain on the extinguishment of debt during the second quarter of 2009, which did not recur in 2010. In addition, a reduction in interest expense of \$12.8 million was the result of (i) debt buy-backs in 2009, (ii) the subsequent repayment of debt post IPO in 2010, (iii) lower LIBOR rates versus prior year, and (iv) the expiration of interest rate swap contracts in January 2010.

Other expense decreased \$2.7 million, or 12.7%, to \$18.9 million for the six months ended June 30, 2010 from \$21.6 million for the six months ended June 30, 2009. This decrease was caused by a number of factors. As a result of the previously discussed CCMP debt buy-backs during the six months ended June 30, 2009, we recognized a \$13.5 million gain on the extinguishment of debt, which did not recur in 2010. In addition, the subsequent repayment of debt following our IPO in the first quarter of 2010 resulted in an acceleration of deferred financing cost amortization of \$4.2 million that did not occur in 2009. Lastly, a reduction in interest expense of \$22.2 million was the result of (i) debt buy-backs in 2009, (ii) the subsequent repayment of debt post IPO in 2010, (iii) lower LIBOR rates versus prior year, and (iv) the expiration of interest rate swap contracts in January 2010.

*Provision for income taxes.* Income tax expense was \$0.1 million for both the three months ended June 30, 2010 and 2009. Income tax expense primarily relates to certain state income taxes based on profitability measures other than net income.

Income tax expense was \$0.2 million for both the six months ended June 30, 2010 and 2009. Income tax expense primarily relates to certain state income taxes based on profitability measures other than net income.

*Net income.* As a result of the factors identified above, we generated net income of \$12.8 million for the three months ended June 30, 2010 compared to \$11.0 million for the three months ended June 30, 2009.

As a result of the factors identified above, we generated net income of \$15.3 million for the six months ended June 30, 2010 compared to \$16.8 million for the six months ended June 30, 2009.

Table of Contents

*Adjusted EBITDA.* Adjusted EBITDA decreased to \$36.0 million for the three months ended June 30, 2010 from \$40.0 million for the three months ended June 30, 2009. Adjusted EBITDA decreased slightly to \$67.8 million for the six months ended June 30, 2010 from \$68.9 million for the six months ended June 30, 2009. The previously mentioned decrease in gross profit is the primary driver of this decrease for the three and six months ended June 30, 2010.

*Adjusted Net income.* Adjusted net income of \$26.1 million for the three months ended June 30, 2010 increased 28.9% from \$20.3 million for the three months ended June 30, 2009. Adjusted net income of \$46.3 million for the six months ended June 30, 2010 increased 51.1% from \$30.6 million for the six months ended June 30, 2009. The previously discussed reduction in interest expense offset by reductions in income from operations were the primary driver for this increase.

See *Non-GAAP measures* for a discussion of how we calculate these non-GAAP measures and limitations on their usefulness.

**Liquidity and financial condition**

Our primary cash requirements include the payment of our raw material and components suppliers, salaries and benefits, operating expenses, interest and principal payments on our debt, and capital expenditures. We finance our operations primarily through cash flow from operations and borrowings under our revolving credit facility, if any.

In November 2006, Generac Power Systems entered into a seven-year \$950.0 million first lien term loan (bearing interest at LIBOR + 2.5%), a seven-and-a-half year \$430.0 million second lien term loan (bearing interest at LIBOR + 6%), and a six-year \$150.0 million revolving credit facility (bearing interest at LIBOR + 2.5%). On February 17, 2010, we used approximately \$221.6 million of the net proceeds of our initial public offering to pay down our second lien term loan in full and to repay a portion of our first lien term loan. In March 2010, we used a substantial portion of our cash and cash equivalents on hand to repay an additional \$138.5 million of our first lien term loan. As a result of these pay downs, previous payments of principal and prior repurchases of debt by our affiliates, at June 30, 2010, the outstanding balance on the first lien credit facility had been reduced to \$731.4 million, and our second lien credit facility had been repaid in full and terminated.

