

GENERAC HOLDINGS INC.  
Form 10-Q  
May 07, 2013

---

---

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 March 31, 2013

OR

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

For the transition period from to

Commission File Number 001-34627

---

GENERAC HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

20-5654756  
(IRS Employer  
Identification No.)

S45 W29290 Hwy. 59, Waukesha, WI  
(Address of principal executive offices)

53189  
(Zip Code)

(262) 544-4811

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

Large accelerated filer

Accelerated filer R

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of May 1, 2013, there were 68,398,269 shares of the registrant’s common stock outstanding.

GENERAC HOLDINGS INC.  
TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1.	Condensed Consolidated Financial Statements (Unaudited)
	<u>Condensed Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012</u> 1
	<u>Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2013 and 2012</u> 2
	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2013 and 2012</u> 3
	<u>Notes to Condensed Consolidated Financial Statements</u> 4
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 15
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 25
Item 4.	<u>Controls and Procedures</u> 25
PART II. OTHER INFORMATION	
Item 1.	<u>Legal Proceedings</u> 25
Item 1A.	<u>Risk Factors</u> 25
Item 6.	<u>Exhibits</u> 25
	Signatures 26

---

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	March 31, 2013 (Unaudited)	December 31, 2012 (Audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 54,337	\$ 108,023
Accounts receivable, less allowance for doubtful accounts	169,388	134,978
Inventories	258,821	225,817
Deferred income taxes	37,538	48,687
Prepaid expenses and other assets	5,111	5,048
Total current assets	525,195	522,553
Property and equipment, net	106,474	104,718
Customer lists, net	33,956	37,823
Patents, net	68,358	70,302
Other intangible assets, net	5,409	5,783
Deferred financing costs, net	12,655	13,987
Trade names, net	158,831	158,831
Goodwill	552,943	552,943
Deferred income taxes	127,883	136,754
Other assets	22	153
Total assets	\$ 1,591,726	\$ 1,603,847
Liabilities and stockholders' equity		
Current liabilities:		
Short-term borrowings	\$ 12,532	\$ 12,550
Accounts payable	117,134	94,543
Accrued wages and employee benefits	16,077	19,435
Other accrued liabilities	82,388	86,081
Current portion of long-term borrowings	30,000	82,250
Total current liabilities	258,131	294,859
Long-term borrowings	770,702	799,018
Other long-term liabilities	47,299	46,342
Total liabilities	1,076,132	1,140,219
Stockholders' equity:		

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

Common stock, par value \$0.01, 500,000,000 shares authorized, 68,546,806 and 68,295,960 shares issued at March 31, 2013 and December 31, 2012, respectively	686	683
Additional paid-in capital	750,179	743,349
Treasury stock, at cost	(6,543 )	–
Excess purchase price over predecessor basis	(202,116 )	(202,116 )
Accumulated deficit	(13,118 )	(63,792 )
Accumulated other comprehensive loss	(13,494 )	(14,496 )
Total stockholders' equity	515,594	463,628
Total liabilities and stockholders' equity	\$ 1,591,726	\$ 1,603,847

See notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March	
	31,	
	2013	2012
Net sales	\$399,572	\$294,561
Costs of goods sold	246,110	183,556
Gross profit	153,462	111,005
<b>Operating expenses:</b>		
Selling and service	31,681	25,126
Research and development	6,645	5,055
General and administrative	12,426	9,106
Amortization of intangibles	6,185	12,225
Total operating expenses	56,937	51,512
Income from operations	96,525	59,493
<b>Other (expense) income:</b>		
Interest expense	(15,675 )	(5,674 )
Investment income	17	19
Loss on extinguishment of debt	(1,839 )	(4,309 )
Other, net	396	(425 )
Total other expense, net	(17,101 )	(10,389 )
Income before provision for income taxes	79,424	49,104
Provision for income taxes	28,750	19,044
Net income	\$50,674	\$30,060
Net income per common share - basic:	\$0.75	\$0.45
Weighted average common shares outstanding - basic:	67,864,475	67,200,480
Net income per common share - diluted:	\$0.73	\$0.44
Weighted average common shares outstanding - diluted:	69,554,941	68,637,927
Comprehensive income	\$51,676	\$29,991

See notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31,	
	2013	2012
<b>Operating activities</b>		
Net income	\$50,674	\$30,060
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,565	1,993
Amortization of intangible assets	6,185	12,225
Amortization of original issue discount	616	37
Amortization of deferred finance costs	561	469
Amortization of unrealized loss on interest rate swaps	1,002	–
Loss on extinguishment of debt	1,839	4,309
Provision for losses on accounts receivable	225	79
Deferred income taxes	20,075	18,239
Loss on disposal of property and equipment	2	107
Share-based compensation expense	2,931	2,439
Net changes in operating assets and liabilities:		
Accounts receivable	(34,648 )	(3,255 )
Inventories	(33,007 )	(37,700 )
Other assets	13	(530 )
Accounts payable	22,601	9,663
Accrued wages and employee benefits	(3,358 )	(2,739 )
Other accrued liabilities	7,684	3,919
Excess tax benefits from equity awards	(7,694 )	(731 )
Net cash provided by operating activities	38,266	38,584
<b>Investing activities</b>		
Expenditures for property and equipment	(4,322 )	(2,138 )
Acquisition of business, net of cash acquired	–	(2,279 )
Net cash used in investing activities	(4,322 )	(4,417 )
<b>Financing activities</b>		
Proceeds from long-term borrowings	–	573,614
Repayments of short-term borrowings	(18 )	–
Repayments of long-term borrowings	(82,250 )	(597,874 )
Payment of debt issuance costs	–	(10,756 )
Cash dividends paid for restricted stock upon vesting	(2,649 )	–
Taxes paid related to the net share settlement of equity awards	(10,417 )	(1,278 )
Excess tax benefits from equity awards	7,694	731
Net cash used in financing activities	(87,640 )	(35,563 )
Effect of exchange rate changes on cash and cash equivalents	10	–
Net decrease in cash and cash equivalents	(53,686 )	(1,396 )

Cash and cash equivalents at beginning of period	108,023	93,126
Cash and cash equivalents at end of period	\$54,337	\$91,730

See notes to condensed consolidated financial statements.

3

---



Table of Contents

Generac Holdings Inc.

Notes to Condensed Consolidated Financial Statements  
(Dollars in Thousands, Except Share and Per Share Data)  
(Unaudited)

## 1. Basis of Presentation

## Description of Business

Generac Holdings Inc. (the Company) owns all of the common stock of Generac Acquisition Corp., which in turn, owns all of the common stock of Generac Power Systems, Inc. (the Subsidiary and the Borrower). The Company is a leading designer and manufacturer of a wide range of generators and other engine powered products for the residential, light-commercial, industrial and construction markets.

