

GENERAC HOLDINGS INC.

Form 10-Q

November 06, 2018

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**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 September 30, 2018**

**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 53189**

(Address of principal executive offices) (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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

|                         |                           |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer         |
| Non-accelerated filer   | Smaller reporting company |
| Emerging growth company |                           |

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

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

As of October 30, 2018, there were 62,059,983 shares of registrant's common stock outstanding.



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**GENERAC HOLDINGS INC.**

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Generac Holdings Inc.  
Condensed Consolidated Balance Sheets  
*(U.S. Dollars in Thousands, Except Share and Per Share Data)*  
(Unaudited)

|   | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|---|-----------------------------------|----------------------------------|
| <b>Assets</b>   |                                   |                                  |
| Current assets:   |                                   |                                  |
| Cash and cash equivalents   | \$174,001                         | \$138,472                        |
| Accounts receivable, less allowance for doubtful accounts             | 341,758                           | 279,294                          |
| Inventories   | 496,088                           | 387,049                          |
| Prepaid expenses and other assets                                     | 28,110                            | 19,741                           |
| Total current assets  | 1,039,957                         | 824,556                          |
| Property and equipment, net   | 243,362                           | 230,380                          |
| Customer lists, net   | 64,585                            | 41,064                           |
| Patents, net  | 32,375                            | 39,617                           |
| Other intangible assets, net  | 3,228                             | 2,401                            |
| Tradenames, net   | 153,585                           | 152,683                          |
| Goodwill  | 769,168                           | 721,523                          |
| Deferred income taxes   | 1,207                             | 3,238                            |
| Other assets  | 25,206                            | 10,502                           |
| Total assets  | \$2,332,673                       | \$2,025,964                      |
| <b>Liabilities and stockholders' equity</b>                           |                                   |                                  |
| Current liabilities:  |                                   |                                  |
| Short-term borrowings   | \$35,758                          | \$20,602                         |
| Accounts payable  | 287,718                           | 233,639                          |
| Accrued wages and employee benefits                                   | 41,335                            | 27,992                           |
| Other accrued liabilities   | 136,416                           | 112,618                          |
| Current portion of long-term borrowings and capital lease obligations | 51,886                            | 1,572                            |
| Total current liabilities   | 553,113                           | 396,423                          |
| Long-term borrowings and capital lease obligations                    | 859,625                           | 906,548                          |
| Deferred income taxes   | 68,380                            | 41,852                           |

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|  |             |             |
|--|-------------|-------------|
| Other long-term liabilities  | 93,023      | 82,893      |
| Total liabilities  | 1,574,141   | 1,427,716   |
| Redeemable noncontrolling interests  | 59,897      | 43,929      |
| Stockholders' equity:  |             |             |
| Common stock, par value \$0.01, 500,000,000 shares authorized, 71,105,573 and 70,820,173 shares issued at September 30, 2018 and December 31, 2017, respectively | 711         | 708         |
| Additional paid-in capital   | 473,886     | 459,816     |
| Treasury stock, at cost  | (321,397 )  | (294,005 )  |
| Excess purchase price over predecessor basis   | (202,116 )  | (202,116 )  |
| Retained earnings  | 756,636     | 610,835     |
| Accumulated other comprehensive loss   | (9,557 )    | (21,198 )   |
| Stockholders' equity attributable to Generac Holdings Inc.   | 698,163     | 554,040     |
| Noncontrolling interests   | 472         | 279         |
| Total stockholders' equity   | 698,635     | 554,319     |
| Total liabilities and stockholders' equity   | \$2,332,673 | \$2,025,964 |

*See notes to condensed consolidated financial statements.*

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Generac  
Holdings Inc.  
Condensed  
Consolidated  
Statements of  
Comprehensive  
Income  
*(U.S. Dollars in  
Thousands,  
Except Share  
and Per Share  
Data)*  
(Unaudited)

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2018</b>                                 | <b>2017</b> | <b>2018</b>                                | <b>2017</b> |
| Net sales   | \$559,515                                   | \$455,839   | \$1,452,098                                | \$1,181,199 |
| Costs of goods sold   | 361,630                                     | 299,608     | 937,968                                    | 783,247     |
| Gross profit  | 197,885                                     | 156,231     | 514,130                                    | 397,952     |
| Operating expenses:   |   |             |  |             |
| Selling and service   | 46,536                                      | 43,463      | 135,270                                    | 124,940     |
| Research and development  | 13,653                                      | 10,850      | 38,122                                     | 31,690      |
| General and administrative  | 25,499                                      | 22,128      | 75,613                                     | 64,508      |
| Amortization of intangibles   | 5,678                                       | 7,242       | 16,792                                     | 21,554      |
| Total operating expenses  | 91,366                                      | 83,683      | 265,797                                    | 242,692     |
| Income from operations  | 106,519                                     | 72,548      | 248,333                                    | 155,260     |
| Other (expense) income:   |   |             |  |             |
| Interest expense  | (9,824 )                                    | (10,672 )   | (30,939 )                                  | (32,353 )   |
| Investment income   | 382   | 14          | 1,095                                      | 57          |
| Loss on extinguishment of debt  | –   | –           | (1,332 )                                   | –           |
| Other, net  | (483 )                                      | (1,710 )    | (2,764 )                                   | (3,525 )    |
| Total other expense, net  | (9,925 )                                    | (12,368 )   | (33,940 )                                  | (35,821 )   |
| Income before provision for income taxes                                    | 96,594                                      | 60,180      | 214,393                                    | 119,439     |
| Provision for income taxes  | 20,072                                      | 20,404      | 49,870                                     | 42,105      |
| Net income  | 76,522                                      | 39,776      | 164,523                                    | 77,334      |
| Net income attributable to noncontrolling interests                         | 746   | 341         | 1,841                                      | 433         |
| Net income attributable to Generac Holdings Inc.                            | \$75,776                                    | \$39,435    | \$162,682                                  | \$76,901    |
| Net income attributable to common shareholders per<br>common share - basic: | \$1.12                                      | \$0.64      | \$2.36                                     | \$1.25      |
| Weighted average common shares outstanding - basic:                         | 61,579,564                                  | 61,758,190  | 61,659,817                                 | 62,094,807  |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Net income attributable to common shareholders per common share - diluted: | \$ 1.11    | \$ 0.63    | \$ 2.34    | \$ 1.24    |
| Weighted average common shares outstanding - diluted:                      | 62,220,298 | 62,316,788 | 62,266,140 | 62,703,269 |
| Comprehensive income attributable to Generac Holdings Inc.                 | \$ 80,768  | \$ 42,939  | \$ 173,355 | \$ 90,867  |

*See notes to condensed consolidated financial statements.*



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Generac Holdings Inc.  
 Condensed Consolidated Statements of Cash Flows  
*(U.S. Dollars in Thousands)*  
 (Unaudited)

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2018</b>                                | <b>2017</b> |
| <b>Operating activities</b>  |  |             |
| Net income   | \$ 164,523                                 | \$ 77,334   |
| Adjustment to reconcile net income to net cash provided by operating activities: |  |             |
| Depreciation   | 18,332                                     | 17,137      |
| Amortization of intangible assets  | 16,792                                     | 21,554      |
| Amortization of original issue discount and deferred financing costs             | 3,554                                      | 2,400       |
| Loss on extinguishment of debt   | 1,332                                      | –           |
| Deferred income taxes  | 17,218                                     | 25,336      |
| Share-based compensation expense   | 9,910                                      | 8,402       |
| Other  | 1,249                                      | 361         |
| Net changes in operating assets and liabilities, net of acquisitions:            |  |             |
| Accounts receivable  | (55,649 )                                  | (68,003 )   |
| Inventories  | (99,957 )                                  | 9,379       |
| Other assets   | (16,488 )                                  | (3,852 )    |
| Accounts payable   | 47,559                                     | (206 )      |
| Accrued wages and employee benefits  | 13,044                                     | 6,288       |
| Other accrued liabilities  | 18,011                                     | 25,148      |
| Excess tax benefits from equity awards   | (432 )                                     | (661 )      |
| Net cash provided by operating activities  | 138,998                                    | 120,617     |
| <b>Investing activities</b>  |  |             |
| Proceeds from sale of property and equipment                                     | 213  | 77          |
| Proceeds from beneficial interests in securitization transactions                | 2,825                                      | 2,102       |
| Expenditures for property and equipment  | (25,577 )                                  | (16,658 )   |
| Acquisition of business, net of cash acquired                                    | (71,926 )                                  | 1,257       |
| Net cash used in investing activities  | (94,465 )                                  | (13,222 )   |
| <b>Financing activities</b>  |  |             |
| Proceeds from short-term borrowings  | 28,332                                     | 74,443      |
| Proceeds from long-term borrowings   | 51,425                                     | 3,069       |
| Repayments of short-term borrowings  | (12,478 )                                  | (80,952 )   |
| Repayments of long-term borrowings and capital lease obligations                 | (51,164 )                                  | (13,051 )   |
| Stock repurchases  | (25,656 )                                  | (30,012 )   |
| Cash dividends paid to noncontrolling interest of subsidiary                     | (314 )                                     | –           |
| Payment of debt issuance costs   | (1,702 )                                   | (1,517 )    |
| Taxes paid related to equity awards  | (2,777 )                                   | (2,479 )    |
| Proceeds from exercise of stock options  | 5,191                                      | 1,717       |

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|  |           |           |
|--|-----------|-----------|
| Net cash used in financing activities                        | (9,143 )  | (48,782 ) |
| Effect of exchange rate changes on cash and cash equivalents | 139       | 2,895     |
| Net increase in cash and cash equivalents                    | 35,529    | 61,508    |
| Cash and cash equivalents at beginning of period             | 138,472   | 67,272    |
| Cash and cash equivalents at end of period                   | \$174,001 | \$128,780 |

*See notes to condensed consolidated financial statements.*

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**Generac Holdings Inc.**  
**Notes to Condensed Consolidated Financial Statements**

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

**(Unaudited)**

**1. Description of Business and Basis of Presentation**

Founded in 1959, Generac Holdings Inc. (the Company) is a leading global designer and manufacturer of a wide range of power generation equipment and other engine powered products serving the residential, light-commercial and industrial markets. The Company's power products are available globally through a broad network of independent dealers, distributors, retailers, wholesalers, equipment rental companies, and e-commerce partners, as well as sold direct to certain end user customers.

Over the years, the Company has executed a number of acquisitions that support its strategic plan (as discussed in Item 1 of its Annual Report on Form 10-K for the year ended December 31, 2017). A summary of acquisitions affecting the reporting periods presented include:

In June 2018, the Company acquired Selmec Equipos Industriales, S.A. de C.V. (Selmec), headquartered in Mexico City, Mexico. Selmec is a designer and manufacturer of industrial generators ranging from 10kW to 2,750kW. Selmec offers a market-leading service platform and specialized engineering capabilities, together with robust integration, project management and remote monitoring services.

In January 2017, the Company acquired Motortech GmbH (Motortech), headquartered in Celle, Germany. Motortech is a leading manufacturer of gaseous-engine control systems and accessories, which are sold primarily to European gas-engine manufacturers and to aftermarket customers around the world.

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries that are consolidated in conformity with U.S. generally accepted accounting principles (U.S. GAAP). All intercompany amounts and transactions have been eliminated in consolidation.

The condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017, the condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2018 and 2017, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2018 and 2017

have been prepared by the Company and have not been audited. In the opinion of management, all adjustments (which include 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.

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

Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

#### ***New Accounting Standards Not Yet Adopted***

In February 2016, the Financial Standards Accounting Board (FASB) issued Accounting Standards Update (ASU) 2016-02, Leases. This guidance was issued to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and by disclosing key information about leasing arrangements. The guidance should be applied using a modified retrospective approach and is effective for the Company in 2019. The Company has developed a comprehensive project plan and established a cross-functional implementation team to evaluate the impact of the standard. The project plan includes evaluating the Company's lease portfolio, analyzing the standard's impact on the Company's various types of lease contracts and identifying the reporting requirements of the standard. While the Company does not anticipate the impact to the statement of comprehensive income to be material, it is still calculating the impact the lease asset and lease liability will have on the balance sheet.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging – Targeted Improvements to Accounting for Hedging Activities*. This guidance was issued to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and to make certain targeted improvements to simplify the application of the hedge accounting guidance. The standard is effective for the Company in 2019, with early adoption permitted. The Company is currently assessing the impact the adoption of this guidance will have on the Company's results of operations and financial position.

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In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software: Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. This guidance was issued to address the diversity in practice related to the accounting for costs of implementation activities performed in a cloud computing arrangement that is a service contract. The guidance can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption, and is effective for the Company in 2020. The Company is currently assessing the impact the adoption of this guidance will have on the Company’s results of operations and financial position.

