

GENERAC HOLDINGS INC.
Form 10-Q
May 08, 2012

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, 2012

OR

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

For the transition period from to

Commission file number 001-34627

GENERAC HOLDINGS INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-5654756
(IRS Employer
Identification No.)

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

53189
(Zip Code)

(262) 544-4811

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

Large accelerated filer

Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

Yes No

As of May 1, 2012, there were 67,946,135 shares of the Registrant’s common stock outstanding.

GENERAC HOLDINGS INC.
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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, 2012 (Unaudited) | December 31, 2011 (Audited) |
|--|----------------------------------|--------------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$91,730 | \$93,126 |
| Accounts receivable, less allowance for doubtful accounts | 114,027 | 109,705 |
| Inventories | 200,129 | 162,124 |
| Deferred income taxes | 15,778 | 14,395 |
| Prepaid expenses and other assets | 4,260 | 3,915 |
| Total current assets | 425,924 | 383,265 |
| Property and equipment, net | 84,422 | 84,384 |
| Customer lists, net | 63,516 | 72,897 |
| Patents, net | 76,253 | 78,167 |
| Other intangible assets, net | 6,926 | 7,306 |
| Deferred financing costs, net | 10,139 | 3,459 |
| Trade names | 148,751 | 148,401 |
| Goodwill | 547,782 | 547,473 |
| Deferred income taxes | 207,784 | 227,363 |
| Other assets | 220 | 78 |
| Total assets | \$1,571,717 | \$1,552,793 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$91,097 | \$81,053 |
| Accrued wages and employee benefits | 11,700 | 14,439 |
| Other accrued liabilities | 50,381 | 47,024 |
| Current portion of long-term debt | 14,063 | 22,874 |
| Total current liabilities | 167,241 | 165,390 |
| Long-term debt | 559,588 | 575,000 |
| Other long-term liabilities | 44,115 | 43,514 |
| Total liabilities | 770,944 | 783,904 |
| Stockholders' equity: | | |
| Common stock, par value \$0.01, 500,000,000 shares authorized, 67,946,135 and 67,652,812 shares issued at March 31, 2012 and December 31, 2011, respectively | 679 | 676 |

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| | | |
|--|-------------|-------------|
| Additional paid-in capital | 1,144,591 | 1,142,701 |
| Excess purchase price over predecessor basis | (202,116) | (202,116) |
| Accumulated deficit | (126,955) | (157,015) |
| Accumulated other comprehensive loss | (15,426) | (15,357) |
| Total stockholders' equity | 800,773 | 768,889 |
| Total liabilities and stockholders' equity | \$1,571,717 | \$1,552,793 |

See notes to condensed consolidated financial statements.

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

| | Three Months Ended March 31, | |
|---|---------------------------------|------------|
| | 2012 | 2011 |
| Net sales | \$294,561 | \$123,981 |
| Costs of goods sold | 183,556 | 76,804 |
| Gross profit | 111,005 | 47,177 |
| Operating expenses: | | |
| Selling and service | 25,126 | 14,305 |
| Research and development | 5,055 | 3,885 |
| General and administrative | 9,106 | 6,117 |
| Amortization of intangibles | 12,225 | 11,727 |
| Total operating expenses | 51,512 | 36,034 |
| Income from operations | 59,493 | 11,143 |
| Other (expense) income: | | |
| Interest expense | (5,674) | (6,001) |
| Investment income | 19 | 36 |
| Loss on extinguishment of debt | (4,309) | - |
| Other, net | (425) | (241) |
| Total other expense, net | (10,389) | (6,206) |
| Income before provision for income taxes | 49,104 | 4,937 |
| Provision for income taxes | 19,044 | 93 |
| Net income | \$30,060 | \$4,844 |
| Net income per common share - basic: | \$0.45 | \$0.07 |
| Weighted average common shares outstanding - basic: | 67,200,480 | 67,107,560 |
| Net income per common share - diluted: | \$0.44 | \$0.07 |
| Weighted average common shares outstanding - diluted: | 68,637,927 | 67,344,349 |
| Comprehensive income | \$29,991 | \$5,399 |

See notes to condensed consolidated financial statements.