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

The condensed consolidated balance sheet as of March 31, 2013, the condensed consolidated statements of comprehensive income for the three months ended March 31, 2013 and 2012, and the condensed consolidated statements of cash flows for the three months ended March 31, 2013 and 2012 have been prepared by the Company and have not been audited. In the opinion of management, all adjustments, consisting of only normal recurring adjustments necessary for the fair presentation of the financial position, results of operation and cash flows, have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the 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. generally accepted accounting principles 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 our Annual Report on Form 10-K for the year ended December 31, 2012.

## Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss at March 31, 2013 and December 31, 2012 are as follows:

	March 31, 2013	December 31, 2012
Foreign currency translation adjustments	\$(34 )	\$(34 )
Pension liability, net of tax of \$(4,174)	(12,081 )	(12,081 )
Unrealized losses on cash flow hedges, net of tax of \$(63) and \$(109)	(1,379 )	(2,381 )
Accumulated other comprehensive loss	\$(13,494 )	\$(14,496 )



Table of Contents

## 1. Basis of Presentation (continued)

The following presents a tabular disclosure about reclassification adjustments out of accumulated other comprehensive loss during the quarter ended March 31, 2013:

	Amounts reclassified from other accumulated comprehensive loss	Affected line item in the statement where net income is presented
Amortization of unrealized loss on interest rate swaps		Interest
Gross	\$ (1,048 )	expense
Tax benefit	46	
Net of tax	\$ (1,002 )	

There were no reclassification adjustments out of accumulated other comprehensive loss during the quarter ended March 31, 2012. See Note 2 – Derivative Instruments and Hedging Activities for additional details.

## 2. Derivative Instruments and Hedging Activities

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

## Commodities

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

The Company primarily utilizes commodity contracts with maturities of less than 12 months. Such contracts are intended to offset the effect of price fluctuations on actual inventory purchases. There were two outstanding commodity forward contracts in place to hedge the Company's projected commodity purchases at March 31, 2012. The Company entered into these two commodity forward contracts, to purchase \$4,533 and \$1,935 of copper, in September 2011. The contracts were effective from October 1, 2011, and terminated on June 30, 2012. There were one and three outstanding commodity forward contracts in place to hedge the Company's projected commodity purchases at December 31, 2012 and March 31, 2013, respectively. In October 2012, the Company entered into a commodity forward contract to purchase \$3,472 of copper. The contract was effective from January 1, 2013, and terminates on September 30, 2013. In February 2013, the Company entered into a commodity forward contract to purchase \$2,677 of copper. The contract was effective from March 1, 2013, and terminates on December 31, 2013. In

March 2013, the Company entered into a commodity forward contract to purchase \$2,636 of copper. The contract was effective from March 1, 2013, and terminates on December 31, 2013.

Total gains or losses recognized in the consolidated statement of comprehensive income on commodity contracts was a loss of \$292 for the three months ended March 31, 2013 and a gain of \$420 for the three months ended March 31, 2012.

#### Foreign Currencies

The Company is exposed to foreign currency exchange risk as a result of transactions denominated in other currencies. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with foreign currency purchases in the normal course of business. Contracts typically have maturities of 12 months or less. There were no foreign currency hedge contracts outstanding as of March 31, 2013 or 2012.

Table of Contents

## 2. Derivative Instruments and Hedging Activities (continued)

## Interest Rates

The Company has two interest rate swap agreements outstanding as of March 31, 2013. Both interest rate swap agreements were entered into on April 1, 2011. The effective date of the first swap is July 1, 2012 with a notional amount of \$200,000, a fixed LIBOR rate of 1.905% and an expiration date of July 1, 2013. The effective date of the second swap is October 1, 2012 with a notional amount of \$100,000, a fixed LIBOR rate of 2.22% and an expiration date of October 1, 2013.

Prior to February 9, 2012, the Company entered into various interest rate swap agreements. The Company had formally documented all relationships between interest rate hedging instruments and hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions, in order for such agreements to qualify as cash flow hedges. For derivatives that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative's change in fair value is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the derivatives' change in fair value, if any, is immediately recognized in earnings. The Company assessed on an ongoing basis whether derivatives used in hedging transactions were highly effective in offsetting changes in cash flows of hedged items. The impact of hedge ineffectiveness on earnings was not material for the periods prior to February 9, 2012.

As discussed in Note 7—Credit Agreements, on February 9, 2012, a subsidiary of the Company entered into a new credit agreement (“Credit Agreement”) with certain commercial banks and other lenders. The Credit Agreement provided for a \$150,000 revolving credit facility, a \$325,000 tranche A term loan facility and a \$250,000 tranche B term loan facility. Proceeds received by the Company from loans made under the Credit Agreement were used to repay in full all outstanding borrowings under the Company's former credit agreement, dated November 10, 2006, as amended from time to time. The future cash flows associated with the Credit Agreement were materially consistent with that of the former credit agreement, resulting in the continued designation of the interest rate swap agreements as cash flow hedges. However, as a result of a change in certain critical terms between the Credit Agreement and former credit agreement, the interest rate swap agreements in place on the date of refinancing were required to be measured for hedge effectiveness. The ineffective portion of the change in fair value of the cash flow hedges was not material for the period from February 9, 2012 to May 30, 2012.

As discussed in Note 7—Credit Agreements, on May 30, 2012, a subsidiary of the Company amended and restated its existing Credit Agreement by entering into a new credit agreement (“Term Loan Credit Agreement”) with certain commercial banks and other lenders. Proceeds received by the Company from loans made under the Term Loan Credit Agreement were used to repay the Company's previous Credit Agreement. Due to the incorporation of a new interest rate floor provision in the Term Loan Credit Agreement, which constitutes a change in critical terms, the Company concluded as of May 30, 2012, the outstanding swaps would no longer be highly effective in achieving offsetting changes in cash flows during the periods the hedges are designated. As a result, the Company was required to de-designate the hedges outstanding as of May 30, 2012. Beginning May 31 2012, the effective portion of the swaps prior to the change (i.e. amounts previously recorded in Accumulated Other Comprehensive Loss) have been and will continue to be amortized as interest expense over the period of the originally designated hedged transactions which have various expiration dates through October of 2013. Future changes in fair value of the swaps have been and will continue to be immediately recognized in the condensed consolidated statements of comprehensive income as interest expense.

