

GENERAC HOLDINGS INC.  
Form 10-Q  
November 04, 2016  
**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2016**

**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)

<b>Delaware</b>	<b>20-5654756</b>
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

**S45 W29290 Hwy 59, Waukesha, WI 53189**  
(Address of principal executive offices) (Zip Code)

**(262) 544-4811**

(Registrant's telephone number, including area code)

**Not Applicable**

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

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

Indicate by check mark whether the registrant has submitted electronically 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 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 the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” 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 October 31, 2016, there were 63,837,342 shares of 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  
*(U.S. Dollars  
in Thousands,  
Except Share  
and Per  
Share Data)*

	<b>September 30, 2016</b> (Unaudited)	<b>December 31, 2015</b> (Audited)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 54,163	\$ 115,857
Accounts receivable, less allowance for doubtful accounts	244,722	182,185
Inventories	359,363	325,375
Prepaid expenses and other assets	13,185	8,600
Total current assets	671,433	632,017
Property and equipment, net	207,504	184,213
Customer lists, net	49,776	39,313
Patents, net	50,640	53,772
Other intangible assets, net	3,111	2,768
Tradenames, net	161,451	161,057
Goodwill	711,794	669,719
Deferred income taxes	9,298	34,812
Other assets	3,506	964
Total assets	\$ 1,868,513	\$ 1,778,635
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Short-term borrowings	\$ 35,517	\$ 8,594
Accounts payable	145,894	108,332

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Accrued wages and employee benefits	21,041	13,101
Other accrued liabilities	92,415	82,540
Current portion of long-term borrowings and capital lease obligations	38,712	657
Total current liabilities	333,579	213,224
Long-term borrowings and capital lease obligations	1,013,671	1,037,132
Deferred income taxes	8,806	4,950
Other long-term liabilities	62,330	57,458
Total liabilities	1,418,386	1,312,764
Redeemable noncontrolling interests	36,269	–
Stockholders' equity:		
Common stock, par value \$0.01, 500,000,000 shares authorized, 70,144,760 and 69,582,669 shares issued at September 30, 2016 and December 31, 2015, respectively	701	696
Additional paid-in capital	446,267	443,109
Treasury stock, at cost	(212,358 )	(111,516 )
Excess purchase price over predecessor basis	(202,116 )	(202,116 )
Retained earnings	415,452	358,173
Accumulated other comprehensive loss	(34,031 )	(22,475 )
Stockholders' equity attributable to Generac Holdings, Inc.	413,915	465,871
Noncontrolling interests	(57 )	–
Total stockholders' equity	413,858	465,871
Total liabilities and stockholders' equity	\$1,868,513	\$1,778,635

*See notes to condensed consolidated financial statements.*

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net sales	\$373,121	\$359,291	\$1,027,032	\$959,469
Costs of goods sold	235,349	228,965	667,053	630,643
Gross profit	137,772	130,326	359,979	328,826
Operating expenses:				
Selling and service	44,429	34,715	124,064	93,317
Research and development	9,426	8,332	27,512	24,907
General and administrative	18,066	13,127	55,492	40,897
Amortization of intangibles	9,511	6,285	25,525	17,460
Total operating expenses	81,432	62,459	232,593	176,581
Income from operations	56,340	67,867	127,386	152,245
Other (expense) income:				
Interest expense	(11,299 )	(10,210 )	(33,714 )	(32,241 )
Investment income	—	39	36	111
Loss on extinguishment of debt	—	-	—	(4,795 )
Loss on change in contractual interest rate	(2,957 )	(2,381 )	(2,957 )	(2,381 )
Costs related to acquisition	(577 )	(153 )	(994 )	(153 )
Other, net	19	(1,908 )	564	(5,357 )
Total other expense, net	(14,814 )	(14,613 )	(37,065 )	(44,816 )
Income before provision for income taxes	41,526	53,254	90,321	107,429
Provision for income taxes	15,514	19,218	33,154	38,864
Net income	26,012	34,036	57,167	68,565
Net loss attributable to noncontrolling interests	(171 )	-	(112 )	-
Net income attributable to Generac Holdings Inc.	\$26,183	\$34,036	\$57,279	\$68,565
Net income attributable to Generac Holdings Inc. per common share - basic:	\$0.41	\$0.50	\$0.87	\$1.00

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Weighted average common shares outstanding - basic:	64,615,935	68,175,466	65,506,469	68,642,479
Net income attributable to Generac Holdings Inc. per common share - diluted:	\$0.40	\$0.49	\$0.87	\$0.98
Weighted average common shares outstanding - diluted:	65,126,117	69,182,465	65,992,127	69,781,300
Comprehensive income	\$26,647	\$31,899	\$45,723	\$59,939

*See notes to condensed consolidated financial statements.*

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

	<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>
Operating activities		
Net income	\$57,167	\$68,565
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	15,818	12,300
Amortization of intangible assets	25,525	17,460
Amortization of original issue discount and deferred financing costs	3,229	4,368
Loss on extinguishment of debt	–	4,795
Loss on change in contractual interest rate	2,957	2,381
Deferred income taxes	22,909	27,319
Share-based compensation expense	7,805	6,889
Other	(45 )	377
Net changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(11,642 )	(14,838 )
Inventories	6,177	(28,319 )
Other assets	2,663	572
Accounts payable	(2,618 )	(12,226 )
Accrued wages and employee benefits	4,981	(1,167 )
Other accrued liabilities	1,341	(2,644 )
Excess tax benefits from equity awards	(6,754 )	(8,973 )
Net cash provided by operating activities	129,513	76,859
Investing activities		
Proceeds from sale of property and equipment	1,349	105
Expenditures for property and equipment	(20,847 )	(20,108 )
Acquisition of business, net of cash acquired	(61,386 )	(74,477 )
Net cash used in investing activities	(80,884 )	(94,480 )
Financing activities		
Proceeds from short-term borrowings	14,117	14,320
Proceeds from long-term borrowings	–	100,000
Repayments of short-term borrowings	(8,244 )	(15,198 )
Repayments of long-term borrowings and capital lease obligations	(10,976 )	(150,595)



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Stock repurchases	(99,934 )	(64,378 )
Payment of debt issuance costs	–	(2,067 )
Cash dividends paid	(76 )	(1,429 )
Taxes paid related to the net share settlement of equity awards	(12,308 )	(12,380 )
Excess tax benefits from equity awards	6,754	8,973
Net cash used in financing activities	(110,667)	(122,754)
Effect of exchange rate changes on cash and cash equivalents	344	(2,932 )
Net decrease in cash and cash equivalents	(61,694 )	(143,307)
Cash and cash equivalents at beginning of period	115,857	189,761
Cash and cash equivalents at end of period	\$54,163	\$46,454

*See notes to condensed consolidated financial statements*

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

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

**(Unaudited)**

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

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

The Company has executed a number of acquisitions that support our strategic plan (as discussed in Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2015). A summary of these acquisitions include the following:

In October 2011, the Company acquired substantially all of the assets of Magnum Products (Magnum), a supplier of generator powered light towers and mobile generators for a variety of industrial applications. The Magnum business is a strategic fit for the Company as it provides diversification through the introduction of new engine powered products, distribution channels and end markets.

In December 2012, the Company acquired the equity of Ottomotores UK and its affiliates (Ottomotores), with operations in Mexico City, Mexico and Curitiba, Brazil. Ottomotores is a leading manufacturer in the Mexican market for industrial diesel gensets and is a market participant throughout all of Latin America.

In August 2013, the Company acquired the equity of Tower Light SRL and its wholly-owned subsidiaries (Tower Light). Headquartered outside Milan, Italy, Tower Light is a leading developer and supplier of mobile light towers throughout Europe, the Middle East and Africa.

In November 2013, the Company purchased the assets of Baldor Electric Company's generator division (Baldor Generators). Baldor Generators offers a complete line of power generation equipment throughout North America with power output up to 2.5MW, which expands the Company's commercial and industrial product lines.

In September 2014, the Company acquired the equity of Pramac America LLC (Powermate), resulting in the ownership of the Powermate trade name and the right to license the DeWalt brand name for certain residential engine powered tools. This acquisition expands Generac's residential product portfolio in the portable generator category.

In October 2014, the Company acquired MAC, Inc. (MAC). MAC is a leading manufacturer of premium-grade commercial and industrial mobile heaters for the United States and Canadian markets. The acquisition expands the Company's portfolio of mobile power products and provides increased access to the oil & gas market.

In August 2015, the Company acquired Country Home Products and its subsidiaries (CHP). CHP is a leading manufacturer of high-quality, innovative, professional-grade engine powered equipment used in a wide variety of property maintenance applications, which are primarily sold in North America under the DR® Power Equipment brand. The acquisition provides an expanded product lineup and additional scale to the Company's residential engine powered products.