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2012 | 2011 |
| Operating activities | | |
| Net income | \$30,060 | \$4,844 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 1,993 | 1,936 |
| Amortization | 12,225 | 11,727 |
| Loss on extinguishment of debt | 4,309 | – |
| Amortization of deferred financing costs | 506 | 502 |
| Provision for losses on accounts receivable | 79 | 29 |
| Deferred income taxes | 18,239 | – |
| Loss on disposal of property and equipment | 107 | 3 |
| Share-based compensation expense | 2,439 | 2,000 |
| Net changes in operating assets and liabilities: | | |
| Accounts receivable | (3,255) | 715 |
| Inventories | (37,700) | (16,650) |
| Other assets | (530) | 283 |
| Accounts payable | 9,663 | 10,403 |
| Accrued wages and employee benefits | (2,739) | (303) |
| Other accrued liabilities | 3,188 | (2,818) |
| Net cash provided by operating activities | 38,584 | 12,671 |
| Investing activities | | |
| Proceeds from sale of property and equipment | – | 3 |
| Expenditures for property and equipment | (2,138) | (1,569) |
| Acquisition of business | (2,279) | – |
| Net cash used in investing activities | (4,417) | (1,566) |
| Financing activities | | |
| Proceeds from long-term borrowings | 573,614 | – |
| Repayments of long-term borrowings | (597,874) | – |
| Payment of debt issuance costs | (10,756) | – |
| Taxes paid related to the net share settlement of equity awards | (1,278) | – |
| Excess tax benefits from equity awards | 731 | – |
| Proceeds from exercise of stock options | – | 309 |
| Net cash (used in) provided by financing activities | (35,563) | 309 |
| Net (decrease) increase in cash and cash equivalents | (1,396) | 11,414 |
| Cash and cash equivalents at beginning of period | 93,126 | 78,583 |
| Cash and cash equivalents at end of period | \$91,730 | \$89,997 |

See notes to condensed consolidated financial statements.

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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). 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, 2012, the condensed consolidated statements of comprehensive income for the three months ended March 31, 2012 and 2011, and the condensed consolidated statements of cash flows for the three months ended March 31, 2012 and 2011 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, 2011.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss at March 31, 2012 and December 31, 2011 are as follows:

| | March 31, 2012 | December 31, 2011 |
|--|-------------------|-------------------------|
| Pension liability, net of tax of \$3,173 | \$(10,529) | \$(10,529) |
| Unrealized losses on cash flow hedges, net of tax of \$483 | (4,897) | (4,828) |
| Accumulated other comprehensive loss | \$(15,426) | \$(15,357) |

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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 Company's 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. These 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 are effective from October 1, 2011, and terminate on June 30, 2012. In November 2010, the Company entered into a commodity forward contract to purchase \$2,296 of copper. The contract was effective from January 1, 2011, and terminated on April 30, 2011. In February 2011, the Company entered into a commodity forward contract to purchase \$2,378 of copper. The contract was effective from March 1, 2011, and terminated on December 31, 2011. In March 2011, the Company entered into a commodity forward contract to purchase \$2,100 of copper. The contract was effective from April 1, 2011, and terminated on December 31, 2011. Total gains recognized in the consolidated statement of comprehensive income on commodity contracts was \$420 for the three months ended March 31, 2012. The gain (loss) on commodity contracts was not material for the three months ended March 31, 2011.

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, 2012 or December 31, 2011.

Interest Rates

The Company has four interest rate swap agreements outstanding as of March 31, 2012. In 2010, the Company entered into two interest rate swap agreements. The first was entered into on January 21, 2010. The effective date of this swap was July 1, 2010 with a notional amount of \$200,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of that swap was October 1, 2010 with a notional amount of \$100,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. The Company entered into two interest rate swap agreements 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. The Company maintains the swaps as highly effective in accordance with ASC 815 and, therefore, any changes in the fair value of the swaps are recorded in accumulated other comprehensive loss.

As discussed in Note 8 – 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. 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 hedges associated with the Credit Agreement. However, as a result of a change in certain critical terms between the new Credit Agreement and former credit agreement, the interest rate swap agreements in place on the date of refinancing were measured for hedge effectiveness. The ineffective portion of the change in fair value of our cash flow hedges was immaterial. Unrealized losses existing at March 31, 2012, which are expected to be reclassified into the consolidated statement of comprehensive income from other comprehensive loss during the next fiscal year, are also not expected to be significant.