The following table presents the fair value of the Company's derivatives not designated as hedging instruments:

	March 31, 2013	December 31, 2012
Commodity contracts	\$(226 )	\$ 111
Interest rate swaps	(1,766 )	(2,973 )
Net derivatives liability	\$(1,992 )	\$ (2,862 )

6

---

Table of Contents

## 2. Derivative Instruments and Hedging Activities (continued)

The fair value of derivatives not designated as hedging instruments included in other current liabilities is \$1,992 as of March 31, 2013. The fair value of derivatives not designated as hedging instruments included in other current liabilities and other assets was \$2,973 and \$111 respectively, as of December 31, 2012.

The fair value of the derivative contracts considers the Company's credit risk. Excluding the impact of credit risk, the fair value of the derivative contracts as of March 31, 2013 and December 31, 2012 is a net liability of \$2,036 and \$2,936, respectively, which represents the amount the Company would need to pay to exit the agreements on those dates.

The following presents the impact of interest rate swaps and commodity contracts on the condensed consolidated statements of comprehensive income for the three months ended March 31, 2013 and 2012:

	Amount of loss recognized in Accumulated Other Comprehensive Loss for the three months ended		Location of gain (loss) recognized in net income on ineffective portion of hedges	Amount of loss reclassified from Accumulated Other Comprehensive Loss into net income for the three months ended		Amount of gain (loss) recognized in net income (loss) on hedges (ineffective portion) for the three months ended	
	March 31, 2013	March 31, 2012		March 31, 2013	March 31, 2012	March 31, 2013	March 31, 2012
Derivatives designated as hedging instruments							
Interest rate swaps (1)	\$ —	\$ (69 )	Interest expense	\$ —	\$ —	\$ —	\$ —
Derivatives not designated as hedging instruments							
Interest rate swaps (2)	\$ —	\$ —	Interest expense	\$ (1002 )	\$ —	\$ 1,206	\$ —
Commodity contracts	\$ —	\$ —	Cost of goods sold	\$ —	\$ —	\$ (292 )	\$ 420

(1) Periods prior to May 30, 2012

(2) Period subsequent to May 30, 2012

Table of Contents

## 3. Fair Value Measurements

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

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

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and short-term borrowings), excluding long-term borrowings, approximates the fair value of these instruments based upon their short-term nature. The fair value of long-term borrowings was approximately \$822,700 (Level 2) at March 31, 2013, as calculated based on independent valuations whose inputs and significant value drivers are observable.

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

	Total	Fair Value Measurement Using	
		Quoted Prices in Active Markets for Identical Contracts (Level 1)	Significant Other Observable Inputs (Level 2)
	Total		
	March 31, 2013		
Interest rate swaps	\$ (1,766 )	\$ -	\$ (1,766 )
Commodity contracts	\$ (226 )	\$ -	\$ (226 )
	Total	Fair Value Measurement Using	
		Quoted Prices in Active Markets for Identical Contracts (Level 1)	Significant Other Observable Inputs (Level 2)
	Total		
	December 31, 2012		
Interest rate swaps	\$ (2,973 )	\$ -	\$ (2,973 )
Commodity contracts	\$ 111	\$ -	\$ 111

The valuation techniques used to measure the fair value of derivative contracts classified as level 2, all of which have counterparties with high credit ratings, were valued 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.

#### 4. Segment Reporting

The Company operates in and reports as a single operating segment, which is the design and manufacture of a wide range of power products. Net sales are predominantly generated through the sale of generators and other engine powered products through various distribution channels. The Company manages and evaluates its operations as one segment primarily due to similarities in the nature of the products, production processes and methods of distribution. The Company's sales in the United States represent approximately 91% and 94% of total sales for the three months ended March 31, 2013 and 2012, respectively. Approximately 98% of the Company's identifiable long-lived assets are located in the United States as of March 31, 2013 and December 31, 2012, respectively.

Table of Contents

## 4. Segment Reporting (continued)

The Company's product offerings consist primarily of power products with a range of power output geared for varying end customer uses. Residential power products and commercial & industrial power products are each a similar class of products based on similar power output and end customer usage. The breakout of net sales between residential, commercial & industrial, and other products is as follows:

	Three Months Ended March 31,	
	2013	2012
Residential power products	\$255,244	\$175,077
Commercial & industrial power products	127,080	105,013
Other	17,248	14,471
Total	\$399,572	\$294,561

## 5. Balance Sheet Details

Inventories consist of the following:

	March 31,	December
	2013	31, 2012
Raw materials	\$186,551	\$168,459
Work-in-process	10,274	8,580
Finished goods	68,402	55,777
Reserves for excess and obsolescence	(6,406 )	(6,999 )
Total	\$258,821	\$225,817

Property and equipment consists of the following:

	March 31,	December
	2013	31, 2012
Land and improvements	\$6,559	\$6,511
Buildings and improvements	69,317	68,934
Machinery and equipment	45,751	42,581
Dies and tools	16,016	15,406
Vehicles	1,889	1,872
Office equipment	13,431	12,993
Leasehold improvements	1,406	1,393
Construction in progress	3,016	3,439
Gross property and equipment	157,385	153,129
Accumulated depreciation	(50,911 )	(48,411 )
Total	\$106,474	\$104,718

Table of Contents

## 5. Balance Sheet Details (continued)

Other accrued liabilities consist of the following:

	March 31, 2013	December 31, 2012
Accrued commissions	\$8,620	\$7,467
Accrued interest	14,060	15,809
Product warranty obligations – short term	33,242	28,752
Accrued dividends for unvested restricted stock	1,222	3,957
Accrued volume rebates	5,299	7,991
Accrued customer prepayments	3,098	6,569
Other accrued selling expenses	8,636	7,753
Other accrued liabilities	8,211	7,783
<b>Total</b>	<b>\$82,388</b>	<b>\$86,081</b>

Other long-term liabilities consist of the following:

	March 31, 2013	December 31, 2012
Accrued pension costs	\$23,338	\$23,174
Product warranty obligations – long term	22,007	20,833
Other long-term liabilities	1,954	2,335
<b>Total</b>	<b>\$47,299</b>	<b>\$46,342</b>

## 6. Product Warranty Obligations

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

Table of Contents

## 6. Product Warranty Obligations (continued)

Changes in product warranty obligations are as follows:

	For the three months ended March 31,	
	2013	2012
Balance at beginning of period	\$49,585	\$34,380
Payments, net of extended warranty receipts	(3,556 )	(4,452 )
Charged to operations	9,220	9,151
Balance at end of period	\$55,249	\$39,079

The product warranty obligations are included in the condensed consolidated balance sheets as follows:

	March 31, 2013	December 31, 2012
Other accrued liabilities	\$33,242	\$28,752
Other long-term liabilities	22,007	20,833
Balance at end of period	\$55,249	\$49,585

## 7. Credit Agreements

The revolving credit facilities and credit agreements discussed below were outstanding for all periods presented. The Company refinanced this debt on February 9, 2012 and amended and restated its credit agreements on May 30, 2012.