In March 2016, the Company acquired a majority ownership interest in PR Industrial S.r.l and its subsidiaries (Pramac). Headquartered in Siena, Italy, Pramac is a leading global manufacturer of stationary, mobile and portable generators primarily sold under the Pramac® brand. Pramac products are sold in over 150 countries through a broad distribution network.

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

The condensed consolidated balance sheet as of September 30, 2016, the condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2016 and 2015, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2016 and 2015 have been prepared by the Company and have not been audited. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary for the fair presentation of the financial position, results of operation and cash flows, have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015.

### *New Accounting Standards*

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. This guidance is the culmination of the FASB's joint project with the International Accounting Standards Board to clarify the principles for recognizing revenue. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process that entities should follow in order to achieve that core principal. ASU 2014-09, as amended by ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, and ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, becomes effective for the Company in 2018. The guidance can be applied either on a full retrospective basis or on a modified retrospective basis in which the cumulative effect of initially applying the standard is recognized at the date of initial application. The Company is currently assessing the impact the adoption of this guidance will have on the Company's results of operations.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This guidance is being issued to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the statement of financial position and by disclosing key information about leasing arrangements. The guidance should be applied using a modified retrospective approach and is effective for the Company in 2019, with early adoption permitted. The Company is currently assessing the impact the adoption of this guidance will have on the Company's results of operations and financial position.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. This guidance is a part of the FASB's initiative to reduce complexity in accounting standards, and includes simplification involving several aspects of the accounting for share-based payment transactions, including excess tax benefits. The guidance should be applied on a modified retrospective basis and is effective for the Company in 2017, with early adoption permitted. The Company is currently assessing the impact the adoption of this guidance will have on the Company's results of operations, financial position and classification on the statements of cash flow.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*. This guidance is being issued to decrease diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This guidance should be applied on a retrospective basis and is effective for the Company in 2018, with early adoption permitted. The Company does not believe that this guidance will have a significant impact on the presentation of the statement of cash flows.

In the first quarter of 2016, the Company adopted ASU 2015-03, *Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*. As a result, the Company adjusted the impacted line items in the December 31, 2015 condensed consolidated balance sheet to conform to the current period's presentation; decreasing both the Deferred financing costs, net and Long-term borrowings and capital lease obligations line items by \$12,965. Also in the first quarter of 2016, the Company adopted ASU 2015-17, *Income Taxes: Balance Sheet Classification of Deferred Taxes*. As a result, the Company adjusted the impacted line items in the December 31, 2015 condensed consolidated balance sheet to conform to the current period's presentation; decreasing the Deferred income taxes line item within current assets by \$29,355, increasing the Deferred income taxes line item within noncurrent assets by \$28,139, and decreasing the Deferred income taxes line within noncurrent liabilities by \$1,216.

There are several other new accounting pronouncements issued by the FASB. Management does not believe any of these other accounting pronouncements has had or will have a material impact on the Company's consolidated financial statements.

## 2. Acquisitions

### *Acquisition of Pramac*

On March 1, 2016, the Company acquired a 65% ownership interest in Pramac for a purchase price, net of cash acquired, of \$60,886. Headquartered in Siena, Italy, Pramac is a leading global manufacturer of stationary, mobile and portable generators primarily sold under the Pramac® brand. Pramac products are sold in over 150 countries through a broad distribution network. The acquisition purchase price was funded solely through cash on hand.

The 35% noncontrolling interest in Pramac had an acquisition date fair value of \$34,253, and was recorded as a redeemable noncontrolling interest in the condensed consolidated balance sheet, as the noncontrolling interest party has within its control the right to require the Company to redeem its interest in Pramac. The noncontrolling interest holder has a put option to sell their interests to the Company any time within five years from the acquisition. The put option price is either (i) a fixed amount if voluntarily exercised within the first two years after the acquisition, or (ii) based on a multiple of earnings, subject to the terms of the acquisition. Additionally, the Company holds a call option that it may redeem commencing five years from the acquisition, or earlier upon the occurrence of certain circumstances. The call option price is based on a multiple of earnings that is subject to the terms of the acquisition. Both the put and call option only provide for the complete transfer of the noncontrolling interest, with no partial transfers of interest permitted.

The Company recorded a preliminary purchase price allocation during the first quarter of 2016, and was updated in the third quarter of 2016, based upon its estimates of the fair value of the acquired assets and assumed liabilities. The preliminary purchase price allocation as of September 30, 2016 was as follows:

	<b>March 1, 2016</b>
Accounts receivable	\$51,108
Inventories	40,070
Property and equipment	19,129
Intangible assets	34,471
Goodwill	47,682
Other assets	8,153
Total assets acquired	200,613
Short-term borrowings	21,105
Accounts payable	40,270
Long-term debt and capital lease obligations (including current portion)	18,599
Other liabilities	25,447
Redeemable noncontrolling interest	34,253
Noncontrolling interest	53
Net assets acquired	\$60,886

The goodwill ascribed to this acquisition is not deductible for tax purposes. The accompanying condensed consolidated financial statements include the results of Pramac from the date of acquisition through September 30, 2016.

#### *Acquisition of CHP*

On August 1, 2015, a subsidiary of the Company acquired CHP for a purchase price, net of cash acquired, of \$74,570. Headquartered in Vergennes, Vermont, CHP is a leading manufacturer of high-quality, innovative, professional-grade engine powered equipment used in a wide variety of property maintenance applications, with sales primarily in North America. The acquisition was funded solely through cash on hand.

The Company recorded a preliminary purchase price allocation during the third quarter of 2015 based upon its estimates of the fair value of the acquired assets and assumed liabilities. As a result, the Company recorded approximately \$81,726 of intangible assets, including approximately \$30,076 of goodwill, as of the acquisition date. The purchase price allocation was finalized in the fourth quarter of 2015, resulting in a \$6,552 decrease to total intangible assets, including an increase of \$6,208 in goodwill. The goodwill ascribed to this acquisition is not deductible for tax purposes. In addition, the Company assumed \$12,000 of CHP's debt in conjunction with this acquisition. The accompanying condensed consolidated financial statements include the results of CHP from the date of acquisition through September 30, 2016.

***Pro Forma Information***

The following unaudited pro forma information of the Company gives effect to these acquisitions as though the transactions had occurred on January 1, 2015:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net Sales:				
As reported	\$373,121	\$359,291	\$1,027,032	\$959,469
Pro forma	373,121	415,260	1,056,379	1,159,587
Net income attributable to Generac Holdings Inc.:				
As reported	\$26,183	\$34,036	\$57,279	\$68,565
Pro forma	26,257	32,675	58,989	68,380
Net income attributable to Generac Holdings Inc. per common share - diluted				
As reported	\$0.40	\$0.49	\$0.87	\$0.98
Pro forma	0.40	0.47	0.89	0.98

This unaudited pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisitions been consummated on January 1, 2015.

**3. Derivative Instruments and Hedging Activities**

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

***Commodities***



The Company is exposed to significant price fluctuations in commodities it uses as raw materials, and periodically utilizes commodity derivatives to mitigate the impact of these potential price fluctuations on its financial results and its economic well-being. These derivatives typically have maturities of less than eighteen months. At September 30, 2016, December 31, 2015 and September 30, 2015, the Company had one, one and three commodity contracts outstanding, respectively, covering the purchases of copper.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in cost of goods sold in the Company's condensed consolidated statements of comprehensive income. Net gains (losses) recognized for the three and nine months ended September 30, 2016 were \$(10) and \$66, respectively. Net gains (losses) recognized for the three and nine months ended September 30, 2015 were \$(667) and \$(1,708), respectively.

### ***Foreign Currencies***

The Company is exposed to foreign currency exchange risk as a result of transactions denominated in currencies other than the U.S. Dollar. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with certain foreign currency purchases and sales in the normal course of business. Contracts typically have maturities of twelve months or less. As of September 30, 2016, December 31, 2015 and September 30, 2015, the Company had fifteen, six and three foreign currency contracts outstanding, respectively.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in cost of goods sold in the Company's condensed consolidated statements of comprehensive income. Net gains (losses) recognized for the three and nine months ended September 30, 2016 were \$24 and \$(154), respectively. Net gains (losses) recognized for the three and nine months ended September 30, 2015 were \$(107) and \$(465), respectively.

***Interest Rate Swaps***

In October 2013, the Company entered into two interest rate swap agreements, and in May 2014, the Company entered into an additional interest rate swap agreement. The Company formally documented all relationships between interest rate hedging instruments and the related hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions. These interest rate swap agreements qualify as cash flow hedges, and accordingly, the effective portions of the gains or losses are reported as a component of accumulated other comprehensive loss (AOCL). The cash flows of the swaps are recognized as adjustments to interest expense each period. The ineffective portions of the derivatives' changes in fair value, if any, are immediately recognized in earnings.