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

| | March 31, 2012 | December 31, 2011 |
|---|-------------------|----------------------|
| Derivatives designated as hedging instruments: | | |
| Interest rate swaps | \$(5,380) | \$ (5,268) |
| | (5,380) | (5,268) |
| Derivatives not designated as hedging instruments: | | |
| Commodity contracts | 169 | (373) |
| Net derivatives liability | \$(5,211) | \$ (5,641) |

The fair value of derivatives designated as hedging instruments included in other current liabilities and other long-term liabilities is \$1,000 and \$4,380 respectively, as of March 31, 2012. The fair value of derivatives designated as hedging instruments included in other current liabilities and other long-term liabilities is \$1,546 and \$3,722 respectively, as of December 31, 2011.

The fair value of derivatives not designated as hedging instruments is included in other assets and other current liabilities as of March 31, 2012 and December 31, 2011, respectively.

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, 2012 and December 31, 2011 is a net liability of \$(5,352) and \$(5,780), 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, 2012 and 2011:

| | Amount of gain (loss) recognized in Accumulated Other Comprehensive Loss during the three months ended March 31, | | Location of gain (loss) recognized in net income on ineffective portion of hedges | Amount of gain (loss) recognized in net income on hedges (ineffective portion) during three months ended March 31, | |
|--|--|-------|--|---|--------|
| | 2012 | 2011 | | 2012 | 2011 |
| Derivatives designated as hedging instruments | | | | | |
| Interest rate swaps | \$(69) | \$555 | Interest expense | \$— | \$— |
| Derivatives not designated as hedging instruments | | | | | |
| Commodity and foreign currency contracts | \$— | \$— | Cost of goods sold | \$420 | \$(1) |

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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 that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the pronouncement establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

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

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities), excluding long-term debt, approximates the fair value of these instruments based upon their short-term nature. The fair value of long-term debt was approximately \$558,200 (Level 2) at March 31, 2012, 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 March 31, 2012 | Fair Value Measurement Using Quoted Prices in Active Markets for Identical Contracts (Level 1) | Significant Other Observable Inputs (Level 2) |
|---------------------|----------------------------|--|---|
| Interest rate swaps | \$ (5,380) | \$ - | \$ (5,380) |
| Commodity contracts | \$ 169 | \$ - | \$ 169 |

| | Total December 31, 2011 | Fair Value Measurement Using Quoted Prices in Active Markets for Identical Contracts (Level 1) | Significant Other Observable Inputs (Level 2) |
|---------------------|-------------------------------|--|---|
| Interest rate swaps | \$ (5,268) | \$ - | \$ (5,268) |
| Commodity contracts | \$ (373) | \$ - | \$ (373) |

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. Acquisitions

On February 1, 2012, a subsidiary of the Company acquired substantially all of the assets and assumed certain liabilities of a leading transfer switch and portable generator accessory manufacturer. The Company recorded a preliminary purchase price allocation based on initial estimates of fair value. As a result, the Company recorded \$1,200 of intangible assets, including approximately \$300 of goodwill, as of the acquisition date. The acquisition is not material to the Company's consolidated financial statements.

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5. 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. Substantially all of the Company's identifiable assets are located in the United States. The Company's sales in the United States represent approximately 94% of total sales for the three months ended March 31, 2012.

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 industrial/commercial 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, industrial/commercial, and other products is as follows:

| | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2012 | 2011 |
| Residential power products | \$ 175,077 | \$ 69,186 |
| Industrial and commercial power products | 105,013 | 44,310 |
| Other | 14,471 | 10,485 |
| Total | \$ 294,561 | \$ 123,981 |

6. Balance Sheet Details

Inventories consist of the following:

| | March 31, | December |
|--------------------------------------|------------|-------------|
| | 2012 | 31, 2011 |
| Raw materials | \$ 133,552 | \$ 121,098 |
| Work-in-process | 1,316 | 578 |
| Finished goods | 70,404 | 45,165 |
| Reserves for excess and obsolescence | (5,143) | (4,717) |
| Total | \$ 200,129 | \$ 162,124 |

Property and equipment consists of the following:

| | March 31, | December |
|------------------------------|-----------|-------------|
| | 2012 | 31, 2011 |
| Land and improvements | \$ 5,067 | \$ 5,050 |
| Buildings and improvements | 53,026 | 52,941 |
| Machinery and equipment | 38,543 | 38,132 |
| Dies and tools | 13,132 | 12,982 |
| Vehicles | 1,023 | 1,026 |
| Office equipment | 8,595 | 8,380 |
| Leasehold improvements | 58 | 44 |
| Construction in progress | 3,981 | 3,131 |
| Gross property and equipment | 123,425 | 121,686 |

| | | |
|--------------------------|-----------|-----------|
| Accumulated depreciation | (39,003) | (37,302) |
| Total | \$84,422 | \$84,384 |