There are several other new accounting pronouncements issued by the FASB. Each of these pronouncements, as applicable, has been or will be adopted by the Company. Management does not believe any of these accounting pronouncements has had or will have a material impact on the Company’s consolidated financial statements.

***Recently Adopted Accounting Standards***

On January 1, 2018, the Company adopted ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The new standard requires presentation of certain components of net periodic pension cost as non-operating expense. The adoption of this new standard did not have a significant impact on the Company’s financial statements. The changes in presentation of the components of net periodic pension cost were applied retrospectively to all periods presented.

On January 1, 2018, the Company adopted ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*. The changes in presentation of the proceeds from beneficial interests in securitization transactions were applied retrospectively to all periods presented.

On January 1, 2018, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers*, and all related amendments (the “new revenue recognition standard”) using the full retrospective method, which requires application to all periods presented.

The impact of adopting the above standards on the Company’s previously reported condensed consolidated financial statements is as follows:

| <b><i>Condensed Consolidated Balance Sheets</i></b> | <b>September 30, 2017</b> |                  |                 |
|---|---------------------------|------------------|-----------------|
|   | <b>As</b>                 | <b>Impact of</b> | <b>As</b>       |
|   | <b>Reported</b>           | <b>Adoption</b>  | <b>Adjusted</b> |

|                             |           |             |            |
|-----------------------------|-----------|-------------|------------|
| Accounts receivable         | \$320,626 | \$ (4,207 ) | \$ 316,419 |
| Inventories                 | 349,023   | 7,359       | 356,382    |
| Other accrued liabilities   | 109,362   | 5,584       | 114,946    |
| Deferred income taxes       | 49,528    | (3,367 )    | 46,161     |
| Other long-term liabilities | 69,556    | 6,178       | 75,734     |
| Retained earnings           | \$535,172 | \$ (5,243 ) | \$ 529,929 |

**December 31, 2017**

|                             | <b>As<br/>Reported</b> | <b>Impact of<br/>Adoption</b> | <b>As<br/>Adjusted</b> |
|-----------------------------|------------------------|-------------------------------|------------------------|
| Accounts receivable         | \$280,002              | \$ (708 )                     | \$ 279,294             |
| Inventories                 | 380,341                | 6,708                         | 387,049                |
| Other accrued liabilities   | 105,067                | 7,551                         | 112,618                |
| Deferred income taxes       | 43,789                 | (1,937 )                      | 41,852                 |
| Other long-term liabilities | 76,995                 | 5,898                         | 82,893                 |
| Retained earnings           | \$616,347              | \$ (5,513 )                   | \$ 610,835             |

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| <i>Condensed Consolidated Statements of Comprehensive Income</i> | <b>Three Months Ended<br/>September 30, 2017</b> |                               |                        |
|--|--|-------------------------------|------------------------|
|  | <b>As<br/>Reported</b>                           | <b>Impact of<br/>Adoption</b> | <b>As<br/>Adjusted</b> |
| Net sales  | \$457,253  | \$ (1,414 )                   | \$455,839              |
| Cost of goods sold   | 299,784  | (176 )                        | 299,608                |
| Selling and service expenses                                     | 44,402   | (939 )                        | 43,463                 |
| Research and development expenses                                | 10,864   | (14 )                         | 10,850                 |
| General and administrative expenses                              | 22,102   | 26                            | 22,128                 |
| Other, net   | 1,570  | 140                           | 1,710                  |
| Provision for income taxes                                       | 20,581   | (177 )                        | 20,404                 |
| Net income attributable to Generac Holdings Inc.                 | \$39,709   | \$ (274 )                     | \$39,435               |
| Earnings per share   |  |                               |                        |
| Basic  | \$0.64   | \$ -                          | \$0.64                 |
| Diluted  | \$0.64   | \$ (0.01 )                    | \$0.63                 |
| Comprehensive income attributable to Generac Holdings Inc.       | \$43,213   | \$ (274 )                     | \$42,939               |

|  | <b>Nine Months Ended September 30,<br/>2017</b> |                               |                        |
|--|---|-------------------------------|------------------------|
|  | <b>As<br/>Reported</b>                          | <b>Impact of<br/>Adoption</b> | <b>As<br/>Adjusted</b> |
| Net sales  | \$1,184,443                                     | \$ (3,244 )                   | \$1,181,199            |
| Cost of goods sold   | 782,028   | 1,219                         | 783,247                |
| Selling and service expenses                               | 127,702   | (2,762 )                      | 124,940                |
| Research and development expenses                          | 31,732  | (42 )                         | 31,690                 |
| General and administrative expenses                        | 64,436  | 72                            | 64,508                 |
| Other, net   | 3,105   | 420                           | 3,525                  |
| Provision for income taxes                                 | 42,946  | (841 )                        | 42,105                 |
| Net income attributable to Generac Holdings Inc.           | \$78,211  | \$ (1,310 )                   | \$76,901               |
| Earnings per share   |   |                               |                        |
| Basic  | \$1.27  | \$ (0.02 )                    | \$1.25                 |
| Diluted  | \$1.26  | \$ (0.02 )                    | \$1.24                 |
| Comprehensive income attributable to Generac Holdings Inc. | \$92,177  | \$ (1,310 )                   | \$90,867               |

| <i>Condensed Consolidated Statement of Cash Flows</i> | <b>Nine Months Ended September<br/>30, 2017</b> |                               |                        |
|---|---|-------------------------------|------------------------|
|   | <b>As<br/>Reported</b>                          | <b>Impact of<br/>Adoption</b> | <b>As<br/>Adjusted</b> |
| Net income  | \$78,644  | \$ (1,310 )                   | \$77,334               |

|   |             |             |             |
|---|-------------|-------------|-------------|
| Deferred income taxes   | 28,703      | (3,367 )    | 25,336      |
| Accounts receivable   | (70,108 )   | 2,105       | (68,003 )   |
| Inventories   | 16,738      | (7,359 )    | 9,379       |
| Other accrued liabilities   | 17,319      | 7,829       | 25,148      |
| Net cash provided by operating activities                         | \$ 122,719  | \$ (2,102 ) | \$ 120,617  |
| Proceeds from beneficial interests in securitization transactions | \$-         | \$ 2,102    | \$ 2,102    |
| Net cash used in investing activities                             | \$(15,324 ) | \$ 2,102    | \$(13,222 ) |

## 2. Revenue Recognition

The Company's revenues primarily consist of product sales to its customers. The Company considers the purchase orders, which in some cases are governed by master sales agreements, to be the contracts with the customers. For each contract, the Company considers the commitment to transfer products, each of which is distinct, to be the identified performance obligations. Revenue is measured as the amount of consideration the Company expects to be entitled in exchange for the transfer of product, which is generally the price stated in the contract specific for each item sold, adjusted for the value of expected returns, discounts, rebates, or other promotional incentives or allowances offered to our customers. Expected returns for damaged or defective product are estimated using the expected value method based upon historical product return experience. Discounts and rebates offered to customers are typically defined in the master sales agreements with customers and, therefore, are recorded using the most likely amount method based on the terms of the contract. Promotional incentives are defined programs offered for short, specific periods of time and are estimated using the expected value method based upon historical experience. The Company does not expect the transaction price for revenue recognized will be subject to a significant revenue reversal. As the Company's product sale contracts and standard payment terms have a duration of less than one year, it uses the practical expedient applicable to such contracts and does not consider the time value of money. Sales, use, value add and other similar taxes assessed by governmental authorities and collected concurrent with revenue-producing activities are excluded from revenue. The Company has elected to recognize the cost for freight activities when control of the product has transferred to the customer as an expense within cost of goods sold in the condensed consolidated statements of comprehensive income. Product revenues are recognized at the point in time when control of the product is transferred to the customer, which typically occurs upon shipment or delivery to the customer. To determine when control has transferred, the Company considers if there is a present right to payment and if legal title, physical possession, and the significant risks and rewards of ownership of the asset has transferred to the customer. As substantially all of the Company's revenues are recognized at a point in time, the amount of unsatisfied performance obligations at each period end is not material. The Company's contracts have an original expected duration of one year or less. As a result, the Company has elected to use the practical expedient to not disclose its remaining performance obligations.



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At the request of certain customers, the Company will warehouse inventory billed to the customer but not delivered. Unless all revenue recognition criteria have been met, the Company does not recognize revenue on these transactions until the customer takes possession of the product.

While the Company's standard payment terms are less than one year, the specific payment terms and conditions in its customer contracts vary. In some cases, customers prepay for their goods; in other cases, after appropriate credit evaluation, an open credit line is granted and payment is due in arrears. Contracts with payment in arrears are recognized in the condensed consolidated balance sheets as accounts receivable upon revenue recognition, while contracts where customers pay in advance are recognized as customer deposits and recorded in other accrued liabilities in the condensed consolidated balance sheets until revenue is recognized. The balance of customer deposits (contract liabilities) was \$18,543 and \$7,034 at September 30, 2018 and December 31, 2017, respectively. During the nine month period ended September 30, 2018, the Company recognized revenue of \$6,824 related to amounts included in the December 31, 2017 customer deposit balance. The Company typically recognizes revenue within one year of the receipt of the customer deposit.

The Company offers standard warranty coverage on substantially all products that it sells and accounts for this standard warranty coverage as an assurance warranty. As such, no transaction price is allocated to the standard warranty, and the Company records a liability for product warranty obligations at the time of sale to a customer based upon historical warranty experience. Refer to Note 10, "Product Warranty Obligations," to the condensed consolidated financial statements for further information regarding the Company's standard warranties.

The Company also sells extended warranty coverage for certain products, which it accounts for as service warranties. In most cases, the extended warranty is sold as a separate contract. As such, extended warranty sales are considered a separate performance obligation, and the extended warranty transaction price is separate and distinct from the product. The extended warranty transaction price is initially recorded as deferred revenue on the condensed consolidated balance sheets and amortized on a straight-line basis to selling and service expenses in the condensed consolidated statements of comprehensive income, as an offset to warranty expense, over the life of the contracts following the standard warranty period. For extended warranty contracts that the Company sells under a third-party marketing agreement, it is required to pay fees to the third-party service provider and classifies these fees as costs to obtain a contract. The contract costs are deferred and recorded as other assets on the condensed consolidated balance sheets. The deferred contract costs are amortized to selling and service expense in the condensed consolidated statements of comprehensive income consistent with how the related deferred revenue is recognized. Refer to Note 10, "Product Warranty Obligations," to the condensed consolidated financial statements for further information regarding the Company's extended warranties.

The Company offers other services, including remote monitoring, installation and maintenance services in limited circumstances. These other services are currently not material, accounting for less than one percent of revenue in 2018.

Refer to Note 8, "Segment Reporting," to the condensed consolidated financial statements for the Company's disaggregated revenue disclosure. The information discussed above is applicable to each of the Company's product classes.

### **3. Selmec Acquisition**

On June 1, 2018, the Company acquired Selmec for a purchase price of \$86,459, net of cash acquired and inclusive of estimated earnout payments of \$14,902. Headquartered in Mexico City, Mexico, Selmec is a designer and manufacturer of industrial generators ranging from 10kW to 2,750kW. Selmec offers a market-leading service platform and specialized engineering capabilities, together with robust integration, project management and remote monitoring services. To date, the acquisition purchase price was funded solely through cash on hand.

The Company recorded a preliminary purchase price allocation during the third quarter of 2018 based upon its estimates of the fair value of the acquired assets and assumed liabilities. As a result, the Company recorded approximately \$81,500 of intangible assets, including approximately \$47,870 of goodwill recorded in the International segment, as of the acquisition date. The goodwill ascribed to the acquisition is not deductible for tax purposes. The accompanying condensed consolidated financial statements include the results of Selmec from the date of acquisition through September 30, 2018.

Table of Contents**4. Redeemable Noncontrolling Interest**

On March 1, 2016, the Company acquired a 65% ownership interest in PR Industrial S.r.l. and its subsidiaries (Pramac). The 35% noncontrolling interest in Pramac had an acquisition date fair value of \$34,253 and was recorded as a redeemable noncontrolling interest in the condensed consolidated balance sheets, as the noncontrolling interest holder has within its control the right to require the Company to redeem its interest in Pramac. The noncontrolling interest holder has a put option to sell his interest to the Company any time within five years from the date of acquisition. Within the first two years from the date of acquisition, the put option price was based on a fixed amount if voluntarily exercised. Subsequently, the put option price is based on the greater of the fixed amount or a multiple of earnings, subject to the terms of the acquisition. Additionally, the Company holds a call option that it may redeem commencing five years from the date of acquisition, or earlier upon the occurrence of certain circumstances. The call option price is based on a multiple of earnings that is subject to the terms of the acquisition. Both the put and call option only provide for the complete transfer of the noncontrolling interest, with no partial transfers of interest permitted.