***Fair Value***

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

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Commodity contracts	\$ 48	\$ (400 )
Foreign currency contracts	417	(171 )
Interest rate swaps	(3,454 )	(2,618 )

The fair value of the commodity and foreign currency contracts are included in other assets, and the fair value of the interest rate swaps are included in other long-term liabilities in the condensed consolidated balance sheets as of September 30, 2016. The fair value of the commodity and foreign currency contracts are included in other accrued liabilities, and the fair value of the interest rate swaps are included in other long-term liabilities in the condensed consolidated balance sheets as of December 31, 2015. Excluding the impact of credit risk, the fair value of the derivative contracts as of September 30, 2016 and December 31, 2015 is a liability of \$3,067 and \$3,248, respectively, which represents the amount the Company would need to pay to exit the agreements on those dates.

The amount of gains (losses) recognized in AOCL in the condensed consolidated balance sheets on the effective portion of interest rate swaps designated as hedging instruments for the three and nine months ended September 30, 2016 were \$779 and \$(509), respectively. The amount of gains (losses) for the three and nine months ended September 30, 2015 were \$(1,065) and \$(2,071), respectively.

The amount of gains (losses) recognized in cost of goods sold in the condensed consolidated statements of comprehensive income for commodity and foreign currency contracts not designated as hedging instruments for the three and nine months ended September 30, 2016 were \$14 and \$(88), respectively. The amount of gains (losses) for the three and nine months ended September 30, 2015 were \$(774) and \$(2,173), respectively.

#### 4. Fair Value Measurements

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

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, short-term borrowings and ABL facility borrowings), excluding Term Loan borrowings, approximates the fair value of these instruments based upon their short-term nature. The fair value of Term Loan borrowings, which have an aggregate carrying value of \$930,409, was approximately \$933,875 (Level 2) at September 30, 2016, as calculated based on independent valuations whose inputs and significant value drivers are observable.

For the fair value of the assets and liabilities measured on a recurring basis, see the fair value table in Note 3, "Derivative Instruments and Hedging Activities," to the condensed consolidated financial statements. The fair value of all derivative contracts is classified as Level 2. The valuation techniques used to measure the fair value of derivative contracts, all of which have counterparties with high credit ratings, were based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data. The fair value of derivative contracts above considers the Company's credit risk in accordance with ASC 820-10.

## 5. Accumulated Other Comprehensive Loss

The following presents a tabular disclosure of changes in AOCL during the three and nine months ended September 30, 2016 and 2015, net of tax:

	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan	Unrealized Gain (Loss) on Cash Flow Hedges	Total
<b>Beginning Balance – July 1, 2016</b>	\$ (20,234 )	\$(11,362)	\$ (2,899 )	\$(34,495)
Other comprehensive gain (loss) before reclassifications	(315 )	-	779	(1) 464
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive income (loss)	(315 )	-	779	464
<b>Ending Balance – September 30, 2016</b>	\$ (20,549 )	\$(11,362)	\$ (2,120 )	\$(34,031)

	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan	Unrealized Loss on Cash Flow Hedges	Total
<b>Beginning Balance – July 1, 2015</b>	\$ (7,361 )	\$(13,243)	\$ (1,652 )	\$(22,256)
Other comprehensive loss before reclassifications	(1,072 )	-	(1,065 )	(2) (2,137 )
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive loss	(1,072 )	-	(1,065 )	(2,137 )
<b>Ending Balance – September 30, 2015</b>	\$ (8,433 )	\$(13,243)	\$ (2,717 )	\$(24,393)

	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan	Unrealized Loss on Cash Flow Hedges	Total
<b>Beginning Balance – January 1, 2016</b>	\$ (9,502 )	\$(11,362)	\$ (1,611 )	\$(22,475)
Other comprehensive loss before reclassifications	(11,047 )	-	(509 )	(3) (11,556)
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive loss	(11,047 )	-	(509 )	(11,556)
<b>Ending Balance – September 30, 2016</b>	\$ (20,549 )	\$(11,362)	\$ (2,120 )	\$(34,031)

Foreign Currency	Defined Benefit	Unrealized Loss on	Total
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	<b>Translation Adjustments</b>	<b>Pension Plan</b>	<b>Cash Flow Hedges</b>	
<b>Beginning Balance – January 1, 2015</b>	\$ (1,878 )	\$(13,243)	\$ (646 )	\$(15,767)
Other comprehensive loss before reclassifications	(6,555 )	-	(2,071 )	(4) (8,626 )
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive loss	(6,555 )	-	(2,071 )	(8,626 )
<b>Ending Balance – September 30, 2015</b>	\$ (8,433 )	\$(13,243)	\$ (2,717 )	\$(24,393)

(1) Represents unrealized gains of \$1,279, net of tax effect of \$(500) for the three months ended September 30, 2016.

(2) Represents unrealized losses of \$(1,727), net of tax benefit of \$662 for the three months ended September 30, 2015.

(3) Represents unrealized losses of \$(836), net of tax benefit of \$327 for the nine months ended September 30, 2016.

(4) Represents unrealized losses of \$(3,370), net of tax benefit of \$1,299 for the nine months ended September 30, 2015.

## 6. Segment Reporting

Effective in the second quarter of 2016, the Company changed its segment reporting from one reportable segment to two reportable segments - Domestic and International - as a result of the recent Pramac acquisition and the ongoing strategy to expand the business internationally. The Domestic segment includes the legacy Generac business and the impact of acquisitions that are based in the United States, all of which have revenues that are substantially derived from the U.S. and Canada. The International segment includes the Ottomotores, Tower Light and Pramac acquisitions, all of which have revenues that are substantially derived from outside of the U.S. and Canada. Both reportable segments design and manufacture a wide range of engine powered products. The Company has multiple operating segments, which it aggregates into the two reportable segments, based on materially similar economic characteristics, products, production processes, classes of customers and distribution methods.

Reportable Segments	Net Sales Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	Domestic	\$299,095	\$332,213	\$833,831
International	74,026	27,078	193,201	81,527
Total net sales	\$373,121	\$359,291	\$1,027,032	\$959,469

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

Product Classes	Net Sales Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Residential products	\$192,856	\$184,968	\$533,572	\$475,268
Commercial & industrial products	149,676	148,234	409,396	416,577
Other	30,589	26,089	84,064	67,624
Total net sales	\$373,121	\$359,291	\$1,027,032	\$959,469

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

	Adjusted EBITDA			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Domestic	\$69,309	\$77,117	\$173,521	\$180,018
International	3,527	4,055	13,050	10,714

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Total adjusted EBITDA	\$72,836	\$81,172	\$186,571	\$190,732
Interest expense	(11,299)	(10,210)	(33,714 )	(32,241 )
Depreciation and amortization	(14,900)	(10,597)	(41,343 )	(29,760 )
Non-cash write-down and other adjustments (1)	1,093	(2,115 )	(1,689 )	(4,091 )
Non-cash share-based compensation expense (2)	(2,419 )	(1,799 )	(7,805 )	(6,889 )
Loss on extinguishment of debt (3)	-	-	-	(4,795 )
Loss on change in contractual interest rate (4)	(2,957 )	(2,381 )	(2,957 )	(2,381 )
Transaction costs and credit facility fees (5)	(739 )	(317 )	(1,499 )	(999 )
Business optimization expenses (6)	(58 )	(5 )	(7,164 )	(1,743 )
Other	(31 )	(494 )	(79 )	(404 )
Income before provision for income taxes	\$41,526	\$53,254	\$90,321	\$107,429

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

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

(3) Represents the write-off of original issue discount and capitalized debt issuance costs due to voluntary debt prepayments.

For the three and nine months ended September 30, 2016, represents a non-cash loss relating to the continued 25 basis point increase in borrowing costs as a result of the credit agreement leverage ratio remaining above 3.0 times based on current projections. For the three and nine months ended September 30, 2015, represents a non-cash loss relating to a 25 basis point increase in borrowing costs as a result of the credit agreement leverage ratio rising above 3.0 effective third quarter 2015 and remaining above 3.0 times based on projections at the time.

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

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

The Company's sales in the United States represented approximately 77% and 88% of total sales for the three months ended September 30, 2016 and 2015, respectively, and represented approximately 78% and 86% of total sales for the nine months ended September 30, 2016 and 2015, respectively. Approximately 86% and 93% of the Company's identifiable long-lived assets are located in the United States at September 30, 2016 and December 31, 2015, respectively.

## 7. Balance Sheet Details

Inventories consist of the following:

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Raw material	\$ 218,787	\$ 179,769
Work-in-process	3,014	2,567
Finished goods	137,562	143,039
Total	\$ 359,363	\$ 325,375

Property and equipment consists of the following:

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Land and improvements	\$ 12,124	\$ 8,553
Buildings and improvements	117,795	104,774
Machinery and equipment	79,875	72,280
Dies and tools	22,813	20,066
Vehicles	1,535	1,244
Office equipment and systems	59,866	29,395
Leasehold improvements	4,256	3,338
Construction in progress	10,550	30,482
Gross property and equipment	308,814	270,132
Accumulated depreciation	(101,310 )	(85,919 )
Total	\$ 207,504	\$ 184,213



**8. 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. Additionally, the Company sells extended warranty coverage for certain products. The sales of extended warranties are recorded as deferred revenue, which is recognized over the life of the contracts.