The Company entered into two new interest rate swap agreements during the six month period ending June 30, 2010. The first was entered into on January 21, 2010. The effective date of the swap is July 1, 2010 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of the swap is October 1, 2010 with a notional amount of \$100,000,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. We expect to maintain the swaps as highly effective in accordance with ASC 815 (formerly SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities) and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss). These two swap agreements are the only interest rate swap agreements outstanding as of June 30, 2010.

At June 30, 2010, we had cash and cash equivalents of \$93.1 million and \$147 million of availability under our revolving credit facility, net of outstanding letters of credit.



**Long-term liquidity**

We believe that our cash flows from operations and our availability under our revolving credit facility, combined with our low capital expenditure requirements, our favorable tax attributes, and reduced debt service costs, will provide us with sufficient capital to continue to grow our business in the next twelve months and beyond. However, even with our reduced leverage, we will continue to use a significant portion of our cash flow to pay interest on our outstanding debt, limiting the amount available for working capital, capital expenditures and other general corporate purposes. As we continue to expand our business, we may in the future require additional capital to fund working capital, capital expenditures, or acquisitions.

**Cash flow**

*Six months ended June 30, 2010 compared to six months ended June 30, 2009*

The following table summarizes our cash flows by category for the periods presented:

Table of Contents

(Dollars in thousands)	Six months ended		\$ Change	% Change
	2010	June 30, 2009		
Net cash provided by operating activities	\$ 46,645	\$ 20,821	\$ 25,824	124%
Net cash used in investing activities	\$ (3,035)	\$ (1,724)	\$ (1,311)	76%
Net cash used in financing activities	\$ (111,808)	\$ (9,500)	\$ (102,308)	1077%

Net cash provided by operating activities was \$46.6 million for the six months ended June 30, 2010 compared to \$20.8 million for the six months ended June 30, 2009. Reductions in interest paid and reductions in inventory levels contributed to this increase in cash flows from operating activities. Partially offsetting these sources of cash were reductions in income from operations.

Net cash used in investing activities for the six months ended June 30, 2010 was \$3.0 million, all related to the purchase of property and equipment. Net cash used in investing activities for the six months ended June 30, 2009 was \$1.7 million and included \$1.9 million used for the purchase of property and equipment. Timing of capital expenditures during the year contributed to this increase versus the prior year comparable period.

Net cash used in financing activities was \$111.8 million for the six months ended June 30, 2010, representing the net impact of net proceeds received as a result of our IPO and subsequent repayment of debt. During the six months ended June 30, 2010, we received approximately \$248.3 million of net proceeds from our IPO, which was offset by a \$360.1 million subsequent repayment of our term loans. Net cash used in financing activities was \$9.5 million for the six months ended June 30, 2009, representing principal payments on our credit facilities.

**Contractual Obligations**

There have been no material changes to our contractual obligations, in the three month period ended June 30, 2010.

**Off-balance sheet arrangements**

There have been no material changes since the March 30, 2010 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

**Critical accounting policies**

There have been no material changes in our critical accounting policies since the March 30, 2010 filing of our Annual Report on Form 10-K, except for the adoption of share based compensation accounting in accordance with Accounting Standards Codification (ASC) section 718. Under the fair value recognition provisions of ASC 718, share based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period. Determining the fair value of share based awards at the grant date

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

requires judgment, including estimating expected dividends and market volatility of our stock. In addition, judgment is also required in estimating the amount of share based awards that are expected to be forfeited. If actual results differ significantly from these estimates, share based compensation expense and our results of operations could be impacted.

As discussed in our Annual Report on Form 10-K, in preparing the financial statements in accordance with accounting principles generally accepted in the U.S., we are required to make estimates and assumptions that have an impact on the asset, liability, revenue and expense amounts reported. These estimates can also affect our supplemental information disclosures, including information about contingencies, risk and financial condition. We believe, given current facts and circumstances, that our estimates and assumptions are reasonable, adhere to accounting principles generally accepted in the U.S., and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. We make routine estimates and judgments in determining net realizable value of accounts receivable, inventories, property, plant and equipment, and prepaid expenses. We believe that our most critical accounting estimates and assumptions are in the following areas: goodwill and other indefinite-lived intangible asset impairment assessment, defined benefit pension obligations, estimates of allowance for doubtful accounts, excess and obsolete inventory reserves, product warranty, other contingencies, derivative accounting, income taxes, and share based compensation.