The redeemable noncontrolling interest is recorded at the greater of the initial fair value, increased or decreased for the noncontrolling interests' share of comprehensive income (loss), or the estimated redemption value, with any adjustments to the redemption value impacting retained earnings, but not net income. However, the redemption value adjustments are reflected in the earnings per share calculation, as detailed in Note 13, "Earnings Per Share," to the condensed consolidated financial statements. The following table presents the changes in the redeemable noncontrolling interest:

|                                   | <b>Three Months<br/>Ended September<br/>30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-----------------------------------|---|-------------|--|-------------|
|                                   | <b>2018</b>                                     | <b>2017</b> | <b>2018</b>                                | <b>2017</b> |
| Balance at beginning of period    | \$53,035  | \$37,796    | \$43,929                                   | \$33,138    |
| Noncontrolling interest of Pramac | -   | 1,540       | (1) -                                      | 1,540 (1)   |
| Net income                        | 519   | 283         | 1,341                                      | 493         |
| Foreign currency translation      | (569 )  | 2,178       | (2,255 )                                   | 7,535       |
| Redemption value adjustment       | 6,912 (2)                                       | -           | 16,882 (2)                                 | (909 )      |
| Balance at end of period          | \$59,897  | \$41,797    | \$59,897                                   | \$41,797    |

(1) Represents the additional noncontrolling interest of Pramac resulting from a common control transaction between the Generac Mobile Products S.r.l. and Pramac UK Limited legal entities.

The redemption value adjustments recorded during the three and nine month periods ended September 30, 2018

(2) relate to the adjustment required to reflect the redeemable noncontrolling interest value as a multiple of earnings after two years from the date of acquisition, in accordance with the terms of the acquisition.

## 5. Derivative Instruments and Hedging Activities

The Company records all derivatives in accordance with Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, which requires derivative instruments to be reported on the condensed 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 Company is exposed to price fluctuations in commodities it uses as raw materials, primarily steel, copper and aluminum, and periodically utilizes commodity derivatives to mitigate the impact of these potential price fluctuations on its financial results. These derivatives typically have maturities of less than eighteen months. At September 30, 2018, December 31, 2017 and September 30, 2017, the Company had five, one and one commodity contracts outstanding, respectively, covering the purchases of copper.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in cost of goods sold in the Company's condensed consolidated statements of comprehensive income. Net pre-tax losses recognized for the three and nine months ended September 30, 2018 were \$607 and \$810, respectively. Net pre-tax gains recognized for the three and nine months ended September 30, 2017 were \$140 and \$325, respectively.

Table of Contents*Foreign Currencies*

The Company is exposed to foreign currency exchange risk as a result of transactions denominated in currencies other than the U.S. Dollar. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with certain foreign currency purchases and sales in the normal course of business. Contracts typically have maturities of twelve months or less. As of September 30, 2018, December 31, 2017 and September 30, 2017, the Company had thirty-six, twenty-eight and twenty-two foreign currency contracts outstanding, respectively.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in other, net in the Company's condensed consolidated statements of comprehensive income. Net pre-tax losses recognized for the three and nine months ended September 30, 2018 were \$124 and \$442, respectively. Net pre-tax gains recognized for the three and nine months ended September 30, 2017 were \$447 and \$626, respectively.

*Interest Rate Swaps*

In October 2013, the Company entered into two interest rate swap agreements. In May 2014, the Company entered into one interest rate swap agreement, and in 2017, the Company entered into 20 additional interest rate swap agreements. The Company formally documented all relationships between interest rate hedging instruments and the related hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions. These interest rate swap agreements qualify as cash flow hedges and therefore, the effective portions of the gains or losses are reported as a component of accumulated other comprehensive loss (AOCL) in the condensed consolidated balance sheets. The amount of gains, net of tax, recognized for the three and nine months ended September 30, 2018 were \$1,626 and \$10,403, respectively. The amount of gains, net of tax, recognized for the three and nine months ended September 30, 2017 were \$581 and \$1,345, respectively. The cash flows of the swaps are recognized as adjustments to interest expense each period. The ineffective portions of the derivatives' changes in fair value, if any, are immediately recognized in earnings.

*Fair Value*

The following table presents the fair value of all of the Company's derivatives:

| <b>September</b> | <b>December</b> |
|------------------|-----------------|
| <b>30,</b>       | <b>31,</b>      |

|                            | <b>2018</b> |   | <b>2017</b> |
|----------------------------|-------------|---|-------------|
| Commodity contracts        | \$ (542     | ) | \$ 107      |
| Foreign currency contracts | (67         | ) | 167         |
| Interest rate swaps        | 18,414      |   | 4,356       |

The fair values of the commodity contracts and foreign currency contracts are included in other accrued liabilities, and the fair value of the interest rate swaps is included in other assets in the condensed consolidated balance sheet as of September 30, 2018. The fair values of the commodity and foreign currency contracts are included in prepaid expenses and other assets, and the fair value of the interest rate swaps is included in other assets in the consolidated balance sheet as of December 31, 2017. Excluding the impact of credit risk, the fair value of the derivative contracts as of September 30, 2018 and December 31, 2017 is an asset of \$18,211 and \$4,703, respectively, which represents the amount the Company would receive upon exit of the agreements on those dates.

## 6. Fair Value Measurements

ASC 820-10, *Fair Value Measurement*, 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 in the sale of 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 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.

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, short-term borrowings and ABL facility borrowings), excluding Term Loan borrowings, approximates the fair value of these instruments based upon their short-term nature. The fair value of Term Loan borrowings, which have an aggregate carrying value of \$856,729, was approximately \$858,516 (Level 2) at September 30, 2018, as calculated based on independent valuations whose inputs and significant value drivers are observable.

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For the fair value of the derivatives measured on a recurring basis, see the fair value table in Note 5, “Derivative Instruments and Hedging Activities,” to the condensed consolidated financial statements. The fair value of all derivative contracts is classified as Level 2. The valuation techniques used to measure the fair value of derivative contracts, all of which have counterparties with high credit ratings, were based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data. The fair value of derivative contracts above considers the Company’s credit risk in accordance with ASC 820-10.

**7. Accumulated Other Comprehensive Loss**

The following presents a tabular disclosure of changes in AOCL during the three and six months ended June 30, 2018 and 2017, net of tax:

|   | <b>Foreign<br/>Currency<br/>Translation<br/>Adjustments</b> | <b>Defined<br/>Benefit<br/>Pension<br/>Plan</b> | <b>Unrealized<br/>Gain<br/>(Loss) on<br/>Cash Flow<br/>Hedges</b> | <b>Total</b> |
|---|---|---|---|--------------|
| Beginning Balance – July 1, 2018                    | \$ (17,335 )  | \$ (10,978 )                                    | \$ 11,413   | \$ (16,900)  |
| Other comprehensive income before reclassifications | 5,717   | -   | 1,626   | (1) 7,343    |
| Amounts reclassified from AOCL                      | -   | -   | -   | -            |
| Net current-period other comprehensive income       | 5,717   | -   | 1,626   | 7,343        |
| Ending Balance – September 30, 2018                 | \$ (11,618 )  | \$ (10,978 )                                    | \$ 13,039   | \$ (9,557 )  |
| Beginning Balance – July 1, 2017                    | \$ (15,857 )  | \$ (11,040 )                                    | \$ (312 )   | \$ (27,209)  |
| Other comprehensive income before reclassifications | 3,826   | -   | 581   | (2) 4,407    |
| Amounts reclassified from AOCL                      | -   | -   | -   | -            |
| Net current-period other comprehensive income       | 3,826   | -   | 581   | 4,407        |
| Ending Balance – September 30, 2017                 | \$ (12,031 )  | \$ (11,040 )                                    | \$ 269  | \$ (22,802)  |
| Beginning Balance – January 1, 2018                 | \$ (12,856 )  | \$ (10,978 )                                    | \$ 2,636  | \$ (21,198)  |
| Other comprehensive income before reclassifications | 1,238   | -   | 10,403  | (3) 11,641   |
| Amounts reclassified from AOCL                      | -   | -   | -   | -            |
| Net current-period other comprehensive income       | 1,238   | -   | 10,403  | 11,641       |
| Ending Balance – September 30, 2018                 | \$ (11,618 )  | \$ (10,978 )                                    | \$ 13,039   | \$ (9,557 )  |

|   |            |              |           |     |            |
|---|------------|--------------|-----------|-----|------------|
| Beginning Balance – January 1, 2017                 | \$ (28,047 | ) \$(11,040) | \$ (1,076 | )   | \$(40,163) |
| Other comprehensive income before reclassifications | 16,016     | -            | 1,345     | (4) | 17,361     |
| Amounts reclassified from AOCL                      | -          | -            | -         | -   | -          |
| Net current-period other comprehensive income       | 16,016     | -            | 1,345     |     | 17,361     |
| Ending Balance – September 30, 2017                 | \$ (12,031 | ) \$(11,040) | \$ 269    |     | \$(22,802) |

(1) Represents unrealized gains of \$2,197, net of tax effect of \$(571), for the three months ended September 30, 2018.

(2) Represents unrealized gains of \$954, net of tax effect of \$(373), for the three months ended September 30, 2017.

(3) Represents unrealized gains of \$14,057, net of tax effect of \$(3,654), for the nine months ended September 30, 2018.

(4) Represents unrealized gains of \$2,208, net of tax effect of \$(863), for the nine months ended September 30, 2017.

## 8. Segment Reporting

The Company has two reportable segments for financial reporting purposes - Domestic and International. The Domestic segment includes the legacy Generac business and the impact of acquisitions based in the United States, all of which have revenues that are substantially derived from the U.S. and Canada. The International segment includes the Ottomotores, Tower Light, Pramac, Motortech and Selmeac businesses, all of which have revenues that are substantially derived from outside of the U.S. and Canada. Both reportable segments design and manufacture a wide range of power generation equipment and other engine powered products. The Company has multiple operating segments, which it aggregates into the two reportable segments, based on materially similar economic characteristics, products, production processes, classes of customers and distribution methods.



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The Company's product offerings consist primarily of power generation equipment and other engine powered products geared for varying end customer uses. Residential products and commercial & industrial (C&I) products are each a similar class of products based on similar power output and end customer. The breakout of net sales between residential, C&I, and other products by reportable segment is as follows:

**Net Sales by Segment  
Three Months Ended September  
30, 2018**

| <b>Product Classes</b>           | <b>Domestic</b> | <b>International</b> | <b>Total</b> |
|----------------------------------|-----------------|----------------------|--------------|
| Residential products             | \$300,387       | \$ 11,531            | \$311,918    |
| Commercial & industrial products | 121,952         | 84,414               | 206,366      |
| Other                            | 30,920          | 10,311               | 41,231       |
| Total net sales                  | \$453,259       | \$ 106,256           | \$559,515    |

**Three Months Ended September  
30, 2017**

| <b>Product Classes</b>           | <b>Domestic</b> | <b>International</b> | <b>Total</b> |
|----------------------------------|-----------------|----------------------|--------------|
| Residential products             | \$236,821       | \$ 14,382            | \$251,203    |
| Commercial & industrial products | 101,122         | 72,720               | 173,842      |
| Other                            | 24,966          | 5,828                | 30,794       |
| Total net sales                  | \$362,909       | \$ 92,930            | \$455,839    |

**Nine Months Ended September 30,  
2018**

| <b>Product Classes</b>           | <b>Domestic</b> | <b>International</b> | <b>Total</b> |
|----------------------------------|-----------------|----------------------|--------------|
| Residential products             | \$711,203       | \$ 37,587            | \$748,790    |
| Commercial & industrial products | 340,244         | 256,875              | 597,119      |
| Other                            | 83,078          | 23,111               | 106,189      |
| Total net sales                  | \$1,134,525     | \$ 317,573           | \$1,452,098  |

**Nine Months Ended September 30,  
2017**

| <b>Product Classes</b>           | <b>Domestic</b> | <b>International</b> | <b>Total</b> |
|----------------------------------|-----------------|----------------------|--------------|
| Residential products             | \$563,636       | \$ 40,252            | \$603,888    |
| Commercial & industrial products | 284,796         | 209,702              | 494,498      |
| Other                            | 67,051          | 15,762               | 82,813       |
| Total net sales                  | \$915,483       | \$ 265,716           | \$1,181,199  |

Residential products consist primarily of automatic home standby generators ranging in output from 6kW to 60kW, portable generators, power washers and other outdoor power equipment. These products are sold through independent residential dealers, national and regional retailers, e-commerce merchants, electrical and HVAC wholesalers and outdoor power equipment dealers. The residential products revenue consists of the sale of the product to our

distribution partners, which in turn sell or rent the product to the end consumer, including installation and maintenance services. In some cases, residential products are sold direct to the end consumer. Substantially all of the residential products revenues are transferred to the customer at a point in time.