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

	March 31, 2013	December 31, 2012
ABL facility	\$-	\$-
Other lines of credit, as described below	12,532	12,550
	\$12,532	\$12,550

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

	March 31, 2013	December 31, 2012
Term loan	\$ 815,500	\$ 897,750
Discount on debt	(14,798 )	(16,482 )
Total	800,702	881,268
Less current portion of debt	30,000	82,250
	\$ 770,702	\$ 799,018

Table of Contents

7. Credit Agreements (continued)

On February 9, 2012, a subsidiary of the Company (the “Borrower” or “Generac Power Systems”) entered into a new credit agreement (“Credit Agreement”) with certain commercial banks and other lenders. The Credit Agreement provided for borrowings under a \$150,000 revolving credit facility, a \$325,000 tranche A term loan facility and a \$250,000 tranche B term loan facility. The revolving credit facility and tranche A term loan facility were scheduled to mature in February 2017 and the tranche B term loan facility was scheduled to mature in February 2019. Proceeds received by the Company from loans made under the Credit Agreement were used to repay in full all outstanding borrowings under the former credit agreement, dated as of November 10, 2006, as amended from time to time, and for general corporate purposes. The Company’s former credit agreement was comprised of a revolving credit facility and a first-lien term loan which were scheduled to mature in November 2012 and November 2013, respectively.

On May 30, 2012, the Borrower amended and restated its then existing Credit Agreement by entering into a new credit agreement (“Term Loan Credit Agreement”) with certain commercial banks and other lenders. The Term Loan Credit Agreement provides for a \$900,000 term loan B credit facility (“Term Loan”) and a \$125,000 uncommitted incremental term loan facility. The Term Loan Credit Agreement matures on May 30, 2018. Proceeds from the Term Loan were used to repay the Company’s previous Credit Agreement. The remaining proceeds from the Term Loan were used, along with cash on hand, to pay a special cash dividend of \$6.00 per share on the Company’s common stock.

The Term Loan is guaranteed by all of the Borrower’s wholly-owned domestic restricted subsidiaries and the Parent, and is secured by associated collateral agreements which pledge a first priority lien on virtually all of the Borrower’s assets, including fixed assets and intangibles, and the assets of the guarantors (other than the Company), 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 amortizes in equal installments of 0.25% of the original principal amount of the Term Loan payable on the first day of April, July, October and January commencing on October 1, 2012 until the maturity date of the Term Loan. On February 11, 2013, the Company made an \$80,000 voluntary prepayment of debt with available cash on hand that was applied to both the required excess cash flow payment and all required future principal amortizations. The final principal repayment installment of the Term Loan is required to be repaid on the maturity date in an amount equal to the aggregate principal amount of the Term Loan outstanding on such date. The Term Loan initially bears interest at rates based upon either a base rate plus an applicable margin of 4.00% or adjusted LIBOR rate plus an applicable margin of 5.00%, subject to a LIBOR floor of 1.25%.

The Term Loan Credit Agreement restricts the circumstances in which the Borrower can pay distributions and dividends, which are in addition to those to be paid in connection with the Transactions (as defined in the Term Loan Credit Agreement). Payments can be made by the Borrower to the Company or other parent companies for certain expenses such as operating expenses in the ordinary course, fees and expenses related to any debt or equity offering and to pay franchise or similar taxes. Dividends can be used to repurchase equity interests, subject to limitations in certain circumstances. Additionally, the Term Loan Credit Agreement restricts the aggregate amount of dividends and distributions that can be paid and, in certain circumstances, requires Pro Forma (as defined in the Term Loan Credit Agreement) compliance with certain fixed charge coverage ratios in order to pay certain dividends or distributions. The Term Loan Credit Agreement also contains certain other affirmative and negative covenants that, among other things, provide limitations on the incurrence of additional indebtedness, liens on property, sale and leaseback transactions, investments, loans and advances, mergers or consolidations, asset sales, acquisitions, transactions with affiliates, prepayments of certain other indebtedness and modifications of the Company’s organizational documents. The Term Loan Credit Agreement does not contain any financial maintenance covenants.

The Term Loan Credit Agreement contains customary events of default, including, among others, nonpayment of principal, interest or other amounts, failure to perform covenants, inaccuracy of representations or warranties in any material respect, cross-defaults with other material indebtedness, certain undischarged judgments, the occurrence of certain ERISA or bankruptcy or insolvency events or the occurrence of a change in control (as defined in the Term Loan Credit Agreement). A bankruptcy or insolvency event of default causes such obligations to automatically become immediately due and payable.

Concurrent with the closing of the Term Loan Credit Agreement, on May 30, 2012, the Borrower also entered into a new revolving credit agreement (the "ABL Credit Agreement") with certain commercial banks and other lenders. The ABL Credit Agreement provides for borrowings under a \$150,000 senior secured ABL revolving credit facility (the "ABL Facility"). The size of the ABL Facility could increase by \$50,000 pursuant to an uncommitted incremental credit facility. The ABL Credit Agreement matures May 30, 2017.

Borrowings under the ABL Facility are guaranteed by all of the Borrower's wholly-owned domestic restricted subsidiaries and the Parent, 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 Borrower, certain domestic subsidiaries of the Borrower and the guarantors (other than the Company).

Borrowings under the ABL Facility bear interest at rates based upon either a base rate plus an applicable margin of 1.00% or adjusted LIBOR rate plus an applicable margin of 2.00%, in each case, subject to adjustments based upon average availability under the ABL Facility. The ABL Credit Agreement requires the Borrower to maintain a minimum consolidated fixed charge coverage ratio of 1.0x, tested on a quarterly basis, when Availability plus the amount of Qualified Cash (up to \$5,000) (as defined in the ABL Credit Agreement) under the ABL Facility is less than the greater of (i) 10.0% of the lesser of the aggregate commitments and the applicable borrowing base under the ABL Facility or (ii) \$10,000. The ABL Credit Agreement also contains covenants and events of default substantially similar to those in the Term Loan Credit Agreement, as described above. There were no borrowings outstanding under the ABL Facility as of March 31, 2013 or December 31, 2012. At March 31, 2013, we had cash and cash equivalents of \$54,337 and \$147,219 of availability under our ABL Facility, net of outstanding letters of credit.