Table of Contents

**Non-GAAP measures**

Adjusted EBITDA represents net income before interest expense, taxes, depreciation and amortization, as further adjusted for the other items reflected in the reconciliation table set forth below. This presentation is substantially consistent with the presentation used in our senior secured credit facilities (Covenant EBITDA), except that we do not give effect to certain additional adjustments that are permitted under those facilities which, if included, would increase the amount reflected in this table.

We view Adjusted EBITDA as a key measure of our performance. We present Adjusted EBITDA not only due to its importance for purposes of our senior secured credit facilities but also because it assists us in comparing our performance across reporting periods on a consistent basis because it excludes items that we do not believe are indicative of our core operating performance. Our management uses Adjusted EBITDA:

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
- to allocate resources to enhance the financial performance of our business;
- as a benchmark for the determination of the bonus component of compensation for our senior executives under our management incentive plan, as described further in our 2010 Proxy Statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
- in communications with our board of directors and investors concerning our financial performance.

We believe Adjusted EBITDA is used by securities analysts, investors and other interested parties in the evaluation of our company. Management believes that the disclosure of Adjusted EBITDA offers an additional financial metric that, when coupled with U.S. GAAP results and the reconciliation to U.S. GAAP results, provides a more complete understanding of our results of operations and the factors and trends affecting our business. We believe Adjusted EBITDA is useful to investors for the following reasons:

- Adjusted EBITDA and similar non-GAAP measures are widely used by investors to measure a company's operating performance without regard to items that can vary substantially from company to company depending upon financing and accounting methods, book values of assets, tax jurisdictions, capital structures and the methods by which assets were acquired;

- Investors can use Adjusted EBITDA as a supplemental measure to evaluate the overall operating performance of our company, including our ability to service our debt and other cash needs; and
- by comparing our Adjusted EBITDA in different historical periods, our investors can evaluate our operating performance excluding the impact of items described below.

The adjustments included in the reconciliation table listed below are provided for under our senior secured credit facilities (except where noted in footnote (j) below) and also are presented to illustrate the operating performance of our business in a manner consistent with the presentation used by our management and board of directors. These adjustments eliminate the impact of a number of items that:

- we do not consider indicative of our ongoing operating performance, such as non-cash impairment and other charges, transaction costs relating to the CCMP Transactions and to repurchases of our debt by affiliates of CCMP, non-cash gains and write-offs relating to the retirement of debt, severance costs and other restructuring-related business optimization expenses;
- we believe to be akin to, or associated with, interest expense, such as administrative agent fees, revolving credit facility commitment fees and letter of credit fees;
- are non-cash in nature, such as share-based compensation; or
- were eliminated following the consummation of our initial public offering, such as sponsor fees.

Table of Contents

We explain in more detail in footnotes (a) through (j) below why we believe these adjustments are useful in calculating Adjusted EBITDA as a measure of our operating performance.

Adjusted EBITDA does not represent, and should not be a substitute for, net income or cash flows from operations as determined in accordance with U.S. GAAP. Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under U.S. GAAP. Some of the limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- several of the adjustments that we use in calculating Adjusted EBITDA, such as non-cash impairment charges, while not involving cash expense, do have a negative impact on the value of our assets as reflected in our consolidated balance sheet prepared in accordance with U.S. GAAP;
- the adjustments for business optimization expenses, which we believe are appropriate for the reasons set out in note (f) below, represent costs associated with severance and other items which are reflected in operating expenses and income (loss) from continuing operations in our condensed consolidated statements of operations prepared in accordance with U.S. GAAP; and
- other companies may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Furthermore, as noted above, one of our uses of Adjusted EBITDA is as a benchmark for determining elements of compensation for our senior executives. At the same time, some or all of these senior executives have responsibility for monitoring our financial results generally, including the items that are included as adjustments in calculating Adjusted EBITDA (subject ultimately to review by our board of directors in the context of the board's review of our quarterly financial statements). While many of the adjustments (for example, transaction costs and credit facility fees and sponsor fees), involve mathematical application of items reflected in our financial statements, others (such as business optimization adjustments) involve a degree of judgment and discretion. While we believe that all of these adjustments are appropriate, and while the quarterly

## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

calculations are subject to review by our board of directors in the context of the board's review of our quarterly financial statements and certification by our chief financial officer in a compliance certificate provided to the lenders under our senior secured credit facilities, this discretion may be viewed as an additional limitation on the use of Adjusted EBITDA as an analytical tool.