C&I products consist of larger output stationary generators used in C&I applications and fueled by diesel, natural gas, liquid propane and bi-fuel, with power outputs ranging from 10kW up to 3,250kW. Also included in C&I products are mobile generators, light towers, mobile heaters and mobile pumps. These products are sold through industrial distributors and dealers, equipment rental companies and equipment distributors. The C&I products revenue consists of the sale of the product to our distribution partners, which in turn sell or rent the product to the end customer, including installation and maintenance services. In some cases, C&I products are sold direct to the end customer. Substantially all of the C&I products revenues are transferred to the customer at a point in time.

Other products consist primarily of aftermarket service parts sold to our dealers, product accessories and proprietary engines sold to third-party original equipment manufacturers. Substantially all of the Other products revenues are transferred to the customer at a point in time.

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Management evaluates the performance of its segments based primarily on Adjusted EBITDA, which is reconciled to Income before provision for income taxes below. The computation of Adjusted EBITDA is based on the definition that is contained in the Company's credit agreements.

|  | <b>Adjusted EBITDA</b>                  |             |  |             |
|--|---|-------------|--|-------------|
|  | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|  | <b>2018</b>                             | <b>2017</b> | <b>2018</b>                            | <b>2017</b> |
| Domestic                                       | \$117,108                               | \$82,817    | \$273,185                              | \$188,400   |
| International                                  | 7,366                                   | 5,625       | 25,300                                 | 16,471      |
| Total adjusted EBITDA                          | \$124,474                               | \$88,442    | \$298,485                              | \$204,871   |
| Interest expense                               | (9,824 )                                | (10,672 )   | (30,939 )                              | (32,353 )   |
| Depreciation and amortization                  | (11,841 )                               | (13,108 )   | (35,124 )                              | (38,691 )   |
| Non-cash write-down and other adjustments (1)  | (900 )                                  | (756 )      | (3,522 )                               | (2,632 )    |
| Non-cash share-based compensation expense (2)  | (2,919 )                                | (2,584 )    | (9,910 )                               | (8,402 )    |
| Loss on extinguishment of debt (3)             | -                                       | -           | (1,332 )                               | -           |
| Transaction costs and credit facility fees (4) | (1,767 )                                | (234 )      | (2,470 )                               | (970 )      |
| Business optimization expenses (5)             | (583 )                                  | (487 )      | (750 )                                 | (1,933 )    |
| Other  | (46 )                                   | (421 )      | (45 )                                  | (451 )      |
| Income before provision for income taxes       | \$96,594                                | \$60,180    | \$214,393                              | \$119,439   |

(1) Includes gains/losses on disposal of assets, unrealized mark-to-market adjustments on commodity contracts, transactional foreign currency gains/losses and certain purchase accounting related adjustments.

(2) Represents share-based compensation expense to account for stock options, restricted stock and other stock awards over their respective vesting periods.

(3) Represents the non-cash write-off of original issue discount and deferred financing costs due to a voluntary prepayment of Term Loan debt.

(4) Represents transaction costs incurred directly in connection with any investment, as defined in our credit agreement, equity issuance, debt issuance or refinancing; together with certain fees relating to our senior secured credit facilities.

(5) Represents charges relating to business optimization and restructuring costs.

The Company's sales in the United States represented approximately 78% and 76% of total sales for the three month periods ended September 30, 2018 and 2017, respectively, and represented approximately 74% of total sales for the nine month periods ended September 30, 2018 and 2017. Approximately 80% and 85% of the Company's identifiable long-lived assets were located in the United States at September 30, 2018 and December 31, 2017, respectively.

**9. Balance Sheet Details**

Inventories consist of the following:

|                 | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|-----------------|-----------------------------------|----------------------------------|
| Raw material    | \$ 294,519                        | \$ 242,947                       |
| Work-in-process | 4,101                             | 2,544                            |
| Finished goods  | 197,468                           | 141,558                          |
| Total           | \$ 496,088                        | \$ 387,049                       |

Property and equipment consists of the following:

|                              | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|------------------------------|-----------------------------------|----------------------------------|
| Land and improvements        | \$ 15,583                         | \$ 13,118                        |
| Buildings and improvements   | 141,275                           | 132,072                          |
| Machinery and equipment      | 96,756                            | 90,487                           |
| Dies and tools               | 26,921                            | 24,504                           |
| Vehicles                     | 1,947                             | 1,878                            |
| Office equipment and systems | 80,144                            | 73,254                           |
| Leasehold improvements       | 2,471                             | 2,436                            |
| Construction in progress     | 19,216                            | 18,799                           |
| Gross property and equipment | 384,313                           | 356,548                          |
| Accumulated depreciation     | (140,951 )                        | (126,168 )                       |
| Total                        | \$ 243,362                        | \$ 230,380                       |

Table of Contents**10. Product Warranty Obligations**

The Company records a liability for standard product warranty obligations accounted for as assurance warranties 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 following is a tabular reconciliation of the Company's standard product warranty liability accounted for as an assurance warranty:

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2018</b> |          | <b>Nine Months<br/>Ended September<br/>30,<br/>2017</b> |          |
|--|--|----------|---|----------|
| Balance at beginning of period                   | \$38,660   | \$32,813 | \$35,422  | \$31,695 |
| Product warranty reserve assumed in acquisition  | -  | -        | -   | 43       |
| Payments   | (5,205 )   | (5,135 ) | (15,097 )   | (13,980) |
| Provision for warranty issued                    | 8,074  | 6,206    | 19,552  | 14,452   |
| Changes in estimates for pre-existing warranties | (974 )   | (705 )   | 678   | 969      |
| Balance at end of period                         | \$40,555   | \$33,179 | \$40,555  | \$33,179 |

Additionally, the Company sells extended warranty coverage for certain products, which it accounts for as a service warranty. The sales of extended warranties are recorded as deferred revenue, and typically have a duration of five to ten years. The deferred revenue related to extended warranty coverage is amortized over the duration of the extended warranty contract period, following the standard warranty period, using the straight-line method. The Company believes the straight-line method is appropriate because the performance obligation is satisfied based on the passage of time. The amortization of deferred revenue is recorded to selling and service expenses on the condensed consolidated statements of comprehensive income as an offset to warranty expense. The following is a tabular reconciliation of the deferred revenue related to extended warranty coverage:

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2018</b> |          | <b>Nine Months<br/>Ended<br/>September 30,<br/>2017</b> |          |
|--|--|----------|---|----------|
| Balance at beginning of period             | \$63,007   | \$43,356 | \$57,854  | \$36,139 |
| Deferred revenue contracts issued          | 4,787  | 12,741   | 15,029  | 23,204   |
| Amortization of deferred revenue contracts | (2,873 )   | (1,908 ) | (7,962 )  | (5,154 ) |
| Balance at end of period                   | \$64,921   | \$54,189 | \$64,921  | \$54,189 |

The timing of recognition of the Company's deferred revenue balance related to extended warranties at September 30, 2018 is as follows:

|                   |          |
|-------------------|----------|
| Remainder of 2018 | \$3,187  |
| 2019              | 12,941   |
| 2020              | 12,566   |
| 2021              | 10,821   |
| 2022              | 8,502    |
| After 2022        | 16,904   |
| Total             | \$64,921 |

In the second quarter of 2017, the Company launched a post-sale extended warranty marketing program. In the program's agreement, the Company is required to pay fees to a third-party service provider based on the number of extended warranty contracts sold, which it classifies as costs to obtain a contract. The contract costs are deferred and recorded as other assets in the condensed consolidated balance sheets. The deferred contract costs are amortized to selling and service expense in the condensed consolidated statements of comprehensive income over the same period that the underlying deferred revenue is recognized. The balance of deferred contract costs as of September 30, 2018 and 2017 was \$4,563 and \$2,196, respectively. Amortization of deferred contract costs recorded during the nine months ended September 30, 2018 was \$449.

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Standard product warranty obligations and extended warranty related deferred revenues are included in the condensed consolidated balance sheets as follows:

|   | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|---|-----------------------------------|----------------------------------|
| Product warranty liability                      |                                   |                                  |
| Current portion - other accrued liabilities     | \$ 23,374                         | \$ 20,576                        |
| Long-term portion - other long-term liabilities | 17,181                            | 14,846                           |
| Total   | \$ 40,555                         | \$ 35,422                        |
| Deferred revenue related to extended warranties |                                   |                                  |
| Current portion - other accrued liabilities     | \$ 13,641                         | \$ 11,017                        |
| Long-term portion - other long-term liabilities | 51,280                            | 46,837                           |
| Total   | \$ 64,921                         | \$ 57,854                        |

**11. Credit Agreements**

Short-term borrowings are included in the condensed consolidated balance sheets as follows:

|                       | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|-----------------------|-----------------------------------|----------------------------------|
| ABL Facility          | \$ 11,000                         | \$ -                             |
| Other lines of credit | 24,758                            | 20,602                           |
| Total                 | \$ 35,758                         | \$ 20,602                        |

Long-term borrowings are included in the condensed consolidated balance sheets as follows:

|  | <b>September<br/>30,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|--|-----------------------------------|----------------------------------|
| Term Loan  | \$ 879,000                        | \$ 929,000                       |
| Original issue discount and deferred financing costs | (23,635 )                         | (26,937 )                        |
| ABL Facility   | 50,000                            | -                                |
| Capital lease obligation                             | 4,091                             | 4,690                            |
| Other  | 2,055                             | 1,367                            |

|   |            |            |
|---|------------|------------|
| Total   | 911,511    | 908,120    |
| Less: current portion of debt                     | 51,266     | 936        |
| Less: current portion of capital lease obligation | 620        | 636        |
| Total   | \$ 859,625 | \$ 906,548 |

The Company's credit agreements originally provided for a \$1,200,000 term loan B credit facility (Term Loan) and currently include a \$300,000 uncommitted incremental term loan facility. The maturity date of the Term Loan is May 31, 2023. The Term Loan is guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and is secured by associated collateral agreements which pledge a first priority lien on virtually all of the Company's assets, including fixed assets and intangibles, other than all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, which are secured by a second priority lien. The Term Loan initially bore interest at rates based upon either a base rate plus an applicable margin of 1.75% or adjusted LIBOR rate plus an applicable margin of 2.75%, subject to a LIBOR floor of 0.75%. Beginning in the second quarter of 2014, the applicable margin related to base rate loans was reduced to 1.50% and the applicable margin related to LIBOR rate loans was reduced to 2.50%, in each case, if the Company's net debt leverage ratio, as defined in the Term Loan, fell below 3.00 to 1.00 for that measurement period.

In May 2017, the Company amended the Term Loan, modifying the pricing of the facility by reducing the applicable margin rates to base rate plus a fixed applicable margin of 1.25% or adjusted LIBOR rate plus a fixed applicable margin of 2.25%. Further, the amendment removed the pricing grid that would reduce the applicable margin if a net debt leverage ratio of 3.00 to 1.00 was achieved. As a result, the Company does not anticipate any future catch-up gains or losses resulting from changes in contractual interest rates to be recorded in the statements of comprehensive income. The amended Term Loan pricing, however, is still subject to the 0.75% LIBOR floor. In connection with this amendment and in accordance with ASC 470-50, the Company capitalized \$1,432 of fees paid to creditors as deferred financing costs on long-term borrowings in the second quarter of 2017.



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In December 2017, the Company again amended the Term Loan, which further reduced the applicable margin rates to base rate plus a fixed applicable margin of 1.00% or adjusted LIBOR rate plus a fixed applicable margin of 2.00%. Additionally, the amendment eliminated the Excess Cash Flow payment requirement for 2017, and eliminated future related payment requirements if the Company's secured leverage ratio was maintained below 3.75 to 1.00 times. In connection with this amendment and in accordance with ASC 470-50, the Company capitalized \$2,346 of fees paid to creditors as original issue discount and deferred financing costs on long-term borrowings in the fourth quarter of 2017.

In June 2018, the Company again amended the Term Loan, which further reduced the applicable margin rates to base rate plus a fixed applicable margin of 0.75% or adjusted LIBOR rate plus a fixed applicable margin of 1.75%. In connection with this amendment and in accordance with ASC 470-50, the Company capitalized \$829 of fees paid to creditors as deferred financing costs on long-term borrowings in the second quarter of 2018.

As of September 30, 2018, the Company's secured leverage ratio was 1.82 to 1.00 times, and the Company was in compliance with all Term Loan covenants. There are no financial maintenance covenants on the Term Loan.