The following is a tabular reconciliation of the product warranty liability, excluding the deferred revenue related to extended warranty coverage:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>2015</b>	<b>September 30, 2016</b>	<b>2015</b>
Balance at beginning of period	\$30,735	\$28,185	\$30,197	\$30,909
Product warranty reserve assumed in acquisition	-	351	840	351
Payments	(5,424 )	(5,812 )	(13,976)	(16,345)
Provision for warranties issued	5,762	6,033	13,464	15,062
Changes in estimates for pre-existing warranties	286	105	834	(1,115 )
Balance at end of period	\$31,359	\$28,862	\$31,359	\$28,862

The following is a tabular reconciliation of the deferred revenue related to extended warranty coverage:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>2015</b>	<b>September 30, 2016</b>	<b>2015</b>
Balance at beginning of period	\$29,082	\$27,241	\$28,961	\$27,193
Deferred revenue on extended warranty contracts assumed in acquisition	-	291	-	291
Deferred revenue on extended warranty contracts sold	2,843	1,694	5,606	3,884
Amortization of deferred revenue on extended warranty contracts	(1,430)	(1,138)	(4,072)	(3,280)
Balance at end of period	\$30,495	\$28,088	\$30,495	\$28,088

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

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Product warranty liability		
Current portion - other accrued liabilities	\$ 21,159	\$ 21,726
Long-term portion - other long-term liabilities	10,200	8,471
Total	\$ 31,359	\$ 30,197
Deferred revenue related to extended warranty		
Current portion - other accrued liabilities	\$ 6,131	\$ 6,026
Long-term portion - other long-term liabilities	24,364	22,935
Total	\$ 30,495	\$ 28,961

## 9. Credit Agreements

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

<b>September 30, 2016</b>	<b>December 31, 2015</b>
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ABL facility	\$ -	\$ -
Other lines of credit	35,517	8,594
Total	\$ 35,517	\$ 8,594

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

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Term loan	\$954,000	\$954,000
Original issue discount and deferred financing costs	(23,719 )	(29,905 )
ABL facility	100,000	100,000
Capital lease obligation	5,431	1,694
Other	16,671	12,000
Total	1,052,383	1,037,789
Less: current portion of debt	38,122	500
Less: current portion of capital lease obligation	590	157
Total	\$1,013,671	\$1,037,132

The Company's credit agreements provide for a \$1,200,000 term loan B credit facility (Term Loan) and include a \$300,000 uncommitted incremental term loan facility. The Term Loan matures on May 31, 2020. On November 2, 2016, the Term Loan maturity date was extended to May 31, 2023. (See Note 14, "Subsequent Events" to the condensed consolidated financial statements.) The Term Loan is guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and is secured by associated collateral agreements which pledge a first priority lien on virtually all of the Company's assets, including fixed assets and intangibles, other than all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, which are secured by a second priority lien.



The Term Loan initially bore interest at rates based upon either a base rate plus an applicable margin of 1.75% or adjusted LIBOR rate plus an applicable margin of 2.75%, subject to a LIBOR floor of 0.75%. Beginning in the second quarter of 2014, and measured each quarterly period thereafter, the applicable margin related to base rate loans is reduced to 1.50% and the applicable margin related to LIBOR rate loans is reduced to 2.50%, in each case, if the Borrower's net debt leverage ratio, as defined in the Term Loan, falls below 3.00 to 1.00 for that measurement period. The Company's net debt leverage ratio as of September 30, 2016 was above 3.00 to 1.00.

Because the Company's net debt leverage ratio was above 3.00 to 1.00 on July 1, 2015, it realized a 25 basis point increase in borrowing costs in the third quarter of 2015. As a result, the Company recorded a cumulative catch-up loss of \$2,381 in the third quarter of 2015, which represents the additional cash interest expected to be paid while the net debt leverage ratio is expected to be above 3.00 to 1.00 using current forecasts at that time.

As the Company's net debt leverage ratio continued to be above 3.00 to 1.00 on July 1, 2016, the Company recorded a cumulative catch-up loss of \$2,957 in the third quarter of 2016, which represents the additional cash interest expected to be paid while the net debt leverage ratio is expected to be above 3.00 to 1.00 using current forecasts at that time.

On May 18, 2015, the Company amended certain provisions and covenants of the Term Loan. In connection with this amendment and in accordance with ASC 470-50, *Debt Modifications and Extinguishments*, the Company capitalized \$1,528 of fees paid to creditors as original issue discount on long-term borrowings and expensed \$49 of transaction fees in the second quarter of 2015. As of September 30, 2016, the Company is in compliance with all covenants of the Term Loan. There are no financial maintenance covenants on the Term Loan.

The Company's credit agreements also originally provided for a \$150,000 senior secured ABL revolving credit facility (ABL Facility). The maturity date of the ABL Facility originally was May 31, 2018. Borrowings under the ABL Facility are guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and are secured by associated collateral agreements which pledge a first priority lien on all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, and a second priority lien on all other assets, including fixed assets and intangibles of the Company and certain domestic subsidiaries. ABL Facility borrowings initially bore 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.

On May 29, 2015, the Company amended its ABL Facility. The amendment (i) increased the ABL Facility from \$150,000 to \$250,000 (Amended ABL Facility), (ii) extended the maturity date from May 31, 2018 to May 29, 2020, (iii) increased the uncommitted incremental facility from \$50,000 to \$100,000, (iv) reduced the interest rate spread by 50 basis points and (v) reduced the unused line fee by 12.5 basis points across all tiers. Additionally, the amendment relaxed certain restrictions on the Company's ability to, among other things, (i) make additional investments and acquisitions (including foreign acquisitions), (ii) make restricted payments and (iii) incur additional secured and unsecured debt (including foreign subsidiary debt). In connection with this amendment and in accordance with ASC

470-50, the Company capitalized \$490 of new debt issuance costs in 2015.

On May 29, 2015, the Company borrowed \$100,000 under the Amended ABL Facility, the proceeds of which were used as a voluntary prepayment towards the Term Loan. As of September 30, 2016, there was \$100,000 outstanding under the Amended ABL Facility, leaving \$144,924 of availability, net of outstanding letters of credit.

On March 30 and May 29, 2015, the Company made voluntary prepayments of the Term Loan of \$50,000 and \$100,000, respectively, which will be applied to the Excess Cash Flow payment requirement in the Term Loan. As a result of the prepayments, the Company wrote off \$4,795 of original issue discount and capitalized debt issuance costs in the first half of 2015 as a loss on extinguishment of debt in the condensed consolidated statement of comprehensive income.

As of September 30, 2016 and December 31, 2015, short-term borrowings consisted of borrowings by our foreign subsidiaries on local lines of credit, which totaled \$35,517 and \$8,594, respectively.

## **10. Stock Repurchase Program**

In August 2015, the Company's Board of Directors approved a \$200,000 stock repurchase program. Under the program, the Company may repurchase up to \$200,000 of its common stock over 24 months from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. For the three months ended September 30, 2016, the Company repurchased 1,798,206 shares of its common stock for \$65,358. Since the inception of the program, the Company has repurchased 6,036,706 shares of its common stock for \$199,876, all funded with cash on hand. The repurchases in the third quarter of 2016 completed the total authorized amount under the program. See Note 14, "Subsequent Events" to the condensed consolidated financial statements for further discussion of our stock repurchase programs.

## 11. Earnings Per Share

Basic earnings per share is calculated by dividing net income attributable to the Company by the weighted average number of common shares outstanding during the period, exclusive of restricted shares. Except where the result would be anti-dilutive, diluted earnings per share is calculated by assuming the vesting of unvested restricted stock and the exercise of stock options, 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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income attributable to Generac Holdings Inc. (numerator)	\$26,183	\$34,036	\$57,279	\$68,565
Weighted average shares (denominator)				
Basic	64,615,935	68,175,466	65,506,469	68,642,479
Dilutive effect of stock compensation awards (1)	510,182	1,006,999	485,658	1,138,821
Diluted	65,126,117	69,182,465	65,992,127	69,781,300
Net income attributable to Generac Holdings Inc. per share				
Basic	\$0.41	\$0.50	\$0.87	\$1.00
Diluted	\$0.40	\$0.49	\$0.87	\$0.98

(1) Excludes approximately 208,400 stock options for the three month period ended September 30, 2016 and 172,900 stock options for the nine month period ended September 30, 2016, as the impact of such awards was anti-dilutive. Excludes approximately 250,900 stock options and 11,000 shares of restricted stock for the three month period ended September 30, 2015 and 138,900 stock options and 800 shares of restricted stock for the nine month period ended September 30, 2015, as the impact of such awards was anti-dilutive.