Table of Contents

## 7. Credit Agreements (continued)

On February 11, 2013, the Company made an \$80,000 voluntary prepayment of debt with available cash on hand that was applied to future principal amortizations. As a result, the Company wrote off \$1,839 of original issue discount and capitalized debt issuance costs. The Company amortizes remaining capitalized debt issuance costs and the original issue discount under the effective interest method.

As of March 31, 2013 and December 31, 2012, short-term borrowings primarily consisted of borrowings by our foreign subsidiaries on local lines of credit, which totaled 12,532 and 12,550, respectively.

## 8. Earnings Per Share

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

	Three months ended March 31,	
	2013	2012
Numerator- net income	\$50,674	\$30,060
Denominator- weighted average shares		
Basic	67,864,475	67,200,480
Dilutive effect of stock compensation awards (1)	1,690,466	1,437,447
Diluted	69,554,941	68,637,927
Net income per share		
Basic	\$0.75	\$0.45
Diluted	\$0.73	\$0.44

(1) Excludes approximately 250,000 stock options and 60,000 shares of restricted stock for 2013 as the impact of such awards was anti-dilutive. Excludes approximately 350,000 stock options and 190,000 shares of restricted stock for 2012 as the impact of such awards was anti-dilutive.

## 9. Income Taxes

The effective income tax rates for the quarters ended March 31, 2013 and 2012 were 36.2% and 38.8%, respectively. The decrease in the effective income tax rate year-over-year is primarily due to the lower tax rate of a foreign subsidiary acquired during the fourth quarter of 2012 and the reinstatement of the federal research and development tax credit.

## 10. Benefit Plans

The Company has noncontributory salaried and hourly pension plans (collectively, "Pension Plans") covering substantially all of its employees. These plans were frozen to new participants effective December 31, 2008. Information related to the Pension Plans is as follows:

Three months ended  
March 31,

Components of net periodic pension expense:	2013	2012
Interest cost	\$606	\$613
Expected return on plan assets	(630 )	(599 )
Amortization of net loss	277	227
Net periodic pension expense	\$253	\$241



Table of Contents

11. Share Plans

During the first quarter ended March 31, 2013, approximately 442,000 restricted stock awards vested. As permitted by the Company's equity incentive plan, these restricted stock awards were net-share settled such that the Company withheld shares with a value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes. In effect, the Company repurchased, and classified as treasury stock, 162,819 of the issued shares at fair value (total cost of \$6,543), and used the cash on behalf of the employee to satisfy the tax withholding requirements. This tax amount, together with an additional \$3,874 of taxes paid related to the net share settlement of stock option exercises during the first quarter of 2013, is reflected as a cash outflow in the financing section of the condensed consolidated statement of cash flows.

Excess tax benefits of \$7,694 were recorded during the first quarter of 2013 as a result of the stock activity discussed above. This amount is reflected as a cash inflow in the financing section of the condensed consolidated statement of cash flows.

12. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for selected dealers and 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 March 31, 2013 and December 31, 2012 was approximately \$21,642 and \$16,600 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.

13. Subsequent Events

On May 2 2013, the Company prepaid \$30,000 of principal on its existing Term Loan with available cash on hand.

Table of Contents

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" 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 and objectives and other similar expressions concerning matters that are not historical facts.

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

- demand for our products;
  - frequency and duration of major power outages;
- availability, cost and quality of raw materials and key components used in producing our products;
- the impact on our results of the substantial increases in our outstanding indebtedness and related interest expense due to the dividend recapitalization transaction completed in May 2012 and the proposed dividend recapitalization transaction discussed below under "Liquidity and financial condition – Proposed dividend recapitalization";
- the possibility that the expected synergies, efficiencies and cost savings of the acquisition of the Ottomotores businesses or other acquisitions will not be realized, or will not be realized within the expected time period;
- the risk that the Ottomotores businesses or other acquisitions that we make will not be integrated successfully;
  - competitive factors in the industry in which we operate;
  - our dependence on our distribution network;
- our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;

- loss of our key management and employees;
- increase in product and other liability claims; and
- changes in environmental, health and safety laws and regulations.

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in 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 fiscal year ended December 31, 2012.

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

## Table of Contents

### Overview

We are a leading designer and manufacturer of a wide range of generators and other engine powered products for the residential, light commercial, industrial and construction markets. 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. We design, manufacture, source and modify engines, alternators, transfer switches and other components necessary for our products. Our products are fueled by natural gas, liquid propane, gasoline, diesel and Bi-Fuel™ and are available through a broad network of independent dealers, retailers, wholesalers, and equipment rental companies.

### Business drivers and measures

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

### Industry trends

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

**Increasing penetration opportunity.** Many potential customers are not aware of the costs and benefits of automatic backup power solutions. We estimate that penetration rates for residential products are under 3% 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 2009 American Housing Survey for the United States, and penetration rates of many light-commercial outlets such as restaurants, drug stores, and gas stations are significantly lower than penetration of hospitals and industrial locations. We believe that by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby generators.

**Impact of residential investment cycle.** The market for residential generators is affected by the residential investment cycle and overall consumer sentiment. When homeowners are confident of their household income or net worth, they are more likely to invest in their home. These trends can have a material impact on demand for residential generators. Trends in the new housing market can also impact demand for our residential products.

**Effect of large scale power disruptions.** Power disruptions are an important driver of consumer awareness and have historically influenced demand for generators. Increased frequency and duration of major power outage events caused by the aging U.S. power grid 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 for standby generators. For example, multiple major outage events that occurred during 2012 drove strong demand for portable and home standby generators and the increased awareness of these products contributed to substantial revenue growth for us in the first quarter of 2013. While there are power outages every year across all regions of the country, major outage activity is unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period.

**Impact of business capital investment cycle.** The market for commercial and industrial stationary and mobile generators and other power equipment is affected by the capital investment cycle and overall non-residential construction and durable goods spending, as businesses 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 industrial and commercial end markets that we serve (industrial, telecommunications, distribution, retail, health care facilities, construction, energy and municipal infrastructure,

among others). The market for these products is also affected by general economic conditions and credit availability in the geographic regions that we serve.

#### Operational factors

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

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

**Effect of commodity, 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, together with foreign currency fluctuations, can have a material impact on our results of operations. We have historically attempted to mitigate the impact of rising commodity, currency and component prices 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 borne by our customers and in other cases are paid by us.