The Company's credit agreements also originally provided for a \$250,000 senior secured ABL revolving credit facility (ABL Facility), with a maturity date of May 29, 2020. Borrowings under the ABL Facility are guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and are secured by associated collateral agreements which pledge a first priority lien on all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, and a second priority lien on all other assets, including fixed assets and intangibles of the Company and certain domestic subsidiaries. ABL Facility borrowings originally bore interest at rates based upon either a base rate plus an applicable margin of 0.50% or adjusted LIBOR rate plus an applicable margin of 1.50%, in each case, subject to adjustments based upon average availability under the ABL Facility.

In June 2018, the Company amended the ABL Facility; increasing it from \$250,000 to \$300,000 and extending the maturity date from May 29, 2020 to June 12, 2023 (Amended ABL Facility). In addition, the Amended ABL Facility modified the pricing by reducing certain applicable interest rates to either a base rate plus an applicable margin of 0.375% or an adjusted LIBOR rate plus an applicable margin of 1.375%. In connection with this amendment and in accordance with ASC 470-50, the Company capitalized \$755 of new debt issuance costs as deferred financing costs on long-term borrowings in 2018 and wrote-off \$34 of capitalized debt issuance costs as a loss on extinguishment of debt in the second quarter of 2018.

In June 2018, the Company borrowed \$50,000 under the Amended ABL Facility, the proceeds of which were used as a voluntary prepayment of the Term Loan. As a result of the prepayment of the Term Loan, the Company wrote-off \$1,298 of original issue discount and capitalized debt issuance costs during the second quarter of 2018 as a loss on extinguishment of debt in the condensed consolidated statements of comprehensive income.

As of September 30, 2018, there was \$61,000 outstanding under the Amended ABL Facility, leaving \$207,498 of availability, net of outstanding letters of credit. In October 2018, the Company repaid the \$50,000 outstanding Amended ABL Facility balance classified as current portion of long-term borrowings as of September 30, 2018.

As of September 30, 2018 and December 31, 2017, short-term borrowings consisted of borrowings by the Company's foreign subsidiaries on local lines of credit and the Amended ABL Facility, which totaled \$35,758 and \$20,602, respectively.

## **12. Stock Repurchase Program**

In August 2015, the Company's Board of Directors approved a \$200,000 stock repurchase program, which the Company completed in the third quarter of 2016. In October 2016, the Company's Board of Directors approved an additional \$250,000 stock repurchase program. Under the second program, the Company may repurchase up to \$250,000 of its common stock over the 24 months following the date of approval. The Company may repurchase its common stock from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The repurchases may be executed using open market purchases, privately negotiated agreements or other transactions. The actual timing, number and value of shares repurchased under the program will be determined by management at its discretion and will depend on a number of factors, including the market price of the Company's common stock and general market and economic conditions, applicable legal requirements, and compliance with the terms of the Company's outstanding indebtedness. The repurchases may be funded with cash on hand, available borrowings or proceeds from potential debt or other capital markets sources. The stock repurchase program may be suspended or discontinued at any time without prior notice. During the nine months ended September 30, 2018 and 2017, the Company repurchased 560,000 and 844,500 shares of its common stock, respectively, for \$25,656 and \$30,012, respectively, all funded with cash on hand. Since the inception of both programs, the Company has repurchased 8,676,706 shares of its common stock for \$305,547, all funded with cash on hand.

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In September 2018, the Company's Board of Directors approved another \$250,000 stock repurchase program, which will commence in October 2018 upon the expiration of the previous stock repurchase program.

**13. Earnings Per Share**

Basic earnings per share is calculated by dividing net income attributable to the common stockholders of the Company by the weighted average number of common shares outstanding during the period, exclusive of restricted shares. Except where the result would be anti-dilutive, diluted earnings per share is calculated by assuming the vesting of unvested restricted stock and the exercise of stock options. The following table reconciles the numerator and the denominator used to calculate basic and diluted earnings per share:

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2018</b>                                 | <b>2017</b> | <b>2018</b>                                | <b>2017</b> |
| <b>Numerator</b>   |   |             |  |             |
| Net income attributable to Generac Holdings Inc.               | \$75,776                                    | \$39,435    | \$162,682                                  | \$76,901    |
| Redeemable noncontrolling interest redemption value adjustment | (6,912)                                     | ) -         | (16,882)                                   | ) 909       |
| Net income attributable to common shareholders                 | \$68,864                                    | \$39,435    | \$145,800                                  | \$77,810    |
| <b>Denominator</b>   |   |             |  |             |
| Weighted average shares, basic                                 | 61,579,564                                  | 61,758,190  | 61,659,817                                 | 62,094,807  |
| Dilutive effect of stock compensation awards (1)               | 640,734                                     | 558,598     | 606,323                                    | 608,462     |
| Diluted shares   | 62,220,298                                  | 62,316,788  | 62,266,140                                 | 62,703,269  |
| Net income attributable to common shareholders per share       |   |             |  |             |
| Basic  | \$1.12                                      | \$0.64      | \$2.36                                     | \$1.25      |
| Diluted  | \$1.11                                      | \$0.63      | \$2.34                                     | \$1.24      |

(1) Excludes approximately 38,900 and 146,000 stock options for the three month periods ended September 30, 2018 and 2017, respectively, as the impact of such awards was anti-dilutive. Excludes approximately 48,200 and 188,800 stock options for the nine month periods ended September 30, 2018 and 2017, respectively, as the impact of such awards was anti-dilutive.

**14. Income Taxes**

The effective income tax rates for the nine months ended September 30, 2018 and 2017 were 23.3% and 35.3%, respectively. The decrease in the effective income tax rate in 2018 was primarily due to a reduction of the U.S. federal corporate tax rate as a result of the Tax Cuts and Jobs Act (Tax Act) enacted on December 22, 2017.

The SEC staff issued Staff Legal Bulletin 118 (SAB 118), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act. The Company's accounting for certain elements of the Tax Act is incomplete. However, reasonable estimates of certain effects were able to be made and, therefore, provisional adjustments were recorded in the Company's financial statements as of, and for the period ended, December 31, 2017. For the nine months ended September 30, 2018, the Company recorded a \$2,500 favorable adjustment to the provisional amounts recorded in 2017 as a result of the completion of the 2017 federal income tax return. For further discussion on the impact of the Tax Act, see Item 8 (Note 13 "Income Taxes") of the Annual Report on Form 10-K for the year ended December 31, 2017.

## 15. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for certain dealers. The Company receives payment from the finance company after shipment of product to the dealer. The Company participates in the cost of dealer financing up to certain limits and has agreed to repurchase products repossessed by the finance company, but does not indemnify the finance company for any credit losses they incur. The amount financed by dealers which remained outstanding under this arrangement at September 30, 2018 and December 31, 2017 was approximately \$40,600 and \$36,500, 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.

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

This quarterly 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,” “forecast,” “project,” “plan,” “intend,” “believe,” “confident,” “may,” “should,” “can have,” “likely,” “future,” “opti words and terms of 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 quarterly 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 quarterly 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, 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:

frequency and duration of power outages impacting demand for our products;  
availability, cost and quality of raw materials and key components and labor needed in producing our products;  
the impact on our results of possible fluctuations in interest rates, foreign currency exchange rates, commodities, product mix and regulatory tariffs;  
the possibility that the expected synergies, efficiencies and cost savings of our acquisitions will not be realized, or will not be realized within the expected time period;  
the risk that our acquisitions will not be integrated successfully;  
difficulties we may encounter as our business expands globally;  
our dependence on our distribution network;  
our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;  
loss of our key management and employees;

increase in product and other liability claims or recalls; 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 any forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in our filings with the Securities and Exchange Commission, including in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017. Stockholders, potential investors and other readers should consider these factors carefully in evaluating the forward-looking statements.

Any forward-looking statement made by us in this report speaks only as of the date on which it is made. 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 global designer and manufacturer of a wide range of power generation equipment and other engine powered products serving the residential, light commercial and industrial markets. Power generation is our primary focus, which differentiates us from our main competitors that also have broad operations outside of the power equipment market. As the only significant market participant focused predominantly on these products, we have one of the leading market positions in the power equipment market in North America and an expanding presence internationally. We believe we have one of the widest ranges of products in the marketplace, including residential, commercial and industrial standby generators, as well as portable and mobile generators used in a variety of applications. Other engine powered products that we design and manufacture include light towers which provide temporary lighting for various end markets; commercial and industrial mobile heaters and pumps used in the oil and gas, construction and other industrial markets; and a broad product line of outdoor power equipment for residential and commercial use.

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Over the past eight years, we have executed a number of acquisitions that support our strategic plan. A summary of the recent acquisitions can be found in Note 1, “Description of Business and Basis of Presentation,” to the condensed consolidated financial statements in Part 1, Item 1 of this Quarterly Report on Form 10-Q, and in Item 8 (Note 1 “Description of Business”) of the Annual Report on Form 10-K for the year ended December 31, 2017.

## **Business Drivers and Operational Factors**

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

### *Business Drivers and Trends*

Our performance is affected by the demand for back-up power generation products, mobile product solutions and other engine powered products by our customer base. This demand is influenced by several important drivers and trends affecting our industry, including the following:

*Increasing penetration opportunity.* Many potential customers are still not aware of the costs and benefits of automatic backup power solutions. We estimate that penetration rates for home standby generators are only approximately 4.0% 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 2015 American Housing Survey for the United States. The decision to purchase backup power for many light-commercial buildings such as convenience stores, restaurants and gas stations is more return-on-investment driven and, as a result, these applications have relatively lower penetration rates as compared to buildings used in code-driven or mission critical applications such as hospitals, wastewater treatment facilities, 911 call centers, data centers and certain industrial locations. The emergence of lower cost, cleaner burning natural gas-fueled generators has helped to increase the penetration of standby generators over the past decade in the light-commercial market. In addition, the installed base of backup power for telecommunications infrastructure is still increasing due to the growing importance for uninterrupted voice and data services. We believe 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 for residential, commercial and industrial purposes.

*Effect of large scale and baseline power disruptions.* Power disruptions are an important driver of customer awareness for back-up power and have historically influenced demand for generators, both in the United States and internationally. Increased frequency and duration of major power outage events, that have a broader impact beyond a localized level, increases product awareness and may drive consumers to accelerate their purchase of a standby or portable generator during the immediate and subsequent period, which we believe may last for six to twelve months

following a major power outage event for standby generators. For example, the major outage events that occurred during the second half of 2017 drove strong demand for portable and home standby generators, and the increased awareness of these products contributed to strong revenue growth in 2017 and thus far in 2018. Major power disruptions are unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. In addition, there are smaller, more localized power outages that occur frequently across the United States that drive the baseline level of demand for back-up power solutions. The level of baseline power outage activity occurring across the United States can also fluctuate, and may cause our financial results to fluctuate from year to year.

*Impact of residential investment cycle.* The market for residential generators is also affected by the residential investment cycle and overall consumer confidence and sentiment. When homeowners are confident of their household income, the value of their home and overall net worth, they are more likely to invest in their home. These trends can have an impact on demand for residential generators. Trends in the new housing market highlighted by residential housing starts can also impact demand for our residential generators. Demand for outdoor power equipment is also impacted by several of these factors, as well as weather precipitation patterns.

*Impact of business capital investment cycles.* The global market for our commercial and industrial products is affected by different capital investment cycles, which can vary across the numerous regions around the world in which we participate. These markets include non-residential building construction, durable goods and infrastructure spending as well as investments in the exploration and production of oil and gas, as businesses or organizations either add new locations or make investments to upgrade existing locations or equipment. These trends can have a material impact on demand for these products. The capital investment cycle may differ for the various commercial and industrial end markets that we serve, including light commercial, retail, telecommunications, industrial, data centers, healthcare, construction, oil and gas and municipal infrastructure, among others. The market for these products is also affected by general economic and geopolitical conditions as well as credit availability in the geographic regions that we serve. In addition, we believe demand for our mobile power products will continue to benefit from a secular shift towards renting versus buying this type of equipment. We believe the passage of the Tax Act in late 2017 could have a favorable impact on future demand within many of the end markets that we serve, as the improved cash flow, liquidity and business sentiment may lead to further investments in equipment, facilities and infrastructure in the United States.



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***Factors Affecting Results of Operations***

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, cost control and hedging. Certain operational and other factors that affect our business include the following:

*Effect of commodity, currency 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, as well as changes in labor costs required to produce our products, can have a material impact on our results of operations. Also, acquisitions in recent years have further expanded our commercial and operational presence outside of the United States. These acquisitions, along with our existing global supply chain, expose us to fluctuations in foreign currency exchange rates and regulatory tariffs that can have a material impact on our results of operations.

We have historically attempted to mitigate the impact of any inflationary pressures through improved product design and sourcing, manufacturing efficiencies, 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 accepted by our customers and in other cases are paid by us.