Because of these limitations, Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our U.S. GAAP results and using Adjusted EBITDA only supplementally.

Our senior secured credit facility requires Generac Power Systems, Inc. to maintain a leverage ratio of consolidated total debt, net of unrestricted cash and marketable securities, to Covenant EBITDA at a level that varies over time. As of June 30, 2010, Generac Power Systems, Inc.'s ratio was 4.34 to 1.00, which was below the covenant requirement of 6.50 to 1.00. Generac Holdings Inc. net debt to adjusted EBITDA as of June 30, 2010 was 4.04x. Our credit agreement does not permit us to net cash and cash equivalents held by the Generac Holdings Inc. entity against our debt balance for covenant purposes. Failure to comply with this covenant would result in an event of default under our senior secured credit facility unless waived by our lenders. An event of default under our senior secured credit facility could result in the acceleration of our indebtedness under the facility, and we may be unable to repay the amounts due.

Table of Contents

The following table presents a reconciliation of net income to Adjusted EBITDA:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income	\$ 12,834	\$ 10,997	\$ 15,302	\$ 16,791
Interest Expense	5,720	18,482	14,212	36,448
Depreciation and amortization	14,859	14,894	29,511	29,621
Income taxes provision	77	107	159	212
Non-cash impairment and other charges (a)	415	(169)	564	(1,366)
Non-cash share based compensation expense (b)	1,713		2,959	
Write-off of deferred financing costs related to debt extinguishment (c)			4,180	
Transaction costs and credit facility fees (d)	305	311	667	710
Non-cash gains (e)		(4,414)		(13,510)
Business optimization expenses (f)			108	
Sponsor fees (g)		125	56	250
Letter of credit fees (h)	19	(2)	21	23
Other state franchise taxes (i)	35	27	96	54
Holding company interest income (j)	(19)	(317)	(45)	(317)
Adjusted EBITDA	\$ 35,958	\$ 40,041	\$ 67,790	\$ 68,916

(a) Represents the following non-cash charges:

- mark-to-market adjustments relating to copper and Euro forward contracts in addition to losses (gains) on disposal of assets;

We believe that adjusting net income for these non-cash charges is useful for the following reasons:

- The gain (loss) on disposals of assets described above result from the sale of assets that are no longer useful in our business and therefore represent losses that are not from our core operations;
- The adjustment for mark-to-market gains and losses on copper forward and Euro contracts represent adjustments to reflect the actual cash flows on derivative contracts. We believe that it is useful to adjust net income for these items because the charges do not represent a cash outlay in the period in which the charge is incurred, although Adjusted EBITDA must always be used together with our U.S. GAAP statements of operations and cash flows to capture the full effect of these contracts on our operating performance;



## Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

(b) Represents share-based compensation expense to account for stock options, restricted stock and other stock awards over their vesting period, issued in connection our initial public offering;

(c) Represents the write-off of a portion of deferred financing costs related to the repayment of debt after our initial public offering;

(d) Represents the following transaction costs and fees relating to our senior secured credit facilities:

- administrative agent fees and revolving credit facility commitment fees under our senior secured credit facilities, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation;

- transaction costs relating to repurchases of debt under our first and second lien credit facilities by affiliates of CCMP, which CCMP's affiliates contributed to our company in exchange for the issuances of securities, which repurchases we do not expect to recur;

(e) represents non-cash gains on the extinguishment of debt repurchased by affiliates of CCMP, as described in note (d) above, which we do not expect to recur.