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Other accrued liabilities consist of the following:

| | March 31, 2012 | December 31, 2011 |
|---|-------------------|-------------------------|
| Accrued commissions | \$5,952 | \$5,731 |
| Accrued interest | 2,263 | 3,119 |
| Product warranty obligations – short term | 23,886 | 19,187 |
| Other accrued liabilities | 18,280 | 18,987 |
| Total | \$50,381 | \$47,024 |

Other long-term liabilities consist of the following:

| | March 31, 2012 | December 31, 2011 |
|--|-------------------|-------------------------|
| Accrued pension costs | \$21,999 | \$22,044 |
| Product warranty obligations – long term | 15,193 | 15,193 |
| Other long-term liabilities | 6,923 | 6,277 |
| Total | \$44,115 | \$43,514 |

7. 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 consolidated balance sheets. The Company recognizes extended warranties over the life of the contracts.

Changes in product warranty obligations are as follows:

| | For the three months ended March 31, | |
|--------------------------------------|---|-----------------|
| | 2012 | 2011 |
| Balance at beginning of period | \$34,380 | \$22,478 |
| Payments, net of extended warranties | (4,452) | (3,658) |
| Charged to operations | 9,151 | 3,430 |
| Balance at end of period | \$39,079 | \$22,250 |

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

| | March 31, 2012 | December 31, 2011 |
|---------------------------------|-------------------|-------------------------|
| Other accrued liabilities | \$23,886 | \$19,187 |
| Other long-term liabilities | 15,193 | 15,193 |
| Balance at end of period | \$39,079 | \$34,380 |

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8. Credit Agreements

Long-term debt consists of the following:

| | March 31, 2012 | December 31, 2011 |
|----------------------------|-------------------|-------------------------|
| First lien term loan | \$- | \$604,372 |
| Tranche A term loan | 325,000 | - |
| Tranche B term loan | 250,000 | - |
| Discount on debt | (1,349) | - |
| Treasury debt – first lien | - | (6,498) |
| Current portion of debt | (14,063) | (22,874) |
| Total | \$559,588 | \$575,000 |

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 provides for borrowings under a new \$150,000 revolving credit facility, a \$325,000 tranche A term loan facility and a \$250,000 tranche B term loan facility. The new revolving credit facility and tranche A term loan facility mature February 9, 2017, and the tranche B term loan facility matures February 9, 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 facility 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.

Borrowings under the Credit Agreement are secured by associated collateral agreements which pledge virtually all assets of the Borrower. The Credit Agreement requires the Borrower, among other things, to meet certain financial and nonfinancial covenants and maintain financial ratios in such amounts and for such periods as set forth therein. The Borrower is required to maintain a leverage ratio of consolidated total debt, net of unrestricted cash and marketable securities, to EBITDA (as defined in the Credit Agreement) and an interest coverage ratio of EBITDA to cash interest expense (as defined in the Credit Agreement). The calculation of EBITDA under and as defined in the Credit Agreement is referred to in this quarterly report as “Covenant EBITDA.” Covenant EBITDA, the leverage ratio and interest coverage ratio are calculated based on the four most recently completed fiscal quarters of Generac Power Systems. Based on the formulations set forth in the Credit Agreement, Generac Power Systems is required to maintain a maximum leverage ratio of 4.00 to 1.00 from the periods June 30, 2012 to September 30, 2012, and 3.75 to 1.00 thereafter. Additionally, Generac Power Systems is required to maintain a minimum interest coverage ratio of 2.50 to 1.00 from June 30, 2012 to September 30, 2012, 2.75 to 1.00 from December 31, 2012 to June 30, 2013, 3.00 to 1.00 from September 30, 2013 to June 30, 2014 and 3.25 to 1.00 thereafter. The Company was in compliance with all requirements as of March 31, 2012.