*Seasonality.* Although there is demand for our products throughout the year, in each of the past five years approximately 20% to 27% of our net sales occurred in the first quarter, 22% to 25% in the second quarter, 24% to 27% in the third quarter and 25% to 29% in the fourth quarter, with different seasonality depending on the occurrence, timing and severity of major power outage activity in each year. Major outage activity is unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. The seasonality experienced during a major power outage, and for the subsequent quarters following the event, will vary relative to other periods when no major outage events occurred. We maintain a flexible production and supply chain infrastructure in order to respond to outage-driven peak demand.

*Factors influencing interest expense and cash interest expense.* Interest expense can be impacted by a variety of factors, including market fluctuations in LIBOR, interest rate election periods, interest rate swap agreements, repayments or borrowings of indebtedness, and amendments to our credit agreements. Cash interest expense decreased during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017, primarily due to lower interest rate spreads resulting from Term Loan amendments, new interest rate swaps beginning July 2, 2018, and the October 2017 repayment of \$100.0 million of ABL Facility borrowings. These factors are partially offset by an increase in the market LIBOR rate. Refer to Note 11, "Credit Agreements," to the condensed consolidated financial statements included in Part 1, Item 1 of this Quarterly Report on Form 10-Q for further information.

*Factors influencing provision for income taxes and cash income taxes paid.* The Tax Act significantly changes how the U.S. taxes corporations. The Tax Act requires complex computations to be performed that were not previously required in U.S. tax law, significant judgments to be made in interpretation of the provisions of the Tax Act and significant estimates in calculations, and the preparation and analysis of information not previously relevant or regularly produced. The U.S. Treasury Department, the IRS, and other standard-setting bodies could interpret or issue guidance on how provisions of the Tax Act will be applied or otherwise administered that is different from our interpretation.

As a result of the Tax Act, we recognized a one-time, non-cash benefit of \$28.4 million in the fourth quarter of 2017 primarily from the impact of the revaluation of our net deferred tax liabilities. While we continue to assess the full impact of the Tax Act, the preliminary analysis suggests a meaningful benefit from the legislation. Specifically for 2018, our combined federal and state effective tax rate is expected to decline to between 23 to 25%, resulting in lower cash income taxes. As we complete our analysis of the Tax Act, collect and prepare necessary data, and interpret any additional guidance, we may make adjustments to provisional amounts that we have recorded that may materially impact our provision for income taxes in the period in which the adjustments are made. Refer to Note 14, "Income Taxes," to the consolidated financial statements in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2017 for further information on the Tax Act and its impact.

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Further, we had approximately \$470 million of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2017 related to our acquisition by CCMP Capital Advisors, LLC in 2006 that we expect to generate aggregate cash tax savings of approximately \$122 million through 2021, assuming continued profitability and a 26% combined federal and state tax rate. The aggregate cash tax savings reflects a decrease of \$61 million from prior estimates due to a reduction in the assumed tax rate from 39% to 26% as a result of the Tax Act. 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 \$32 million through 2020 and \$26 million in 2021, assuming profitability and a 26% combined federal and state tax rate. As a result of the asset acquisition of the Magnum business in the fourth quarter of 2011, we had approximately \$34 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2017. We expect these assets to generate aggregate cash tax savings of \$9.0 million through 2026 assuming continued profitability and a 26% combined federal and state tax rate. The aggregate cash tax savings reflects a decrease of \$4.5 million due to a reduction in the assumed tax rate from 39% to 26% as a result of the Tax Act. The amortization of these assets for tax purposes is expected to be \$3.8 million annually through 2025 and \$2.8 million in 2026, which generates an additional annual cash tax savings of \$1.0 million through 2025 and \$0.7 million in 2026, assuming profitability and a 26% combined federal and state tax rate. Based on current business plans, we believe that our cash tax obligations through 2026 will be significantly reduced by these tax attributes. Other domestic acquisitions have resulted in additional tax deductible goodwill and intangible assets that will generate tax savings, but are not material to our consolidated financial statements.

**Results of Operations*****Three months ended September 30, 2018 compared to the three months ended September 30, 2017***

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

| (U.S. Dollars in thousands)       | Three Months<br>Ended September<br>30, |           | \$<br>Change | %<br>Change |   |
|-----------------------------------|--|-----------|--------------|-------------|---|
|                                   | 2018                                   | 2017      |              |             |   |
| Net sales                         | \$559,515                              | \$455,839 | \$103,676    | 22.7        | % |
| Cost of goods sold                | 361,630                                | 299,608   | 62,022       | 20.7        | % |
| Gross profit                      | 197,885                                | 156,231   | 41,654       | 26.7        | % |
| Operating expenses:               |  |           |              |             |   |
| Selling and service               | 46,536                                 | 43,463    | 3,073        | 7.1         | % |
| Research and development          | 13,653                                 | 10,850    | 2,803        | 25.8        | % |
| General and administrative        | 25,499                                 | 22,128    | 3,371        | 15.2        | % |
| Amortization of intangible assets | 5,678                                  | 7,242     | (1,564)      | -21.6       | % |
| Total operating expenses          | 91,366                                 | 83,683    | 7,683        | 9.2         | % |
| Income from operations            | 106,519                                | 72,548    | 33,971       | 46.8        | % |

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|   |          |           |          |       |   |
|---|----------|-----------|----------|-------|---|
| Total other expense, net                            | (9,925 ) | (12,368 ) | 2,443    | -19.8 | % |
| Income before provision for income taxes            | 96,594   | 60,180    | 36,414   | 60.5  | % |
| Provision for income taxes                          | 20,072   | 20,404    | (332 )   | -1.6  | % |
| Net income  | 76,522   | 39,776    | 36,746   | 92.4  | % |
| Net income attributable to noncontrolling interests | 746      | 341       | 405      | 118.8 | % |
| Net income attributable to Generac Holdings Inc.    | \$75,776 | \$39,435  | \$36,341 | 92.2  | % |

The following table sets forth our reportable segment information for the periods indicated:

| <b>Net Sales</b>                   |             |             |               |               |   |
|------------------------------------|-------------|-------------|---------------|---------------|---|
| <b>Three Months</b>                |             |             |               |               |   |
| <b>Ended September</b>             |             |             |               |               |   |
| <b>30,</b>                         |             |             |               |               |   |
| <b>(U.S. Dollars in thousands)</b> | <b>2018</b> | <b>2017</b> | <b>\$</b>     | <b>%</b>      |   |
|                                    |             |             | <b>Change</b> | <b>Change</b> |   |
| Domestic                           | \$453,259   | \$362,909   | \$90,350      | 24.9          | % |
| International                      | 106,256     | 92,930      | 13,326        | 14.3          | % |
| Total net sales                    | \$559,515   | \$455,839   | \$103,676     | 22.7          | % |

| <b>Adjusted EBITDA</b> |             |             |               |               |   |
|------------------------|-------------|-------------|---------------|---------------|---|
| <b>Three Months</b>    |             |             |               |               |   |
| <b>Ended September</b> |             |             |               |               |   |
| <b>30,</b>             |             |             |               |               |   |
|                        | <b>2018</b> | <b>2017</b> | <b>\$</b>     | <b>%</b>      |   |
|                        |             |             | <b>Change</b> | <b>Change</b> |   |
| Domestic               | \$117,108   | \$82,817    | \$34,291      | 41.4          | % |
| International          | 7,366       | 5,625       | 1,741         | 31.0          | % |
| Total Adjusted EBITDA  | \$124,474   | \$88,442    | \$36,032      | 40.7          | % |

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The following table sets forth our product class information for the periods indicated:

| (U.S. Dollars in thousands)      | Three Months<br>Ended September<br>30, |           |              |             |   |
|----------------------------------|--|-----------|--------------|-------------|---|
|                                  | 2018                                   | 2017      | \$<br>Change | %<br>Change |   |
| Residential products             | \$311,922                              | \$251,203 | \$60,719     | 24.2        | % |
| Commercial & industrial products | 206,366                                | 173,842   | 32,524       | 18.7        | % |
| Other                            | 41,227                                 | 30,794    | 10,433       | 33.9        | % |
| Total net sales                  | \$559,515                              | \$455,839 | \$103,676    | 22.7        | % |

*Net sales.* The increase in Domestic sales for the three months ended September 30, 2018 was primarily due to continued strong growth in shipments of home standby generators, C&I mobile products, C&I stationary generators, and service parts, all of which contributed to the year-over-year growth. Shipments of residential products were particularly strong as disruptions from power outages continued to drive awareness around the home standby category and the need for homeowners to have back-up power. Sales of our C&I mobile and stationary products were also strong during the quarter with rental, telecom, and healthcare verticals experiencing growth.

The increase in International sales for the three months ended September 30, 2018 was primarily due to the contribution from the Selmeac acquisition, which was \$13.4 million for the third quarter. Our Pramac, Tower Light and Motortech businesses grew modestly as we continue to drive market penetration across the globe. However, the tough prior year comparison with hurricane Maria impacted year-over-year growth rates in Latin America.

*Gross profit.* Gross profit margin for the third quarter of 2018 was 35.4% compared to 34.3% in the prior-year third quarter. A significant favorable mix shift towards higher margin home standby generator sales primarily drove this increase. Price and cost factors were largely neutral to gross margins relative to the prior year as a more favorable pricing environment and improved manufacturing overhead absorption helped to offset general inflationary pressures.

*Operating expenses.* The increase in operating expenses was primarily driven by higher variable operating expenses given the higher sales volumes, an increase in employee and incentive compensation costs, and recurring operating expenses from the Selmeac acquisition. These items were partially offset by lower promotion, marketing, and intangible amortization expenses.

*Other expense.* The decrease in other expense, net was primarily due to lower interest expense given the lower interest rate spreads resulting from Term Loan refinancing amendments and the October 2017 repayment of \$100.0 million of ABL Facility borrowings.

*Provision for income taxes.* The effective income tax rates for the three months ended September 30, 2018 and 2017 were 20.8% and 33.9%, respectively. The decrease in the effective income tax rate in 2018 was primarily due to a reduction in the U.S. federal corporate tax rate as a result of the Tax Act enacted on December 22, 2017. In addition, a favorable provision-to-return adjustment was recorded in the current year third quarter related to the finalization of our 2017 federal income tax return.

*Net income attributable to Generac Holdings Inc.* The increase was primarily driven by higher operating earnings as outlined above and a lower effective tax rate during the current year quarter.

*Adjusted EBITDA.* Adjusted EBITDA for the Domestic segment was \$117.1 million, or 25.8% of net sales, as compared to \$82.8 million, or 22.8% of net sales in the prior year. Adjusted EBITDA margin in the current year benefitted from favorable mix, improved operating leverage, a favorable pricing environment, and focused margin improvement initiatives. These benefits were partially offset by an increase in employee costs and general inflationary pressures.

Adjusted EBITDA for the International segment, before deducting for non-controlling interests, improved to \$7.4 million, or 6.9% of net sales, as compared to \$5.6 million, or 6.1% of net sales, in the prior year. The improvement was primarily due to increased leverage of fixed operating costs on the higher organic sales volumes and favorable mix.

*Adjusted Net Income.* Adjusted Net Income of \$89.1 million for the three months ended September 30, 2018 increased 55.3% from \$57.4 million for the three months ended September 30, 2017, due to the factors outlined above, partially offset by an increase in cash income tax expense.

See “Non-GAAP Measures” for a discussion of how we calculate Adjusted EBITDA and Adjusted Net Income and the limitations on their usefulness.