(f) represents severance costs incurred from restructuring-related activities. We do not believe the charges for restructuring-related activities in the six months ended June 30, 2010 reflect our ongoing operations. Although we have incurred severance costs in the past, it is difficult to predict the amounts of similar costs in the future, and we believe that adjusting for these costs aids in measuring the performance of our ongoing operations. We believe that these costs will tend to be immaterial to our results of operations in future periods.

Table of Contents

(g) Represents management, consulting, monitoring, transaction and advisory fees and related expenses paid or accrued to affiliates of CCMP and affiliates of Unitas (related parties) under an advisory services and monitoring agreement. This agreement automatically terminated upon consummation of our initial public offering, and, accordingly, we believe that these expenses do not reflect the expenses of our ongoing operations.

(h) Represents fees on letters of credit outstanding under our senior secured credit facilities, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense.

(i) Represents franchise and business activity taxes paid at the state level. We believe that the inclusion of these taxes in calculating Adjusted EBITDA is similar to the inclusion of income taxes, as set forth in the table above.

(j) Represents interest earned on cash held at Generac Holdings Inc. We exclude these amounts because we do not include them in the calculation of Covenant EBITDA under and as defined in our senior secured credit facilities.

Adjusted net income (loss) is defined as net income (loss) before provision (benefit) for income taxes adjusted for the following items: cash income tax expense (benefit), amortization of intangible assets, amortization of deferred loan costs related to the Company's debt, intangible asset impairment charges, and non-cash gains reflected in the reconciliation table set forth below.

We believe Adjusted net income (loss) is used by securities analysts, investors and other interested parties in the evaluation of our company. Management believes the disclosure of adjusted net income (loss) offers an additional financial metric that, when used in conjunction with U.S. GAAP results and the reconciliation to U.S. GAAP results, provides a more complete understanding of our results of operations and the factors and trends affecting our business.

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income	\$ 12,834	\$ 10,997	\$ 15,302	\$ 16,791
Provision for income taxes	77	107	159	212
Income before provision for income taxes	12,911	11,104	15,461	17,003
Amortization of intangible assets	12,921	12,954	25,682	25,766
Amortization of deferred loan costs	562	854	1,301	1,710
Write-off of deferred financing costs related to debt extinguishment			4,180	
Gain on extinguishment of debt		(4,414)		(13,510)
Adjusted net income before provision for income taxes	26,394	20,498	46,624	30,969
Cash income tax expense	(263)	(230)	(373)	(363)
Adjusted net income	\$ 26,131	\$ 20,268	\$ 46,251	\$ 30,606
Adjusted net income per common share - diluted:	0.39	n/m	n/m	n/m

Edgar Filing: GENERAC HOLDINGS INC. - Form 10-Q

Weighted average common shares outstanding - diluted:	67,200,565	n/m	n/m	n/m
---	------------	-----	-----	-----

**New Accounting Standards**

There have been no material changes since the March 30, 2010 filing of our 2009 Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

A discussion of new accounting pronouncements is included in the Notes to Condensed Consolidated Financial Statements of this Form 10-Q under the heading New Accounting Standards to be Adopted and is incorporated herein by reference.

Table of Contents

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For a discussion of changes in commodity and interest rate-related risks, see Note 2 *Derivative Instruments and Hedging Activities* to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q. In other respects, there has been no material change in market risk from the information provided in Item 7A. (Quantitative and Qualitative Disclosures About Market Risk) of our 2009 Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

**Changes in Internal Control Over Financial Reporting**

There have been no changes during the three months ended June 30, 2010 in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in legal proceedings primarily involving product liability and employment matters and general commercial disputes arising in the ordinary course of our business. As of June 30, 2010, we believe that there is no litigation pending that would have a material effect on our results of operations or financial condition.

**Item 1A. Risk Factors**

There have been no material changes since the March 30, 2010 filing of our 2009 Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

**Item 6. Exhibits**

<b>Exhibits Number</b>	<b>Description</b>
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

---

\* Filed herewith.

\*\* Furnished herewith.

Table of Contents

**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.

GENERAC HOLDINGS INC.

By:

/s/ YORK A. RAGEN  
YORK A. RAGEN  
*Chief Financial Officer*  
*(Duly Authorized Officer and Principal Financial and  
Accounting Officer)*

Dated: August 13, 2010