The new revolving credit facility and tranche A term loan facility bear interest at rates based upon either a base rate plus an applicable margin of 1.25% or adjusted LIBOR rate plus an applicable margin of 2.25% through July 1, 2012. The tranche B term loan facility bears interest at rates based upon either a base rate (which, with respect to such tranche B term loan facility, will not be less than 2.00%) plus an applicable margin of 1.75% or adjusted LIBOR rate (which, with respect to such tranche B term loan facility, will not be less than 1.00%) plus an applicable margin of 2.75% through July 1, 2012. In subsequent periods, the new revolving credit facility and the tranche A term loan facility will bear interest at rates based upon either a base rate plus an applicable margin ranging from 0.75% to 1.50%

or adjusted LIBOR rate plus an applicable margin ranging from 1.75% to 2.50%, each determined based on a leverage ratio.

The Credit Agreement restricts the circumstances in which distributions and dividends can be paid by the Borrower. Payments can be made by the Borrower to the Company for certain expenses such as operating expenses in the ordinary course and dividends can be used to repurchase equity interests, subject to limitation in certain circumstances. The Credit Agreement is secured by the associated collateral agreements which pledge virtually all assets of the Borrower. Additionally, the Credit Agreement restricts the aggregate amount of dividends and distributions that can be paid and, in certain circumstances, requires the maintenance of certain leverage ratios in order to pay certain dividends or distributions.

The 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 Credit Agreement). Upon an event of default under the Credit Agreement, the lenders may declare the loans and all other obligations under the Credit Agreement immediately due and payable and require the Borrower to cash collateralize the outstanding letter of credit obligations. A bankruptcy or insolvency event causes such obligations to automatically become immediately due and payable.

In connection with the refinancing and in accordance with ASC 470-50, Debt Modifications and Extinguishments, the Company capitalized \$10.1 million of new debt issuance costs, recorded \$1.4 million of fees paid to creditors as a debt discount, and expensed \$1.4 million of transaction fees. The Company evaluated on a lender by lender basis if the debt related to returning lenders was significantly modified or not, resulting in the write-off of \$2.9 million in unamortized debt issuance costs relating to the former credit agreement. Amounts expensed are recorded as a loss on extinguishment of debt in the consolidated statement of comprehensive income for the three months ended March 31, 2012. The Company amortizes the original issue discount and related capitalized debt issuance costs on its loans under the effective interest method.

At March 31, 2012, we had cash and cash equivalents of \$91.7 million and \$145.3 million of availability under our revolving credit facility, net of outstanding letters of credit.

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9. Earnings Per Share

Basic net income per share is net income divided by the average number of common shares outstanding during the period. Diluted net income per share includes incremental shares assumed to be issued from stock compensation awards.

The information required to compute basic and diluted net income per share is as follows:

| | Three months ended March 31, | |
|--|------------------------------|------------|
| | 2012 | 2011 |
| Numerator- net income | \$30,060 | \$4,844 |
| Denominator- weighted average shares | | |
| Basic | 67,200,480 | 67,107,560 |
| Dilutive effect of stock compensation awards (1) | 1,437,447 | 236,789 |
| Diluted | 68,637,927 | 67,344,349 |
| Net income per share | | |
| Basic | \$0.45 | \$0.07 |
| Diluted | \$0.44 | \$0.07 |

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

10. Income Taxes

The effective income tax rates for the quarters ended March 31, 2012 and 2011 were 38.8% and 1.9%, respectively. In the fourth quarter of 2011, the Company came out of its three-year cumulative loss position and determined that its deferred tax assets were realizable. Therefore, the Company recorded a tax provision in the first quarter of 2012 based on its estimated effective tax rate of approximately 38.8%.

11. Benefit Plans

The Company has noncontributory salaried and hourly pension plans (collectively, "Pension Plans") covering substantially all of its employees. Information related to the Pension Plans is as follows:

| Components of net periodic pension expense: | Three months ended March 31, | |
|---|------------------------------|--------|
| | 2012 | 2011 |
| Interest cost | \$613 | \$592 |
| Expected return on plan assets | (599) | (586) |
| Amortization of net loss | 227 | 68 |
| Net periodic pension expense | \$241 | \$74 |

12. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for selected 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 March 31, 2012 and December 31, 2011 was approximately \$15,416 and \$10,035 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," "project," "plan," "intend," "believe," "confident," "may," "should," "can have," "likely," "future" and other words having 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 of major power outages;
- availability, cost and quality of raw materials and key components used in producing our products;
- the possibility that the expected synergies, efficiencies and cost savings of the acquisition of the Magnum Products business will not be realized, or will not be realized within the expected time period;
 - the risk that the Magnum Products business will not be integrated successfully;
- the impact on our results of the substantial increases in our outstanding indebtedness and related interest expense that will occur if we complete our proposed dividend recapitalization discussed below under "Liquidity and financial condition - Proposed dividend recapitalization";
 - 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 these 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, 2011.