Table of Contents*Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017*

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

| (U.S. Dollars in thousands)                         | Nine Months Ended<br>September 30, |             | \$<br>Change | %<br>Change |   |
|---|------------------------------------|-------------|--------------|-------------|---|
|   | 2018                               | 2017        |              |             |   |
| Net sales   | \$1,452,098                        | \$1,181,199 | \$270,899    | 22.9        | % |
| Cost of goods sold                                  | 937,968                            | 783,247     | 154,721      | 19.8        | % |
| Gross profit  | 514,130                            | 397,952     | 116,178      | 29.2        | % |
| Operating expenses:                                 |                                    |             |              |             |   |
| Selling and service                                 | 135,270                            | 124,940     | 10,330       | 8.3         | % |
| Research and development                            | 38,122                             | 31,690      | 6,432        | 20.3        | % |
| General and administrative                          | 75,613                             | 64,508      | 11,105       | 17.2        | % |
| Amortization of intangible assets                   | 16,792                             | 21,554      | (4,762)      | -22.1       | % |
| Total operating expenses                            | 265,797                            | 242,692     | 23,105       | 9.5         | % |
| Income from operations                              | 248,333                            | 155,260     | 93,073       | 59.9        | % |
| Total other expense, net                            | (33,940)                           | (35,821)    | 1,881        | -5.3        | % |
| Income before provision for income taxes            | 214,393                            | 119,439     | 94,954       | 79.5        | % |
| Provision for income taxes                          | 49,870                             | 42,105      | 7,765        | 18.4        | % |
| Net income  | 164,523                            | 77,334      | 87,189       | 112.7       | % |
| Net income attributable to noncontrolling interests | 1,841                              | 433         | 1,408        | 325.2       | % |
| Net income attributable to Generac Holdings Inc.    | \$162,682                          | \$76,901    | \$85,781     | 111.5       | % |

The following table sets forth our reportable segment information for the periods indicated:

| (U.S. Dollars in thousands) | Net Sales<br>Nine Months Ended<br>September 30, |             | \$<br>Change | %<br>Change |   |
|-----------------------------|---|-------------|--------------|-------------|---|
|                             | 2018  | 2017        |              |             |   |
| Domestic                    | \$1,134,525                                     | \$915,483   | \$219,042    | 23.9        | % |
| International               | 317,573   | 265,716     | 51,857       | 19.5        | % |
| Total net sales             | \$1,452,098                                     | \$1,181,199 | \$270,899    | 22.9        | % |

**Adjusted EBITDA  
Nine Months  
Ended September  
30,**

|                       | 2018      | 2017      | \$<br>Change | %<br>Change |   |
|-----------------------|-----------|-----------|--------------|-------------|---|
| Domestic              | \$273,185 | \$188,400 | \$84,785     | 45.0        | % |
| International         | 25,300    | 16,471    | 8,829        | 53.6        | % |
| Total Adjusted EBITDA | \$298,485 | \$204,871 | \$93,614     | 45.7        | % |

The following table sets forth our product class information for the periods indicated:

| (U.S. Dollars in thousands)      | Nine Months Ended<br>September 30, |             | \$<br>Change | %<br>Change |   |
|----------------------------------|------------------------------------|-------------|--------------|-------------|---|
|                                  | 2018                               | 2017        |              |             |   |
| Residential products             | \$748,794                          | \$603,888   | \$144,906    | 24.0        | % |
| Commercial & industrial products | 597,119                            | 494,498     | 102,621      | 20.8        | % |
| Other                            | 106,185                            | 82,813      | 23,372       | 28.2        | % |
| Total net sales                  | \$1,452,098                        | \$1,181,199 | \$270,899    | 22.9        | % |

*Net sales.* The increase in Domestic sales for the nine months ended September 30, 2018 was primarily due to continued strong growth in shipments of home standby and portable generators, C&I mobile products, C&I stationary generators, and service parts, all of which contributed to the year-over-year growth. Shipments of residential products were particularly strong with demand climbing to record levels as disruptions from power outages continued to drive awareness around the home standby category and the need for homeowners to have back-up power. Sales of our C&I mobile and stationary products were also strong during the quarter with rental, telecom, and healthcare verticals experiencing growth.

The increase in International sales for the nine months ended September 30, 2018 was primarily due to the \$17.4 million contribution from the Selmeac acquisition, growth in our Pramac, Tower Light and Motortech businesses as we continue to drive market penetration across the globe, and the stronger Euro compared to prior year. However, the tough prior year comparison with hurricane Maria caused growth rates in Latin America to be relatively flat compared to the prior year.



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*Gross profit.* Gross profit margin for the first nine months of 2018 was 35.4% compared to 33.7% in the first nine months of 2017. The increase reflected better leverage of fixed manufacturing costs on the increase in sales, favorable mix of home standby generators, a favorable pricing environment, and focused initiatives to improve margins. These items were partially offset by general inflationary pressures from higher commodities, currencies, wages and logistics costs.

*Operating expenses.* The increase in operating expenses was primarily driven by an increase in employee and incentive compensation costs, higher variable operating expenses given the higher sales volumes, the recurring operating expenses from the Selmeac acquisition, and increased International operating expenses given the stronger Euro. These items were partially offset by lower promotion, marketing and intangible amortization costs.

*Other expense.* The decrease in other expense, net was primarily due to lower interest expense, partially offset by the \$1.3 million loss on extinguishment of debt resulting from a \$50.0 million voluntary prepayment of Term Loan debt.

*Provision for income taxes.* The effective income tax rates for the nine months ended September 30, 2018 and 2017 were 23.3% and 35.3%, respectively. The decrease in the effective income tax rate in 2018 was primarily due to a reduction in the U.S. federal corporate tax rate as a result of the Tax Act enacted on December 22, 2017.

*Net income attributable to Generac Holdings Inc.* The increase was primarily driven by higher operating earnings as outlined above and a lower effective tax rate during the current year quarter, partially offset by higher income attributable to noncontrolling interests.

*Adjusted EBITDA.* Adjusted EBITDA for the Domestic segment was \$273.2 million, or 24.1% of net sales, as compared to \$188.4 million, or 20.6% of net sales in the prior year. Adjusted EBITDA margin in the current year benefitted from favorable mix, improved operating leverage, a favorable pricing environment, lower promotional costs, and focused margin improvement initiatives. These benefits were partially offset by an increase in employee costs and general inflationary pressures.

Adjusted EBITDA for the International segment, before deducting for non-controlling interests, improved to \$25.3 million, or 8.0% of net sales, as compared to \$16.5 million, or 6.2% of net sales, in the prior year. The improvement in Adjusted EBITDA margin as compared to the prior year was primarily due to increased leverage of fixed operating costs on the higher organic sales and favorable mix.

*Adjusted Net Income.* Adjusted Net Income of \$204.1 million for the nine months ended September 30, 2018 increased 63.6% from \$124.8 million for the nine months ended September 30, 2017, due to the factors outlined above, partially offset by an increase in cash income tax expense.

See “Non-GAAP Measures” for a discussion of how we calculate Adjusted EBITDA and Adjusted Net Income and the limitations on their usefulness.

## **Liquidity and Financial Condition**

Our primary cash requirements include payment for our raw material and component supplies, salaries and benefits, facility and lease costs, operating expenses, interest and principal payments on our debt and capital expenditures. We finance our operations primarily through cash flow generated from operations and, if necessary, borrowings under our Amended ABL Facility.

Our credit agreements originally provided for a \$1.2 billion Term Loan and currently include a \$300.0 million uncommitted incremental term loan facility that could be utilized in the future if needed. The Term Loan matures on May 31, 2023, and bears interest at rates based upon either a base rate plus an applicable margin of 0.75% or adjusted LIBOR rate plus an applicable margin of 1.75%, subject to a LIBOR floor of 0.75%. The Term Loan does not require an Excess Cash Flow payment if our secured leverage ratio is maintained below 3.75 to 1.00 times. As of September 30, 2018, our secured leverage ratio was 1.82 to 1.00 times, and we were in compliance with all covenants of the Term Loan. There are no financial maintenance covenants on the Term Loan.

Our credit agreements also provide for the \$300.0 million Amended ABL Facility. The maturity date of the Amended ABL Facility is June 12, 2023. As of September 30, 2018, there were \$61.0 million of borrowings outstanding and \$207.5 million of availability under the Amended ABL Facility, net of outstanding letters of credit. In October 2018, the Company repaid the \$50.0 million outstanding Amended ABL Facility balance classified as current portion of long-term borrowings as of September 30, 2018. We were in compliance with all covenants of the Amended ABL Facility as of September 30, 2018.

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In August 2015, our Board of Directors approved a \$200.0 million stock repurchase program, which we completed in the third quarter of 2016. In October 2016, our Board of Directors approved another stock repurchase program, under which we may repurchase an additional \$250.0 million of common stock over 24 months from time to time, in amounts and at prices we deem appropriate, subject to market conditions and other considerations. Since the inception of both programs, we have repurchased 8,676,706 shares of our common stock for \$305.5 million, all funded with cash on hand. During the nine months ended September 30, 2018 and 2017, we repurchased 560,000 and 844,500 shares of our common stock, respectively, for \$25.7 million and \$30.0 million, respectively, all funded with cash on hand.

In September 2018, the Company's Board of Directors approved another \$250,000 stock repurchase program, which will commence in October 2018 upon the expiration of the previous stock repurchase program.

See Note 11, "Credit Agreements," to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

**Long-term Liquidity**

We believe that our cash flow from operations and availability under our Amended ABL Facility and other short-term lines of credit, combined with relatively low ongoing capital expenditure requirements and favorable tax attributes (which result in a lower cash tax rate as compared to the U.S. statutory tax rate), provide us with sufficient capital to continue to grow our business in the future. We will use a portion of our cash flow to pay interest and principal on our outstanding debt as well as repurchase shares of our common stock, impacting the amount available for working capital, capital expenditures and other general corporate purposes. As we continue to expand our business, we may require additional capital to fund working capital, capital expenditures or acquisitions.

**Cash Flow**

*Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017*

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

| (U.S. Dollars in thousands)               | Nine Months Ended<br>September 30, |            | \$<br>Change | %<br>Change |   |
|---|------------------------------------|------------|--------------|-------------|---|
|   | 2018                               | 2017       |              |             |   |
| Net cash provided by operating activities | \$ 138,998                         | \$ 120,617 | \$ 18,381    | 15.2        | % |
| Net cash used in investing activities     | (94,465 )                          | (13,222 )  | (81,243)     | 614.5       | % |
| Net cash used in financing activities     | (9,143 )                           | (48,782 )  | 39,639       | -81.3       | % |

The increase in net cash provided by operating activities was primarily due to an increase in operating earnings as compared to the prior year, partially offset by increased working capital investment driven by organic sales growth and the replenishment of inventory levels as well as the timing of certain cash flows related to taxes, interest, pensions and sales of extended warranties.

Net cash used in investing activities for the nine months ended September 30, 2018 primarily represents cash payments of \$71.9 million related to the acquisition of businesses and \$25.6 million for the purchase of property and equipment. Net cash used in investing activities for the nine months ended September 30, 2017 primarily represents cash payments for the purchase of property and equipment.

Net cash used in financing activities for the nine months ended September 30, 2018 primarily represents \$63.6 million of debt repayments (\$51.1 million of long-term borrowings and \$12.5 million of short-term borrowings) and \$25.7 million cash used for the repurchase of our common stock. These payments were partially offset by \$79.8 million of cash proceeds from borrowings (\$51.4 million long-term and \$28.4 million short-term).

Net cash used in financing activities for the nine months ended September 30, 2017 primarily represents \$94.0 million of debt repayments (\$80.9 million of short-term borrowings and \$13.1 million of long-term borrowings) and \$30.0 million for the repurchase of our common stock. These payments were partially offset by \$77.5 million cash proceeds from borrowings (\$74.4 million short-term and \$3.1 million long-term).

### Contractual Obligations

In June 2018, the Company amended its Term Loan and ABL Facility, and borrowed \$50.0 million under the Amended ABL Facility, the proceeds of which were used as a voluntary prepayment of the Term Loan. In October 2018, the Company repaid the \$50.0 million outstanding Amended ABL Facility balance classified as current portion of long-term borrowings as of September 30, 2018. See Note 11, "Credit Agreements," to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information. Other than these transactions, there have been no material changes to our contractual obligations since the February 26, 2018 filing of our Annual Report on Form 10-K for the year ended December 31, 2017.



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**Off-Balance Sheet Arrangements**

There have been no material changes to off-balance sheet arrangements since the February 26, 2018 filing of our Annual Report on Form 10-K for the year ended December 31, 2017.

**Critical Accounting Policies**

There have been no material changes in our critical accounting policies since the February 26, 2018 filing of our Annual Report on Form 10-K for the year ended December 31, 2017.

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2017, in preparing the financial statements in accordance with U.S. GAAP, management is 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, our estimates and assumptions are reasonable, adhere to U.S. GAAP, 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 and equipment, prepaid expenses, product warranties and other reserves. Management believes our most critical accounting estimates and assumptions are in the following areas: goodwill and other indefinite-lived intangible asset impairment assessment; business combinations and purchase accounting; defined benefit pension obligations; and income taxes.

**Non-GAAP Measures**

***Adjusted EBITDA***

The computation of Adjusted EBITDA attributable to Generac Holdings Inc. is based on the definition of EBITDA contained in our credit agreement, as amended. To supplement our condensed consolidated financial statements presented in accordance with U.S. GAAP, we provide the computation of Adjusted EBITDA attributable to the Company, taking into account certain charges and gains that were recognized during the periods presented.

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 credit agreements but also because it assists us in comparing our performance across reporting periods on a consistent basis as 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 one component for the determination of bonus compensation for our senior executives under our management incentive plan, as described further in our 2018 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 the Company. Management believes 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;

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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 Term Loan and Amended ABL Facility, 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 write-downs and other charges, non-cash gains, 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; or
- are non-cash in nature, such as share-based compensation.