Table of Contents

Other factors

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

**Factors influencing 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 and repayments of indebtedness. Interest expense increased in the first quarter of 2013 versus the first quarter of 2012 as a result of an increase in outstanding debt and the weighted-average cost of debt associated with the Term Loan Credit Agreement. We refer you to Note 7, "Credit Agreements," of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional details. The increase in outstanding debt that will occur if we complete the proposed dividend recapitalization discussed under "Liquidity and financial condition – Proposed dividend recapitalization" may increase our interest expense from recent historical levels depending on market conditions.

**Factors influencing provision for income taxes and cash taxes paid.** We had \$1.1 billion of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2012 related to our acquisition by CCMP in 2006 that we expect to generate cash tax savings of \$422 million through 2021, assuming continued profitability and a 39% tax rate. The recognition of the tax benefit associated with 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 \$48 million through 2020 and \$40 million in 2021, assuming profitability and a 39% tax rate. Additionally, we had federal net operating loss, or NOL, carry-forwards of approximately \$54.1 million as of December 31, 2012, which we expect to generate an additional \$18.9 million of federal cash tax savings at a 35% federal rate when utilized. Based on current business plans, we believe that our cash tax obligations through 2021 will be significantly reduced by these tax attributes. However, any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carry-forwards to offset future federal income tax liabilities. Similarly, the increase in outstanding debt and related interest expense that may occur if we complete the proposed dividend recapitalization discussed under "Liquidity and financial condition – Proposed dividend recapitalization" may have an impact on our ability to fully utilize these tax attributes if we are unable to generate sufficient taxable income. We believe any limitations would not be material.

In addition, as a result of the asset acquisition of the Magnum Products business in the fourth quarter of 2011, we had approximately \$52.0 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2012. We expect these assets to generate cash tax savings of \$20.3 million through 2026 assuming continued profitability and a 39% tax rate. 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 \$1.5 million through 2025 and \$1.1 million in 2026, assuming profitability and a 39% tax rate.

**Seasonality.** Although there is demand for our products throughout the year, in each of the past three years approximately 16% to 25% of our net sales occurred in the first quarter, 20% to 24% in the second quarter, 26% to 30% in the third quarter and 27% to 34% in the fourth quarter, with different seasonality depending on the timing of major power outage activity in each year, such as the outage activity experienced in the third and fourth quarters of both 2011 and 2012. Due to the significant demand and awareness created by the outage events in the second half of 2012, our historical seasonality patterns may not apply in 2013.

We maintain a flexible production and supply chain schedule in order to respond to outage-driven peak demand, but typically increase production levels in the second and third quarters of each year.



Table of Contents

## Results of operations

Three months ended March 31, 2013 compared to three months ended March 31, 2012

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

(Dollars in thousands)	Three months ended March 31,	
	2013	2012
Net sales	\$399,572	\$294,561
Cost of goods sold	246,110	183,556
Gross profit	153,462	111,005
Operating expenses:		
Selling and service	31,681	25,126
Research and development	6,645	5,055
General and administrative	12,426	9,106
Amortization of intangibles	6,185	12,225
Total operating expenses	56,937	51,512
Income from operations	96,525	59,493
Total other expense, net	(17,101 )	(10,389 )
Income before provision for income taxes	79,424	49,104
Provision for income taxes	28,750	19,044
Net income	\$50,674	\$30,060
Residential power products	\$255,244	\$175,077
Commercial & industrial power products	127,080	105,013
Other	17,248	14,471
Net sales	\$399,572	\$294,561

**Net sales.** Net sales increased \$105.0 million, or 35.7%, to \$399.6 million for the three months ended March 31, 2013 from \$294.6 million for the three months ended March 31, 2012. Residential product sales increased \$80.2 million, or 45.8%, primarily due to increased demand for home standby and portable generators from the combination of the significant awareness and demand created by major power outages in recent years, expanded distribution, increased sales and marketing efforts and overall strong operational execution. Additionally, increased revenue from power washer products also contributed to the year-over-year sales growth primarily due to increased shelf space for the 2013 selling season. Commercial & industrial product sales increased \$22.1 million, or 21.0%, primarily due to the Ottomotores acquisition. Strong shipments to national account customers as well as increased sales of natural gas generators used in light commercial/retail applications also contributed to year-over-year organic growth.

**Gross profit.** Gross profit increased \$42.5 million, or 38.2%, to \$153.5 million for the three months ended March 31, 2013 from \$111.0 million for the three months ended March 31, 2012. As a percent of net sales, gross profit margin for the first quarter of 2013 increased to 38.4% from 37.7% in the same period last year, due to the combination of cost-reduction initiatives, improved pricing and a moderation in commodity costs. These margin improvements were partially offset by the mix impact from the addition of Ottomotores sales.

**Operating expenses.** Operating expenses increased \$5.4 million, or 10.5%, to \$56.9 million for the three months ended March 31, 2013 from \$51.5 million for the three months ended March 31, 2012. These additional expenses were driven primarily by operating expenses associated with the Ottomotores acquisition, and increased sales,



engineering and administrative infrastructure to support the strategic growth initiatives and higher baseline sales levels of the Company. This increase was partially offset by a decline in the amortization of intangibles.

Other expense. Other expenses increased \$6.7 million, or 64.6%, to \$17.1 million for the three months ended March 31, 2013 from \$10.4 million for the three months ended March 31, 2012, primarily due to a \$10.0 million increase in interest expense partially offset by a \$2.5 million decrease in the loss on extinguishment of debt. The increase in interest expense in the first quarter of 2013 was a result of the higher debt levels from the refinancing of the Company's senior secured credit facilities in May 2012.

Table of Contents

Provision for income taxes. Income tax expense increased \$9.7 million, or 51.0%, to \$28.8 million for the three months ended March 31, 2013 from \$19.0 million for the three months ended March 31, 2012. This increase was primarily driven by the increase in income in the first quarter of 2013 compared to the first quarter of 2012, partially offset by a lower effective tax rate.

Net income. As a result of the factors identified above, we generated net income of \$50.7 million for the three months ended March 31, 2013 compared to \$30.1 million for the three months ended March 31, 2012.

Adjusted EBITDA. Adjusted EBITDA, as defined in the accompanying reconciliation schedules, increased \$33.0 million, or 43.5%, to \$108.8 million for the three months ended March 31, 2013 from \$75.8 million for the three months ended March 31, 2012.

Adjusted Net income. Adjusted net income, as defined in the accompanying reconciliation schedules, of \$83.9 million for the three months ended March 31, 2013 increased 26.9% from \$66.1 million for the three months ended March 31, 2012.

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

Liquidity and financial condition

Our primary cash requirements include payment for our raw material and component supplies, salaries & benefits, 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 revolving credit facility.