## 12. Income Taxes

The effective income tax rates for the nine months ended September 30, 2016 and 2015 were 36.7% and 36.2%, respectively.

## 13. 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 September 30, 2016 and December 31, 2015 was approximately \$30,500 and \$32,400, 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.

#### **14. Subsequent Events**

On October 24, 2016, the Company's Board of Directors approved a \$250,000 stock repurchase program. Under the stock repurchase program, the Company may repurchase an additional \$250,000 of its common stock over the next 24 months. The Company may repurchase its common stock from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The Company's repurchase may be executed using open market purchases, privately negotiated agreements or other transactions. The actual timing, number and value of shares repurchased under the program will be determined by management at its discretion and will depend on a number of factors, including the market price of the Company's shares of common stock and general market and economic conditions, applicable legal requirements, and compliance with the terms of the Company's outstanding indebtedness. The repurchases will be funded from cash on hand, available borrowings or proceeds from potential debt or other capital markets sources. The stock repurchase program may be suspended or discontinued at any time without prior notice.

On November 2, 2016, the Company made a \$25,000 voluntary prepayment of the Term Loan. Additionally on November 2, 2016, the Company amended its Term Loan to extend the maturity date from May 31, 2020 to May 31, 2023.



**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", "optimistic" words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events.

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

our business, financial and operating results, and future economic performance;  
proposed new product and service offerings; and  
management's goals, expectations 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:

frequency and duration of power outages impacting demand for our products;  
availability, cost and quality of raw materials and key components used in producing our products;  
the impact on our results of possible fluctuations in interest rates and foreign currency exchange rates;  
the possibility that the expected synergies, efficiencies and cost savings of our acquisitions will not be realized, or will not be realized within the expected time period;  
the risk that our acquisitions will not be integrated successfully;  
difficulties we may encounter as our business expands globally;  
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 or recalls; and

changes in environmental, health and safety laws and regulations.

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in any forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in our filings with the Securities and Exchange Commission, including in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 and in our Quarterly Reports on Form 10-Q. Stockholders, potential investors and other readers should consider these factors carefully in evaluating the forward-looking statements.

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

## Overview

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

Over the past several years, we have executed a number of acquisitions that support our strategic plan. A summary of these acquisitions can be found in Note 1, "Description of Business and Basis of Presentation," to the condensed consolidated financial statements in Item 1 of this quarterly report on Form 10-Q.

## **Business Drivers and Operational Factors**

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

### ***Business Drivers and Trends***

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

*Increasing penetration opportunity.* Many potential customers are not aware of the costs and benefits of automatic backup power solutions. We estimate that penetration rates for home standby generators are only approximately 3.5% 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 2013 American Housing Survey for the United States. The decision to purchase backup power for many light-commercial buildings such as convenience stores, restaurants and gas stations is more return-on-investment (ROI) driven and as a result these applications have relatively lower penetration rates as compared to buildings used in code-driven or mission critical applications such as hospitals, wastewater treatment facilities, 911 call centers, data centers and certain industrial locations. The emergence of lower cost, cleaner burning natural gas fueled generators has helped to increase the penetration of standby generators in the light-commercial market. In addition, the importance of backup power for telecommunications infrastructure is increasing due to the growing importance of uninterrupted voice and data services. We believe by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby and mobile generators for residential, commercial and industrial purposes.

*Effect of large scale and baseline power disruptions.* Power disruptions are an important driver of customer awareness and have historically influenced demand for generators, in particular, home standby and portable generators used for residential applications. Increased frequency and duration of major power outage events, that have a broader impact beyond a localized level, increases product awareness and may drive consumers to accelerate their purchase of a standby or portable generator during the immediate and subsequent period, which we believe may last for nine to twelve months following a major power outage event for standby generators. Major power disruptions are unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. In

addition, there are smaller, more localized power outages that occur frequently across the United States that drive the baseline level of demand for back-up power solutions. The level of baseline power outage activity occurring across the United States can also fluctuate, and may cause our financial results to fluctuate from year to year.

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

*Impact of business capital investment cycle.* The market for our commercial and industrial products is affected by the overall capital investment cycle, including non-residential building construction, durable goods and infrastructure spending as well as investments in the exploration and production of oil & gas, as businesses or organizations either add new locations or make investments to upgrade existing locations or equipment. These trends can have a material impact on demand for these products. The capital investment cycle may differ for the various commercial and industrial end markets that we serve including light commercial, retail, telecommunications, industrial, data centers, healthcare, construction, oil & gas and municipal infrastructure, among others. The market for these products is also affected by general economic and geopolitical conditions as well as credit availability in the geographic regions that we serve. In addition, we believe demand for our mobile power products will continue to benefit from a secular shift towards renting versus buying this type of equipment.

### *Factors Affecting Results of Operations*

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

*Effect of commodity, currency and component price fluctuations.* Industry-wide price fluctuations of key commodities, such as steel, copper, aluminum, along with other components we use in our products, can have a material impact on our results of operations. Also, with the Pramac acquisition in March 2016, we have further expanded our commercial and operational presence outside of the United States. This acquisition, along with our existing international presence, exposes us to fluctuations in foreign currency exchange rates that 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 accepted by our customers and in other cases are paid by us.

*Seasonality.* Although there is demand for our products throughout the year, in each of the past five years approximately 16% to 27% of our net sales occurred in the first quarter, 20% to 25% in the second quarter, 24% to 30% in the third quarter and 25% to 34% in the fourth quarter, with different seasonality depending on the occurrence, timing and severity of major power outage activity in each year. Major outage activity is unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. The seasonality experienced during a major power outage, and for the subsequent quarters following the event, will vary relative to other periods where no major outage events occurred. We maintain a flexible production and supply chain infrastructure in order to respond to outage-driven peak demand.

*Factors influencing interest expense and cash interest expense.* Interest expense can be impacted by a variety of factors, including market fluctuations in LIBOR, interest rate election periods, interest rate swap agreements, credit facility pricing grids, and repayments or borrowings of indebtedness. Cash interest expense increased during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015, primarily due to additional debt assumed in recent acquisitions and increased borrowings at other foreign subsidiaries. Refer to Note 9, "Credit Agreements," to the condensed consolidated financial statements in Item 1 of this quarterly report on Form 10-Q for further information.

*Factors influencing provision for income taxes and cash income taxes paid.* We had approximately \$715 million of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2015 related to our acquisition by CCMP in 2006 that we expect to generate aggregate cash tax savings of approximately \$279 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. As a result of the asset acquisition of the Magnum business in the fourth quarter of 2011, we had approximately \$42.0 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2015. We expect these assets to generate aggregate cash tax savings of \$16.4 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. Based on current business plans, we believe that our cash tax obligations through 2026 will be significantly reduced by these tax attributes. Other acquisitions have resulted in additional tax deductible goodwill and intangible assets that will generate tax savings, but are not material to the Company's consolidated financial statements.

**Results of Operations***Three months ended September 30, 2016 compared to the three months ended September 30, 2015*

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

(U.S. Dollars in thousands)	<b>Three Months Ended September 30,</b>		<b>\$ Change</b>	<b>% Change</b>	
	<b>2016</b>	<b>2015</b>			
Net sales	\$373,121	\$359,291	13,830	3.8	%
Cost of goods sold	235,349	228,965	6,384	2.8	%
Gross profit	137,772	130,326	7,446	5.7	%
Operating expenses:					
Selling and service	44,429	34,715	9,714	28.0	%
Research and development	9,426	8,332	1,094	13.1	%
General and administrative	18,066	13,127	4,939	37.6	%
Amortization of intangible assets	9,511	6,285	3,226	51.3	%
Total operating expenses	81,432	62,459	18,973	30.4	%
Income from operations	56,340	67,867	(11,527)	-17.0	%
Total other expense, net	(14,814)	(14,613)	(201)	1.4	%
Income before provision for income taxes	41,526	53,254	(11,728)	-22.0	%
Provision for income taxes	15,514	19,218	(3,704)	-19.3	%
Net income	26,012	34,036	(8,024)	-23.6	%
Net loss attributable to noncontrolling interests	(171)	-	(171)	N/A	
Net income attributable to Generac Holdings Inc.	\$26,183	\$34,036	(7,853)	-23.1	%

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

	<b>Net Sales Three Months Ended September 30,</b>		<b>\$ Change</b>	<b>% Change</b>	
	<b>2016</b>	<b>2015</b>			
Domestic	\$299,095	\$332,213	(33,118)	-10.0	%

International	74,026	27,078	46,948	173.4	%
Total net sales	\$373,121	\$359,291	13,830	3.8	%

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

	<b>2016</b>	<b>2015</b>	<b>\$ Change</b>	<b>% Change</b>	
Domestic	\$69,309	\$77,117	(7,808 )	-10.1	%
International	3,527	4,055	(528 )	-13.0	%
Total Adjusted EBITDA	\$72,836	\$81,172	(8,336 )	-10.3	%

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

	<b>Three Months Ended September 30,</b>		<b>\$</b>	<b>%</b>	
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>Change</b>	
Residential products	\$192,856	\$184,968	7,888	4.3	%
Commercial & industrial products	149,676	148,234	1,442	1.0	%
Other	30,589	26,089	4,500	17.2	%
Total net sales	\$373,121	\$359,291	13,830	3.8	%

*Net sales.* The decrease in Domestic sales for the three months ended September 30, 2016 was primarily due to the ongoing significant declines in shipments of mobile products into oil & gas and general rental markets. In addition, shipments of home standby generators declined modestly over the prior year. Partially offsetting these impacts was the contribution from the CHP acquisition.