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.

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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 the United States and Canada. 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. Although there have been recent increases in product costs for installed standby generators in the residential and light-commercial markets (driven in recent years by raw material costs), these costs have declined overall over the last decade, and many potential customers are not aware of the costs and benefits of backup power solutions. We estimate that penetration rates for residential products are approximately 2.5% 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.

Effect of large scale power disruptions. Power disruptions are an important driver of consumer awareness and have historically influenced demand for generators. Disruptions in the aging U.S. power grid and other outage activity increase 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 the second half of 2011 drove strong demand for home standby generators, and the increased awareness of these products contributed to substantial revenue growth for us in the first quarter of 2012. 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, credit availability and trends in durable goods spending by businesses.

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Operational factors

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

New product start-up costs. When we launch new products, we generally experience an increase in start-up costs, including engineering expenses, 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, 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.

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 decreased in the first quarter of 2012 versus the first quarter of 2011 as a result of nearly \$82 million of debt pre-payments that were made over the last twelve months. Offsetting this decline in interest expense is a slight increase in the weighted-average cost of debt.

On February 9, 2012, a subsidiary of the Company entered into a new credit agreement with certain commercial banks and other lenders. The new credit agreement provides for borrowings under a new \$150.0 million revolving credit facility, a \$325.0 million tranche A term loan facility and a \$250.0 million tranche B term loan facility. The new revolving credit facility and tranche A term loan facility mature February 9, 2017, and the tranche B term loan facility matures February 9, 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 November 10, 2006, as amended from time to time. The Company's former credit facility 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. Factors influencing interest expense under the new credit agreement are substantially the same factors that influenced interest expense under the former credit agreement. However, the increase in outstanding debt that will occur if we complete the proposed dividend recapitalization discussed under "Liquidity and financial condition – Proposed dividend recapitalization" will significantly increase our interest expense.

Factors influencing provision for income taxes and cash taxes paid. We had \$1.2 billion of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2011 related to our acquisition by CCMP in 2006 that we expect to generate cash tax savings of \$470 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 \$127.1 million as of December 31, 2011, which we expect to generate an additional \$44 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 will 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.

In addition, as a result of the asset acquisition of the Magnum Products business in the fourth quarter of 2011, we had approximately \$57.0 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2011. We expect these assets to generate cash tax savings of \$22.2 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 \$2.9 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.

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Seasonality. Although there is demand for our products throughout the year, in each of the past three years approximately 16% to 24% of our net sales occurred in the first quarter, 20% to 25% in the second quarter, 25% to 30% in the third quarter and 26% to 34% in the fourth quarter. However, seasonality can differ depending on the timing of outage activity in each year, such as the outage activity experienced in the second half of 2011. Due to the significant demand and awareness created by these outage events, we expect revenue contribution during 2012 to be heavily weighted toward the first half of the year, assuming no material improvement in the macroeconomic environment and no comparable outage events in 2012. We expect this effect on year-over-year revenue growth to diminish in the second half of 2012, assuming no comparable major outage events during the second half of 2012 similar to the second half of 2011. Because of this, our historical seasonality patterns may not apply in 2012.

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

Results of operations

Three months ended March 31, 2012 compared to three months ended March 31, 2011

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

| (Dollars in thousands) | Three months ended March 31, | |
|--|---------------------------------|-----------|
| | 2012 | 2011 |
| Net sales | \$294,561 | \$123,981 |
| Cost of goods sold | 183,556 | 76,804 |
| Gross profit | 111,005 | 47,177 |
| Operating expenses: | | |
| Selling and service | 25,126 | 14,305 |
| Research and development | 5,055 | 3,885 |
| General and administrative | 9,106 | 6,117 |
| Amortization of intangibles | 12,225 | 11,727 |
| Total operating expenses | 51,512 | 36,034 |
| Income from operations | 59,493 | 11,143 |
| Total other expense, net | (10,389) | (6,206) |
| Income before provision for income taxes | 49,104 | 4,937 |
| Provision for income taxes | 19,044 | 93 |
| Net income | \$30,060 | \$4,844 |
| Residential products | \$175,077 | \$69,186 |
| Industrial & commercial products | 105,013 | |