We explain in more detail in footnotes (a) through (e) 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 write-downs and other charges, while not involving cash expense, do have a negative impact on the value of our assets as reflected in our consolidated balance sheets 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 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), involve mathematical application of items reflected in our financial statements, others involve a degree of judgment and discretion. While we believe all of these adjustments are appropriate, and while the quarterly 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 Term Loan and Amended ABL Facility credit agreements, 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.

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The following table presents a reconciliation of net income to Adjusted EBITDA attributable to Generac Holdings Inc.:

| (U.S. Dollars in thousands)                              | Three Months<br>Ended September<br>30, |          | Nine Months<br>Ended September<br>30, |           |
|--|--|----------|---------------------------------------|-----------|
|  | 2018                                   | 2017     | 2018                                  | 2017      |
| Net income attributable to Generac Holdings Inc.         | \$75,776                               | \$39,435 | \$162,682                             | \$76,901  |
| Net income attributable to noncontrolling interests      | 746                                    | 341      | 1,841                                 | 433       |
| Net income   | 76,522                                 | 39,776   | 164,523                               | 77,334    |
| Interest expense   | 9,824                                  | 10,672   | 30,939                                | 32,353    |
| Depreciation and amortization                            | 11,841                                 | 13,108   | 35,124                                | 38,691    |
| Provision for income taxes                               | 20,072                                 | 20,404   | 49,870                                | 42,105    |
| Non-cash write-down and other adjustments (a)            | 900                                    | 756      | 3,522                                 | 2,632     |
| Non-cash share-based compensation expense (b)            | 2,919                                  | 2,584    | 9,910                                 | 8,402     |
| Loss on extinguishment of debt (c)                       | -                                      | -        | 1,332                                 | -         |
| Transaction costs and credit facility fees (d)           | 1,767                                  | 234      | 2,470                                 | 970       |
| Business optimization expenses (e)                       | 583                                    | 487      | 750                                   | 1,933     |
| Other  | 46                                     | 421      | 45                                    | 451       |
| Adjusted EBITDA  | 124,474                                | 88,442   | 298,485                               | 204,871   |
| Adjusted EBITDA attributable to noncontrolling interests | 1,454                                  | 1,178    | 5,633                                 | 3,589     |
| Adjusted EBITDA attributable to Generac Holdings Inc.    | \$123,020                              | \$87,264 | \$292,852                             | \$201,282 |

(a) Represents the following non-cash charges: gains/losses on disposals of assets, unrealized mark-to-market adjustments on commodity contracts, transactional foreign currency gains/losses and certain purchase accounting related adjustments. We believe that adjusting net income for these non-cash charges is useful for the following reasons:

The gains/losses on disposals of assets result from the sale of assets that are no longer useful in our business and therefore represent gains or losses that are not from our core operations;

The adjustments for unrealized mark-to-market gains and losses on commodity contracts represent non-cash items to reflect changes in the fair value of forward contracts that have not been settled or terminated. We believe 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 comprehensive income and cash flows to capture the full effect of these contracts on our operating performance; and The purchase accounting adjustments represent non-cash items to reflect fair value at the date of acquisition, and therefore do not reflect our ongoing operations.

(b) Represents share-based compensation expense to account for stock options, restricted stock and other stock awards over their respective vesting period.

(c) Represents the non-cash write-off of original issue discount and deferred financing costs due to a \$50.0 million voluntary prepayment of Term Loan debt.

(d) Represents transaction costs incurred directly in connection with any investment, as defined in our credit agreement, equity issuance or debt issuance or refinancing, together with certain fees relating to our senior secured credit facilities, such as administrative agent fees and credit facility commitment fees under our Term Loan and Amended ABL Facility, 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.

(e) For the three and nine months ended September 30, 2018 and 2017, represents severance and other non-recurring restructuring charges related to the consolidation of certain of our facilities. These charges represent expenses that are not from our core operations and do not reflect our ongoing operations.

### ***Adjusted Net Income***

To further supplement our condensed consolidated financial statements in accordance with U.S. GAAP, we provide the computation of Adjusted Net Income attributable to the Company, which is defined as net income before noncontrolling interest and provision for income taxes adjusted for the following items: cash income tax expense, amortization of intangible assets, amortization of deferred financing costs and original issue discount related to our debt, intangible impairment charges, certain transaction costs and other purchase accounting adjustments, losses on extinguishment of debt, business optimization expenses, certain other non-cash gains and losses, and adjusted net income attributable to noncontrolling interests, as set forth in the reconciliation table below.

We believe Adjusted Net Income is used by securities analysts, investors and other interested parties in the evaluation of our company's operations. Management believes the disclosure of Adjusted Net Income 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 ongoing results of operations, and the factors and trends affecting our business.

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The adjustments included in the reconciliation table listed below are presented to illustrate the operating performance of our business in a manner consistent with the presentation used by investors and securities analysts. Similar to the Adjusted EBITDA reconciliation, these adjustments eliminate the impact of a number of items we do not consider indicative of our ongoing operating performance or cash flows, such as amortization costs, transaction costs and write-offs relating to the retirement of debt. We also make adjustments to present cash taxes paid as a result of our favorable tax attributes.

Similar to Adjusted EBITDA, Adjusted Net Income 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 Net Income 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 Net Income does not reflect changes in, or cash requirements for, our working capital needs; although amortization is a non-cash charge, the assets being amortized may have to be replaced in the future, and
- Adjusted Net Income does not reflect any cash requirements for such replacements; and
- other companies may calculate Adjusted Net Income differently than we do, limiting its usefulness as a comparative measure.

The following table presents a reconciliation of net income to Adjusted Net Income attributable to Generac Holdings Inc.:

| (U.S. Dollars in thousands, except share and per share data)       | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2018                                | 2017     | 2018                               | 2017     |
| Net income attributable to Generac Holdings Inc.                   | \$75,776                            | \$39,435 | \$162,682                          | \$76,901 |
| Net income attributable to noncontrolling interests                | 746                                 | 341      | 1,841                              | 433      |
| Net income   | 76,522                              | 39,776   | 164,523                            | 77,334   |
| Provision for income taxes   | 20,072                              | 20,404   | 49,870                             | 42,105   |
| Income before provision for income taxes                           | 96,594                              | 60,180   | 214,393                            | 119,439  |
| Amortization of intangible assets                                  | 5,678                               | 7,242    | 16,792                             | 21,554   |
| Amortization of deferred finance costs and original issue discount | 1,187                               | 1,092    | 3,554                              | 2,400    |
| Loss on extinguishment of debt                                     | -                                   | -        | 1,332                              | -        |
| Transaction costs and other purchase accounting adjustments (a)    | 702                                 | (35)     | 1,516                              | 979      |
| Business optimization expenses                                     | 583                                 | 487      | 750                                | 1,933    |
| Adjusted net income before provision for income taxes              | 104,744                             | 68,966   | 238,337                            | 146,305  |
| Cash income tax expense (b)  | (15,185)                            | (10,878) | (31,709)                           | (19,607) |
| Adjusted net income  | 89,559                              | 58,088   | 206,628                            | 126,698  |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Adjusted net income attributable to noncontrolling interests                           | 447        | 697        | 2,491      | 1,912      |
| Adjusted net income attributable to Generac Holdings Inc.                              | \$89,112   | \$57,391   | \$204,137  | \$124,786  |
| Adjusted net income per common share attributable to Generac Holdings, Inc. - diluted: | \$1.43     | \$0.92     | \$3.28     | \$1.99     |
| Weighted average common shares outstanding - diluted:                                  | 62,220,298 | 62,316,788 | 62,266,140 | 62,703,269 |

(a) Represents transaction costs incurred directly in connection with any investment, as defined in our credit agreement, equity issuance or debt issuance or refinancing, and certain purchase accounting adjustments.

(b) Amounts for the three and nine months ended September 30, 2018 are now based on an anticipated cash income tax rate of approximately 15% for the full year ended 2018. Amounts for the three and nine months ended September 30, 2017 were based on an anticipated cash income tax rate at that time of approximately 17% for the full year ended 2017. Cash income tax expense for the respective periods is based on the projected taxable income and corresponding cash tax rate for the full year after considering the effects of current and deferred income tax items, and is calculated for each respective period by applying the derived full year cash tax rate to the period's pretax income.

### New Accounting Standards

Refer to Note 1, "Description of Business and Basis of Presentation," to the condensed consolidated financial statements in Part 1, Item 1 of this Quarterly Report on Form 10-Q for further information on the new accounting standards applicable to the Company.

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

Refer to Note 5, “Derivative Instruments and Hedging Activities,” to the condensed consolidated financial statements for a discussion of changes in commodity, currency and interest rate related risks and hedging activities. Otherwise, there have been no material changes in market risk from the information provided in Item 7A (Quantitative and Qualitative Disclosures About Market Risk) of our Annual Report on Form 10-K for the year ended December 31, 2017.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief 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**

In June 2018, we acquired Selmec. As a result of the acquisition, we are reviewing the internal control structure of Selmec and are in the process of making appropriate changes as we incorporate our controls and procedures into the acquired business.

Other than the continuing assessment of controls for the Selmec acquisition, there have been no other significant changes during the three months ended September 30, 2018 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.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in legal proceedings primarily involving product liability, employment matters and general commercial disputes arising in the ordinary course of our business. As of September 30, 2018, 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 in our risk factors since the February 26, 2018 filing of our Annual Report on Form 10-K for the year ended December 31, 2017.

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

The following table summarizes our stock repurchase activity for the three months ended September 30, 2018, which consisted of the withholding of shares upon the vesting of restricted stock awards to pay related withholding taxes on behalf of the recipient:

|                         | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share</b> | <b>Total<br/>Number Of<br/>Shares<br/>Purchased<br/>As Part Of<br/>Publicly<br/>Announced<br/>Plans Or<br/>Programs</b> | <b>Approximate<br/>Dollar Value<br/>Of Shares<br/>That May<br/>Yet Be<br/>Purchased<br/>Under The<br/>Plans Or<br/>Programs</b> |
|-------------------------|---|---|---|---|
| 07/01/2018 – 07/31/2018 | -   | -   | -   | \$ 144,453,228  |
| 08/01/2018 – 08/31/2018 | 4,229   | \$ 54.95  | -   | 144,453,228   |
| 09/01/2018 – 09/30/2018 | 1,968   | 57.20   | -   | \$ 144,453,228  |
| Total                   | 6,197   | \$ 55.66  |   |   |

Table of Contents**Item 5. Other Information**

On November 5, 2018, the Company's Compensation Committee approved, and the Company entered into, an amended and restated employment agreement with Aaron Jagdfeld, President and Chief Executive Officer. The amended agreement provides that the term of the agreement will extend until November 4, 2021, and adds automatic renewals in one-year extensions of the term, unless either party provides notice of non-renewal within 90 days of the expiration date. The amended agreement also updates the "Cause" and "Good Reason" definitions and information about the Chief Executive Officer's compensation.

Also on November 5, 2018, the Company's Compensation Committee approved an Executive Change in Control Policy. The policy will replace the individual Change in Control Severance Agreements the Company has with its executive officers, while retaining the "double trigger" nature of such protections. Pursuant to the policy, the Company's executive officers and other designated employees will be entitled to certain payments and benefits in the event of a termination of the executive's employment without "Cause" or for "Good Reason" within the period beginning 120 days before and ending two years after a "Change in Control" (as each such term is defined in the policy). Upon such a "double trigger" event, the executive will be entitled to receive a severance payment equal to two times the executive's annual base salary and target annual bonus for the year of termination, plus any earned but unpaid bonus payments for the year prior to the year of termination. The executive will be entitled to continued participation in the Company's medical and life insurance programs for two years. The executive will also be entitled to vesting of unvested stock options and other long-term incentive awards, with any performance-based awards vesting at the "target" performance level. Receipt of the payments and benefits under the policy are generally contingent upon the executive signing a general release in favor of the Company and complying with applicable restrictive covenants.

**Item 6. Exhibits**

| <b>Exhibits<br/>Number</b> | <b>Description</b>  |
|----------------------------|---|
| 10.1*                      | <u>Amended and Restated Employment Agreement, dated November 5, 2018, between Generac and Aaron P. Jagdfeld, President and Chief Executive Officer.</u>                                   |
| 10.2*                      | <u>Generac Power Systems, Inc. Executive Change in Control Policy, effective November 5, 2018.</u>  |
| 31.1*                      | <u>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.</u> |
| 31.2*                      | <u>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.</u> |
| 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.

101\* The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related Notes to Condensed Consolidated Financial Statements.

\* Filed herewith.

\*\* Furnished herewith.

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**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: November 6, 2018