The increase in International sales for the three months ended September 30, 2016 was primarily due to the contribution from the Pramac acquisition.



The total contribution from non-annualized recent acquisitions to the three months ended September 30, 2016 was \$60.8 million.

*Gross profit.* Gross profit margin for the third quarter of 2016 was 36.9% compared to 36.3% in the prior-year third quarter. Gross margin was positively impacted by the ongoing favorable impacts from lower commodity prices seen in prior quarters and continued overseas sourcing benefits from a stronger U.S. Dollar, along with an overall favorable organic product mix. These benefits were partially offset by the net mix impact from recent acquisitions.

*Operating expenses.* The increase in operating expenses was primarily due to the addition of recurring operating expenses associated with recent acquisitions, and to a lesser extent, increased amortization expense.

*Other expense.* The increase in other expense was due to an increase in interest expense resulting from additional debt assumed in recent acquisitions and increased borrowings at other foreign subsidiaries. Additionally, the prior year third quarter included a \$2.4 million non-cash loss resulting from an increase in our Term Loan interest rate spread of 25 basis points for an anticipated period of four quarters. The current year third quarter included an additional \$3.0 million non-cash loss resulting from a continuation of the 25 basis point spread increase for an anticipated period of five additional quarters.

*Provision for income taxes.* The effective income tax rates for the three months ended September 30, 2016 and 2015 were 37.4% and 36.1%, respectively. The increase in the effective income tax rate is due to a non-recurring discrete tax item impacting the current year third quarter.

*Net income attributable to Generac Holdings Inc.* The decrease in net income attributable to Generac Holdings Inc. was primarily due to the factors outlined above, partially offset by the adjustment for net loss attributable to noncontrolling interests.

*Adjusted EBITDA.* Adjusted EBITDA margins for the Domestic segment for the three months ended September 30, 2016 were 23.2% of net sales, consistent with the three months ended September 30, 2015. Adjusted EBITDA margin in the current year third quarter benefitted from overall favorable product mix as well as lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar, offset by increased promotional activities and reduced overall leverage of fixed operating expenses.

Adjusted EBITDA margins for the International segment for the three months ended September 30, 2016 were 4.8% of net sales as compared to 15.0% of net sales for the three months ended September 30, 2015. This decrease was

primarily due to the Pramac acquisition, unfavorable sales mix and foreign currency impacts, and reduced operating leverage on lower organic sales volume.

*Adjusted Net Income.* Adjusted Net Income of \$53.2 million for the three months ended September 30, 2016 decreased 16.1% from \$63.4 million for the three months ended September 30, 2015, due to the factors outlined above, an increase in cash income tax expense and adjusted net income attributable to noncontrolling interests.

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

***Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015***

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

(U.S. Dollars in thousands)	Nine Months Ended September 30,		\$ Change	% Change	
	2016	2015			
Net sales	\$1,027,032	\$959,469	67,563	7.0	%
Cost of goods sold	667,053	630,643	36,410	5.8	%
Gross profit	359,979	328,826	31,153	9.5	%
Operating expenses:					
Selling and service	124,064	93,317	30,747	32.9	%
Research and development	27,512	24,907	2,605	10.5	%
General and administrative	55,492	40,897	14,595	35.7	%
Amortization of intangible assets	25,525	17,460	8,065	46.2	%
Total operating expenses	232,593	176,581	56,012	31.7	%
Income from operations	127,386	152,245	(24,859)	-16.3	%
Total other expense, net	(37,065)	(44,816)	7,751	-17.3	%
Income before provision for income taxes	90,321	107,429	(17,108)	-15.9	%
Provision for income taxes	33,154	38,864	(5,710)	-14.7	%
Net income	57,167	68,565	(11,398)	-16.6	%
Net loss attributable to noncontrolling interests	(112)	-	(112)	N/A	
Net income attributable to Generac Holdings Inc.	\$57,279	\$68,565	(11,286)	-16.5	%

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

<b>Net Sales</b>					
<b>Nine Months Ended</b>					
<b>September 30,</b>					
	<b>2016</b>	<b>2015</b>	<b>\$</b>	<b>%</b>	
			<b>Change</b>	<b>Change</b>	
Domestic	\$833,831	\$877,942	(44,111 )	-5.0	%
International	193,201	81,527	111,674	137.0	%
Total net sales	\$1,027,032	\$959,469	67,563	7.0	%

<b>Adjusted EBITDA</b>					
<b>Nine Months</b>					
<b>Ended September</b>					
<b>30,</b>					
	<b>2016</b>	<b>2015</b>	<b>\$</b>	<b>%</b>	
			<b>Change</b>	<b>Change</b>	
Domestic	\$173,521	\$180,018	(6,497 )	-3.6	%
International	13,050	10,714	2,336	21.8	%
Total Adjusted EBITDA	\$186,571	\$190,732	(4,161 )	-2.2	%

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

<b>Nine Months Ended</b>					
<b>September 30,</b>					
	<b>2016</b>	<b>2015</b>	<b>\$</b>	<b>%</b>	
			<b>Change</b>	<b>Change</b>	
Residential products	\$533,572	\$475,268	58,304	12.3	%
Commercial & industrial products	409,396	416,577	(7,181 )	-1.7	%
Other	84,064	67,624	16,440	24.3	%
Total net sales	\$1,027,032	\$959,469	67,563	7.0	%

*Net sales.* The decrease in Domestic sales for the nine months ended September 30, 2016 was primarily due to the significant reduction in shipments of mobile products into oil & gas and general rental markets, along with a modest decline in shipments of home standby generators over the prior period. Partially offsetting these impacts was the contribution from the CHP acquisition.

The increase in International sales for the nine months ended September 30, 2016 was largely due to the contribution from the Pramac acquisition, partially offset by declines in organic shipments into the United Kingdom and Latin American markets.

The total contribution from non-annualized recent acquisitions to the nine months ended September 30, 2016 was \$186.1 million.

*Net income attributable to Generac Holdings Inc.* Net income attributable to Generac Holdings Inc. for the nine months ended September 30, 2016 includes the impact of \$7.1 million of non-recurring, pre-tax charges relating to business optimization and restructuring costs to address the impact of the significant and extended downturn for capital spending within the oil & gas industry. The cost actions taken include the consolidation of production facilities, headcount reductions, certain non-cash asset write-downs and other non-recurring product-related charges. The charges consist of \$2.7 million classified within cost of goods sold and \$4.4 million classified within operating expenses. The decrease in net income attributable to Generac Holdings Inc. was primarily due to these charges and the other factors outlined in this section, partially offset by the adjustment for net loss attributable to noncontrolling interests.

*Gross profit.* Gross profit margin for the first nine months of 2016 was 35.1% compared to 34.3% in the first nine months of 2015, which includes the impact of the aforementioned \$2.7 million of business optimization charges classified within cost of goods sold, as well as \$4.2 million of expense relating to the purchase accounting adjustment for the step-up in value of inventories relating to the Pramac acquisition. Excluding the impact of these adjustments, gross profit margin was 35.7%, an improvement of 140 basis points over the prior year. The increase was primarily due to the favorable impacts from lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar, along with an overall favorable organic product mix. In addition, gross margin in the prior year was negatively impacted by temporary increases in certain costs associated with the west coast port congestion as well as other overhead-related costs that did not repeat in the current year. These factors were partially offset by the net mix impact from recent acquisitions.

*Operating expenses.* Excluding the impact of the aforementioned \$4.4 million of business optimization charges classified within operating expenses, operating expenses increased \$51.6 million, or 29.2%, to \$228.2 million for the nine months ended September 30, 2016 from \$176.6 million for the nine months ended September 30, 2015. The increase was primarily due to the addition of recurring operating expenses associated with recent acquisitions and increased amortization expense.

*Other expense.* The decrease in other expense was primarily due to a prior year non-cash \$4.8 million loss on extinguishment of debt resulting from \$150.0 million of voluntary prepayments of term loan debt, which did not repeat in the current year. Additionally, the prior year included a \$2.4 million non-cash loss resulting from an increase in our Term Loan interest rate spread of 25 basis points, while the current year included an additional \$3.0 million non-cash loss resulting from a continuation of the 25 basis point spread increase.