On February 9, 2012, Generac Power Systems repaid an additional \$22.9 million under its first lien term loan and entered into a new agreement. The new credit agreement provided for borrowings under a five-year \$150.0 million revolving credit facility, a five-year \$325.0 million tranche A term loan facility and a seven-year \$250.0 million tranche B term loan facility. Proceeds received by the Company from loans made under this new credit agreement were used to repay in full all outstanding borrowings under the former credit agreement, dated November 10, 2006, as amended from time to time, and for general corporate purposes.

On May 30, 2012, Generac Power Systems amended and restated its then existing Credit Agreement by entering into the Term Loan Credit Agreement and the ABL Credit Agreement. The Term Loan Credit Agreement provides for a \$900.0 million Term Loan and a \$125.0 million uncommitted incremental term loan facility and the ABL Credit Agreement provides for borrowings under a \$150.0 million unfunded ABL Facility. Proceeds from the Term Loan were used to repay the Company’s previous credit agreement and related financing fees. The remaining proceeds from the Term Loan were used, along with available cash on hand, to pay a special cash dividend of \$6.00 per share on the Company’s common stock. As a result of repayments of debt and the refinancing transactions discussed above, our indebtedness, net of unamortized original issue discount, was \$800.7 million and \$881.3 million at March 31, 2013 and December 31, 2012, respectively.

For more information regarding the Term Loan Credit Agreement and the ABL Credit Agreement and their potential impact, we refer you to Note 7, “Credit Agreements,” of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

At March 31, 2013, we had cash and cash equivalents of \$54.3 million and \$147.2 million of availability under our revolving credit facility, net of outstanding letters of credit.

Long-term liquidity

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

Table of Contents

## Proposed dividend recapitalization

On May 2, 2013, the Company announced its plan to execute a recapitalization in which it intends to incur, subject to market and other conditions, approximately \$335 million of additional debt to fund a special cash dividend of up to \$5 per share on its outstanding common stock. As part of this transaction, the Company expects to enter into new debt financing in the aggregate amount of approximately \$1.15 billion, which is expected to be comprised entirely of senior secured term loan credit facilities, the proceeds of which will be used to pay the special cash dividend and refinance the Company's existing senior secured term loan credit facilities. The new debt financing would also include a \$150 million asset-based revolving credit facility, which is expected to be undrawn at the closing of the financing. The declaration of the special cash dividend will not occur unless new debt financing is obtained under acceptable terms. The Company expects its Board of Directors to declare and the Company to pay the special cash dividend before the end of the second quarter of 2013.

Three months ended March 31, 2013 compared to three months ended March 31, 2012

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

(Dollars in thousands)	Three months ended		\$ Change	% Change
	2013	2012		
Net cash provided by operating activities	\$38,266	\$38,584	\$(318)	(0.8)%
Net cash used in investing activities	\$(4,322)	\$(4,417)	\$95	(2.2)%
Net cash used in financing activities	\$(87,640)	\$(35,563)	\$(52,077)	146.4%

Net cash provided by operating activities was \$38.3 million for the three months ended March 31, 2013 compared to \$38.6 million for the three months ended March 31, 2012. This year-over-year decrease was primarily driven by increased working capital investments partially offset by strong operating earnings.

Net cash used in investing activities was \$4.3 million for the three months ended March 31, 2013, which related to the purchase of property and equipment. Net cash used in investing activities was \$4.4 million for the three months ended March 31, 2012, which related to the purchase of property and equipment and acquisition activity.

Net cash used in financing activities was \$87.6 million for the three months ended March 31, 2013, primarily representing \$82.3 million of debt repayments and \$2.6 million cash dividend payments. In addition, the Company paid \$10.4 million related to the net share settlement of equity awards which was partially offset by approximately \$7.7 million of cash inflow related to excess tax benefits of equity awards. Net cash used in financing activities was \$35.6 million for the three months ended March 31, 2012, primarily representing \$573.6 million in cash proceeds from long-term borrowings offset by \$597.9 million of debt repayments. In addition, the Company made \$10.8 million of cash payments for transaction fees incurred in connection with the February 2012 debt refinancing.

## Contractual Obligations

There have been no material changes to our contractual obligations since the March 13, 2013 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

## Off-balance sheet arrangements

There have been no material changes with regards to off-balance sheet arrangements since the March 13, 2013 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Critical accounting policies

There have been no material changes in our critical accounting policies since the March 13, 2013 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

As discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, in preparing the financial statements in accordance with accounting principles generally accepted in the U.S., we are required to make estimates and assumptions that have an impact on the asset, liability, revenue and expense amounts reported. These estimates can also affect our supplemental information disclosures, including information about contingencies, risk and financial condition. We believe, given current facts and circumstances, that our estimates and assumptions are reasonable, adhere to accounting principles generally accepted in the U.S., and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. We make routine estimates and judgments in determining net realizable value of accounts receivable, inventories, property, plant and equipment, and prepaid expenses. We believe that our most critical accounting estimates and assumptions are in the following areas: goodwill and other indefinite-lived intangible asset impairment assessment, defined benefit pension obligations, estimates of allowance for doubtful accounts, excess and obsolete inventory reserves, product warranty, other contingencies, derivative accounting, income taxes, and share based compensation.

Table of Contents

Non-GAAP measures

Adjusted EBITDA

Adjusted EBITDA represents net income before interest expense, taxes, depreciation and amortization, as further adjusted for the other items reflected in the reconciliation table set forth below. This presentation is substantially consistent with the presentation used in our Term Loan Credit Agreement and ABL Credit Agreement. Note that the definitions of EBITDA in the new Term Loan Credit Agreement and ABL Credit Agreement are substantially the same as the definitions of EBITDA in previous credit agreements.

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 Term Loan Credit Agreement and ABL Credit Agreement but also because it assists us in comparing our performance across reporting periods on a consistent basis because it excludes items that we do not believe are indicative of our core operating performance. Our management uses Adjusted EBITDA:

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
  - to allocate resources to enhance the financial performance of our business;
- as a benchmark for the determination of the bonus component of compensation for our senior executives under our management incentive plan, as described further in our 2013 Proxy Statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
  - in communications with our board of directors and investors concerning our financial performance.

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

- Adjusted EBITDA and similar non-GAAP measures are widely used by investors to measure a company's operating performance without regard to items that can vary substantially from company to company depending upon financing and accounting methods, book values of assets, tax jurisdictions, capital structures and the methods by which assets were acquired;
- investors can use Adjusted EBITDA as a supplemental measure to evaluate the overall operating performance of our company, including our ability to service our debt and other cash needs; and
- by comparing our Adjusted EBITDA in different historical periods, our investors can evaluate our operating performance excluding the impact of items described below.