*Provision for income taxes.* The effective income tax rates for the nine months ended September 30, 2016 and 2015 were 36.7% and 36.2%, respectively.

*Adjusted EBITDA.* Adjusted EBITDA margins for the Domestic segment for the nine months ended September 30, 2016 were 20.8% of net sales as compared to 20.5% of net sales for the nine months ended September 30, 2015. This increase was primarily due to overall favorable product mix as well as the favorable impact of lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar, partially offset by increased promotional activities and reduced overall leverage of fixed operating expenses.

Adjusted EBITDA margins for the International segment for the nine months ended September 30, 2016 were 6.8% of net sales as compared to 13.1% of net sales for the nine months ended September 30, 2015. This decrease was primarily due to the Pramac acquisition, unfavorable sales mix and foreign currency impacts, lower absorption of fixed manufacturing overhead costs and reduced leverage of operating expenses on lower organic sales volume.

*Adjusted Net Income.* Adjusted Net Income of \$126.8 million for the nine months ended September 30, 2016 decreased 4.7% from \$133.1 million for the nine months ended September 30, 2015, due to the factors outlined above and adjusted net income attributable to noncontrolling interests, partially offset by a decrease in cash income tax expense.

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

## **Liquidity and Financial Condition**

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

The Company's credit agreements provide for a \$1.2 billion Term Loan and include a \$300.0 million uncommitted incremental term loan facility. The Term Loan matures on May 31, 2020. On November 2, 2016, the Term Loan maturity date was extended to May 31, 2023. (See Note 14, "Subsequent Events" to the condensed consolidated financial statements.) The Term Loan initially bore interest at rates based upon either a base rate plus an applicable margin of 1.75% or adjusted LIBOR rate plus an applicable margin of 2.75%, subject to a LIBOR floor of 0.75%. Beginning in the second quarter of 2014, and measured each subsequent quarter thereafter, the applicable margin related to base rate loans is reduced to 1.50% and the applicable margin related to LIBOR rate loans is reduced to 2.50%, to the extent that the Company's net debt leverage ratio, as defined in the Term Loan, is below 3.00 to 1.00 for that measurement period. The Company's net debt leverage ratio as of September 30, 2016 was above 3.00 to 1.00. As of September 30, 2016, the Company is in compliance with all covenants of the Term Loan. There are no financial maintenance covenants on the Term Loan.

The Company's credit agreements also provide for the \$250.0 million Amended ABL Facility. The maturity date of the Amended ABL Facility is May 29, 2020. In May 2015, the Company borrowed \$100.0 million under the Amended ABL Facility, the proceeds of which were used as a voluntary prepayment of Term Loan borrowings. As of September 30, 2016, there was \$100.0 million outstanding under the Amended ABL Facility, and the Company is in compliance with all covenants of the Amended ABL Facility.

For additional information regarding our credit agreements and their potential impact, see Note 9, "Credit Agreements" of our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

At September 30, 2016, we had cash and cash equivalents on hand of \$54.2 million and \$144.9 million of availability under our Amended ABL Facility, net of outstanding letters of credit.

In August 2015, the Company's Board of Directors approved a \$200.0 million stock repurchase program. Under the program, the Company may repurchase up to \$200.0 million of its common stock over 24 months from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. For the three months ended September 30, 2016, the Company repurchased 1,798,206 shares of its common stock for \$65.4 million. Since the inception of the program, the Company has repurchased 6,036,706 shares of its common stock for \$199.9 million, all funded with cash on hand. The repurchases in the third quarter of 2016 completed the total authorized amount under the program. See Note 14, "Subsequent Events" to the condensed consolidated financial statements for further discussion of our stock repurchase programs.

## Long-term Liquidity

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

## Cash Flow

### *Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015*

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

(U.S. Dollars in thousands)	Nine Months Ended September 30,		\$ Change	% Change	
	2016	2015			
Net cash provided by operating activities	\$ 129,513	\$ 76,859	52,654	68.5	%
Net cash used in investing activities	(80,884 )	(94,480 )	13,596	-14.4	%
Net cash used in financing activities	(110,667)	(122,754)	12,087	-9.8	%

The 68.5% increase in net cash provided by operating activities was primarily driven by a reduction in working capital investment during the current year as compared to the larger investment that was incurred in the prior year, partially offset by an overall decline in operating earnings.

Net cash used in investing activities for the nine months ended September 30, 2016 primarily represents cash payments of \$60.9 million related to the acquisition of Pramac and \$20.8 million for the purchase of property and equipment. Net cash used in investing activities for the nine months ended September 30, 2015 primarily represents cash payments of \$74.5 million related to the acquisition of CHP and \$20.1 million for the purchase of property and equipment.

Net cash used in financing activities for the nine months ended September 30, 2016 primarily represents \$99.9 million of payments for the repurchase of the Company's common stock, \$19.2 million of debt repayments (\$11.0 million of long-term borrowings and \$8.2 million of short-term borrowings) and \$12.3 million related to the net share settlement of equity awards. These payments were partially offset by \$14.1 million cash proceeds from short-term borrowings and a \$6.8 million cash inflow related to excess tax benefits of equity awards.

Net cash used in financing activities for the nine months ended September 30, 2015 primarily represents \$165.8 million of debt repayments (\$150.6 million of long-term borrowings and \$15.2 million of short-term borrowings) partially offset by \$114.3 million cash proceeds from borrowings (\$100.0 million from long-term borrowings under the ABL facility and \$14.3 million from short-term borrowings). In addition, the Company paid \$64.4 million for the repurchase of its common stock and \$12.4 million related to the net share settlement of equity awards, which was partially offset by an \$8.9 million cash inflow related to the excess tax benefits of equity awards.

### **Contractual Obligations**

In connection with the Pramac acquisition, the Company assumed \$21.1 million of short-term borrowings and \$18.6 million of long-term debt and capital lease obligations. Refer to Note 2, "Acquisitions," to the condensed consolidated financial statements for further information. Other than the assumption of the Pramac debt, there have been no material changes to our contractual obligations since the February 26, 2016 filing of our Annual Report on Form 10-K for the year ended December 31, 2015.

### **Off-Balance Sheet Arrangements**

There have been no material changes to off-balance sheet arrangements since the February 26, 2016 filing of our Annual Report on Form 10-K for the year ended December 31, 2015.

### **Critical Accounting Policies**

There have been no material changes in our critical accounting policies since the February 26, 2016 filing of our Annual Report on Form 10-K for the year ended December 31, 2015.



As discussed in our Annual Report on Form 10-K for the year ended December 31, 2015, in preparing the financial statements in accordance with U.S. GAAP, 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 U.S. GAAP and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. We make routine estimates and judgments in determining net realizable value of accounts receivable, inventories, property and equipment, and prepaid expenses. We believe that our most critical accounting estimates and assumptions are in the following areas: goodwill and other intangible asset impairment assessment; business combinations and purchase accounting; defined benefit pension obligations; estimates of allowance for doubtful accounts, excess and obsolete inventory reserves, product warranty and other contingencies; derivative accounting; income taxes and share based compensation.

## **Non-GAAP Measures**

### ***Adjusted EBITDA***

The computation of Adjusted EBITDA attributable to Generac Holdings Inc. is based on the definition of EBITDA contained in our credit agreement dated as of May 31, 2013, as amended. To supplement our condensed consolidated financial statements presented in accordance with U.S. GAAP, we provide the computation of Adjusted EBITDA attributable to the Company, taking into account certain charges and gains that were recognized during the periods presented.

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

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
- to allocate resources to enhance the financial performance of our business;
- as 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 2016 proxy statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
- in communications with our Board of Directors and investors concerning our financial performance.

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

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

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

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

- we do not consider indicative of our ongoing operating performance, such as non-cash write-downs and other charges, non-cash gains 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; or
- are non-cash in nature, such as share-based compensation.

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

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

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- several of the adjustments that we use in calculating Adjusted EBITDA, such as non-cash write-downs and other charges, while not involving cash expense, do have a negative impact on the value of our assets as reflected in our consolidated balance 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 adjustments in calculating Adjusted EBITDA (subject ultimately to review by our Board of Directors in the context of the Board's review of our quarterly financial statements). While many of the adjustments (for example, transaction costs and credit facility fees), involve mathematical application of items reflected in our financial statements, others involve a degree of judgment and discretion. While we believe all of these adjustments are appropriate, and while the quarterly calculations are subject to review by our Board of Directors in the context of the Board's review of our quarterly financial statements and certification by our Chief Financial Officer in a compliance certificate provided to the lenders under our Term Loan and Amended ABL Facility credit agreements, this discretion may be viewed as an additional limitation on the use of Adjusted EBITDA as an analytical tool.

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

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

(U.S. Dollars in thousands)	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net income attributable to Generac Holdings Inc.	\$26,183	\$34,036	\$57,279	\$68,565
Net loss attributable to noncontrolling interests (a)	(171 )	-	(112 )	-
Net income	26,012	34,036	57,167	68,565
Interest expense	11,299	10,210	33,714	32,241
Depreciation and amortization	14,900	10,597	41,343	29,760
Provision for income taxes	15,514	19,218	33,154	38,864
Non-cash write-down and other adjustments (b)	(1,093 )	2,115	1,689	4,091
Non-cash share-based compensation expense (c)	2,419	1,799	7,805	6,889
Loss on extinguishment of debt (d)	-	-	-	4,795
Loss on change in contractual interest rate (e)	2,957	2,381	2,957	2,381
Transaction costs and credit facility fees (f)	739	317	1,499	999
Business optimization expenses (g)	58	5	7,164	1,743
Other	31	494	79	404
Adjusted EBITDA	72,836	81,172	186,571	190,732
Adjusted EBITDA attributable to noncontrolling interests	708	-	3,015	-
Adjusted EBITDA attributable to Generac Holdings Inc.	\$72,128	\$81,172	\$183,556	\$190,732

(a) Includes the noncontrolling interests' share of expenses related to Pramac purchase accounting, including the step-up in value of inventories and intangible amortization, of \$1.3 million and \$6.9 million for the three and nine months ended September 30, 2016, respectively.

(b) Represents the following non-cash charges for the three and nine months ended September 30, 2016 and 2015: gains/losses on disposals of assets, unrealized mark-to-market adjustments on commodity contracts, foreign currency gains/losses and certain purchase accounting related adjustments.

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

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

The adjustments for unrealized mark-to-market gains and losses on commodity contracts represent non-cash items to reflect changes in the fair value of forward contracts that have not been settled or terminated. We believe it is useful to adjust net income for these items because the charges do not represent a cash outlay in the period in which the charge is incurred, although Adjusted EBITDA must always be used together with our U.S. GAAP statements of comprehensive income and cash flows to capture the full effect of these contracts on our operating performance; and The purchase accounting adjustments represent non-cash items to reflect fair value at the date of acquisition, and therefore do not reflect our ongoing operations.

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

(d) Represents the non-cash write-off of original issue discount and capitalized debt issuance costs due to voluntary debt prepayments.

(e) For the three and nine months ended September 30, 2016, represents a non-cash loss relating to the continued 25 basis point increase in borrowing costs as a result of the credit agreement leverage ratio remaining above 3.0 times based on current projections. For the three and nine months ended September 30, 2015, represents a non-cash loss relating to a 25 basis point increase in borrowing costs as a result of the credit agreement leverage ratio rising above 3.0 times effective third quarter 2015 and remaining above 3.0 times based on projections at the time.

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

Amended ABL Facility, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation.

(g) For the nine months ended September 30, 2016, primarily represents charges relating to business optimization and restructuring costs to address the significant and extended downturn for capital spending within the oil & gas industry. For the three and nine months ended September 30, 2015, represents severance and other non-recurring restructuring charges related to the integration of our facilities. These charges represent expenses that are not from our core operations and do not reflect our ongoing operations.

### *Adjusted Net Income*

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

We believe Adjusted Net Income is used by securities analysts, investors and other interested parties in the evaluation of our company's operations. Management believes the disclosure of Adjusted Net Income offers an additional financial metric that, when used in conjunction with U.S. GAAP results and the reconciliation to U.S. GAAP results, provides a more complete understanding of our 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 or cash flows, such as amortization costs, transaction costs and write-offs relating to the retirement of debt. We also make adjustments to present cash taxes paid as a result of our favorable tax attributes.

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

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

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

(U.S. Dollars in thousands, except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income attributable to Generac Holdings Inc.	\$26,183	\$34,036	\$57,279	\$68,565
Net loss attributable to noncontrolling interests	(171)	) -	(112)	) -
Net income	26,012	34,036	57,167	68,565
Provision for income taxes	15,514	19,218	33,154	38,864
Income before provision for income taxes	41,526	53,254	90,321	107,429
Amortization of intangible assets	9,511	6,285	25,525	17,460
Amortization of deferred finance costs and original issue discount	1,107	1,024	3,229	4,368
Loss on extinguishment of debt	-	-	-	4,795
Loss on change in contractual interest rate	2,957	2,381	2,957	2,381
Transaction costs and other purchase accounting adjustments (a)	469	979	5,159	1,482
Business optimization expenses	58	5	7,164	1,743
Adjusted net income before provision for income taxes	55,628	63,928	134,355	139,658
Cash income tax expense (b)	(2,325)	) (500)	(5,595)	) (6,535)
Adjusted net income	53,303	63,428	128,760	133,123
Adjusted net income attributable to noncontrolling interests	58	-	1,939	-
Adjusted net income attributable to Generac Holdings Inc.	\$53,245	\$63,428	\$126,821	\$133,123
Adjusted net income per common share attributable to Generac Holdings, Inc. - diluted:	\$0.82	\$0.92	\$1.92	\$1.91
Weighted average common shares outstanding - diluted:	65,126,117	69,182,465	65,992,127	69,781,300

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

(b) Amount for the three and nine months ended September 30, 2016 is based on an anticipated cash income tax rate of approximately 6% for the full year-ended 2016. Amount for the three and nine months ended September 30, 2015 is based on an anticipated cash income tax rate of approximately 6% for the full year-ended 2015. Cash income tax expense for the respective periods is based on the projected taxable income and corresponding cash tax rate for the full year after considering the effects of current and deferred income tax items, and is calculated for each respective period by applying the derived cash tax rate to the period's pretax income.

### **New Accounting Standards**

Refer to Note 1, "Description of Business and Basis of Presentation," to the condensed consolidated financial statements for further information on the new accounting standards applicable to the Company.

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

Refer to Note 3, "Derivative Instruments and Hedging Activities," to the condensed consolidated financial statements for a discussion of changes in commodity, currency and interest rate related risks and hedging activities. Otherwise, there have been no material changes in market risk from the information provided in Item 7A (Quantitative and Qualitative Disclosures About Market Risk) of our Annual Report on Form 10-K for the year ended December 31, 2015.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

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





## **Changes in Internal Control Over Financial Reporting**

In January 2016, the Company implemented a new global enterprise resource planning (ERP) system for a majority of our business, with another subsidiary of the Company implementing in October 2016. In connection with this ERP system implementation, we have updated our internal controls over financial reporting, as necessary, to accommodate modifications to our business processes and accounting procedures. Additional implementations will occur at the Company's remaining locations over a multi-year period.

On March 1, 2016, the Company acquired a 65% ownership interest in Pramac. As a result of the acquisition, we are in the process of reviewing the internal control structure of Pramac and, if necessary, will make appropriate changes as we incorporate our controls and procedures into the acquired business. We intend to exclude the operations of Pramac from the scope of our Management Report on Internal Control Over Financial Reporting for the year ended December 31, 2016.

Other than the continuing assessment of controls for the ERP system implementation and Pramac acquisition noted above, there have been no changes during the three months ended September 30, 2016 in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time, we are involved in legal proceedings primarily involving product liability, employment matters and general commercial disputes arising in the ordinary course of our business. As of September 30, 2016, we believe that there is no litigation pending that would have a material effect on our results of operations or financial condition.

### **Item 1A. Risk Factors**

There have been no material changes in our risk factors since the February 26, 2016 filing of our Annual Report on Form 10-K for the year ended December 31, 2015.

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

The following table summarizes our stock repurchase activity for the three months ended September 30, 2016, which consisted of the withholding of shares upon the vesting of restricted stock awards to pay related withholding taxes on behalf of the recipient and shares repurchased under the Company's \$200.0 million stock repurchase program:

	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number Of Shares Purchased As Part Of Publicly Announced Plans Or Programs</b>	<b>Approximate Dollar Value Of Shares That May Yet Be Purchased Under The Plans Or Programs</b>
07/01/2016 – 07/31/2016	-	-	-	65,481,994
08/01/2016 – 08/31/2016	1,121,462	\$ 36.60	1,117,000	24,598,989
09/01/2016 – 09/30/2016	682,304	35.93	681,206	124,216
Total	1,803,766	\$ 36.34		

For equity compensation plan information, please refer to our Annual Report on Form 10-K for the year ended December 31, 2015.

**Item 6. Exhibits**

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

## SIGNATURES

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

Generac Holdings Inc.

By: /s/ York A. Ragen

York A. Ragen

*Chief Financial Officer*

*(Duly Authorized Officer and Principal Financial and Accounting Officer)*

Dated: November 4, 2016

**Item 6.**

**EXHIBIT INDEX**

<b>Exhibits Number</b>	<b>Description</b>
10.1*	Terms of Employment for Erik Wilde, Executive Vice President - North America Industrial, as set forth in the Offer of Employment Letter dated July 8, 2016.
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 September 30, 2016 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related Notes to Condensed Consolidated Financial Statements.

\* Filed herewith.

\*\* Furnished herewith.