The adjustments included in the reconciliation table listed below are provided for under our Term Loan Credit Agreement and ABL Credit Agreement and also are presented to illustrate the operating performance of our business in a manner consistent with the presentation used by our management and board of directors. These adjustments eliminate the impact of a number of items that:

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

Table of Contents

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

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

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
  - Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- several of the adjustments that we use in calculating Adjusted EBITDA, such as non-cash impairment charges, while not involving cash expense, do have a negative impact on the value of our assets as reflected in our consolidated balance sheet prepared in accordance with U.S. GAAP; and
- other companies may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Furthermore, as noted above, one of our uses of Adjusted EBITDA is as a benchmark for determining elements of compensation for our senior executives. At the same time, some or all of these senior executives have responsibility for monitoring our financial results generally, including the items that are included as adjustments in calculating Adjusted EBITDA (subject ultimately to review by our board of directors in the context of the board's review of our quarterly financial statements). While many of the adjustments (for example, transaction costs and credit facility fees), 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 Credit Agreement and ABL Credit Agreement, 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.

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

(Dollars in thousands)	Three months ended	
	March 31,	
	2013	2012
Net income	\$50,674	\$30,060



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

Interest expense	15,675	5,674
Depreciation and amortization	8,750	14,218
Income taxes provision	28,750	19,044
Non-cash write-down and other charges (a)	(423 )	(204 )
Non-cash share-based compensation expense (b)	2,931	2,439
Loss on extinguishment of debt	1,839	4,309
Transaction costs and credit facility fees (c)	314	135
Other	291	127
Adjusted EBITDA	\$108,801	\$75,802

Table of Contents

(a) Represents the following non-cash charges:

- for the three months ended March 31, 2013, unrealized mark-to-market adjustments on copper forward contracts, loss on disposal of assets and an adjustment to an earn-out obligation in connection with a permitted business acquisition, as defined in our credit agreement;
- for the three months ended March 31, 2012, unrealized mark-to-market adjustments on copper forward contracts, loss on disposal of assets, and a non-cash inventory write-off;

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

- The losses on disposals of assets described above result from the sale of assets that are no longer useful in our business and therefore represent losses that are not from our core operations;
- The adjustments for unrealized mark-to-market gains and losses on copper forward 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 income and cash flows to capture the full effect of these contracts on our operating performance;

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

(c) 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 revolving credit facility commitment fees under our senior secured credit facilities, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation;
- transaction costs relating to the acquisition of a business;

Adjusted net income

Adjusted net income is defined as net income before 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 the Company's debt, losses on extinguishment of the Company's debt, intangible asset impairment charges (as applicable), transaction costs and other purchase accounting adjustments, and certain non-cash gains and losses as reflected in the reconciliation table set forth below (as applicable).

We believe Adjusted net income is used by securities analysts, investors and other interested parties in the evaluation of our company 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 results of operations, our cash flows, and the factors and trends affecting our business.

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, 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.

Table of Contents

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;
- other companies may calculate Adjusted net income differently than we do, limiting its usefulness as a comparative measure.

(Dollars in thousands)	Three months ended March	
	2013	2012
Net income	\$50,674	\$30,060
Provision for income taxes	28,750	19,044
Income before provision for income taxes	79,424	49,104
Amortization of intangible assets	6,185	12,225
Amortization of deferred finance costs and original issue discount	1,177	506
Loss on extinguishment of debt	1,839	4,309
Transaction costs and other purchase accounting adjustments (a)	(253 )	-
Adjusted net income before provision for income taxes	88,372	66,144
Cash income tax expense (b)	(4,520 )	(55 )
Adjusted net income	\$83,852	\$66,089
Adjusted net income per common share - diluted:	\$1.21	\$0.96
Weighted average common shares outstanding - diluted:	69,554,941	68,637,927

- (a) Represents transaction costs incurred directly in connection with any investment, as defined in our credit agreement, equity issuance or debt issuance or refinancing. Also includes certain purchase accounting adjustments.
- (b) Amount for the three months ended March 31, 2013 is based on an anticipated cash income tax rate of approximately 6.0%.

## New Accounting Standards

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income”. This guidance is the culmination of the FASB’s deliberation on reporting reclassification adjustments from accumulated other comprehensive income (AOCI). The amendments in ASU 2013-02 do not change the current requirements for reporting net income or other comprehensive income. However, the amendments require disclosure of amounts reclassified out of AOCI in its entirety, by component, on the face of the statement of operations or in the notes thereto. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This standard is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. The Company’s adoption of this standard did not have a material impact on the Company’s financial condition or results of operations.

Except as noted, there have been no material changes since the March 13, 2013 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We refer you to Note 2, "Derivative Instruments and Hedging Activities," of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of changes in commodity, currency and interest rate related risks and hedging activities. In other respects, there have been no material change 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 fiscal year ended December 31, 2012.

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

There have been no changes during the three months ended March 31, 2013 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 and employment matters and general commercial disputes arising in the ordinary course of our business. As of March 31, 2013, 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 March 13, 2013 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, except for the following:

Impact of proposed dividend recapitalization

If we complete our proposed dividend recapitalization discussed in this Quarterly Report on Form 10-Q under "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and financial condition - Proposed dividend recapitalization," our outstanding indebtedness and related interest expense may increase from recent historical levels depending on market conditions. This may affect our future results of operations, and may increase the risk described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 under "Risk Factors - Risks related to our capital structure - We have a significant amount of indebtedness which could adversely affect our cash flow and our ability to remain in compliance with debt covenants and make payments on our indebtedness."

Item 6. Exhibits

See “Exhibit Index” for documents filed herewith and incorporated herein by reference.

25

---

Table of Contents

SIGNATURES

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

Generac Holdings Inc.

By:

/s/ York A. Ragen

York A. Ragen  
Chief Financial Officer  
(Duly Authorized Officer and Principal  
Financial and Accounting Officer)

Dated: May 7, 2013



Table of Contents

Item 6.

## EXHIBIT INDEX

Exhibits  
Number

Description

3.1	Amended and Restated Bylaws of Generac Holdings Inc. (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed with the SEC on April 10, 2013).
10.1+*	Amended Form of Nonqualified Stock Option Award Agreement pursuant to the 2010 Equity Incentive Plan.
10.2+*	Amended Form of Restricted Stock Award Agreement with accelerated vesting pursuant to the 2010 Equity Incentive Plan.
10.3+*	Cash award agreement to non-executive chairman.
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 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, tagged as blocks of text.

\* Filed herewith.

\*\* Furnished herewith.

+ Indicates management contract or compensatory plan or arrangement.

27

