

GENERAC HOLDINGS INC.  
Form 10-K  
March 09, 2012

---

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

---

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-34627

---

GENERAC HOLDINGS INC.

(Exact name of registrant as specified in its charter)

DELAWARE

20-5654756

(State or other jurisdiction of incorporation or  
formation)

(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)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

Common Stock, \$0.01 par value

New York Stock Exchange

(Title of class)

(Name of exchange on which registered)

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: None

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

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

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant on June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$494,323,000 based upon the closing price reported for such date on the New York Stock Exchange.

As of March 5, 2012, 67,906,706 shares of registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the 2012 Annual Meeting of Stockholders (the "2012 Proxy Statement"), which will be filed by the registrant on or prior to 120 days following the end of the registrant's fiscal year ended December 31, 2011, are incorporated by reference into Part III of this Form 10-K.

2011 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS

|                        |   | Page      |
|------------------------|---|-----------|
| <b><u>PART I</u></b>   |   |           |
| <u>Item 1.</u>         | <u>Business</u>   | <u>2</u>  |
| <u>Item 1A.</u>        | <u>Risk Factors</u>   | <u>8</u>  |
| <u>Item 1B.</u>        | <u>Unresolved Staff Comments</u>  | <u>18</u> |
| <u>Item 2.</u>         | <u>Properties</u>   | <u>18</u> |
| <u>Item 3.</u>         | <u>Legal Proceedings</u>  | <u>19</u> |
| <u>Item 4.</u>         | <u>Mine Safety Disclosures</u>  | <u>19</u> |
| <b><u>PART II</u></b>  |   |           |
| <u>Item 5.</u>         | <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>19</u> |
| <u>Item 6.</u>         | <u>Selected Financial Data</u>  | <u>21</u> |
| <u>Item 7.</u>         | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>28</u> |
| <u>Item 7A.</u>        | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | <u>45</u> |
| <u>Item 8.</u>         | <u>Financial Statements and Supplementary Data</u>  | <u>47</u> |
| <u>Item 9.</u>         | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | <u>86</u> |
| <u>Item 9A.</u>        | <u>Controls and Procedures</u>  | <u>87</u> |
| <u>Item 9B.</u>        | <u>Other Information</u>  | <u>88</u> |
| <b><u>PART III</u></b> |   |           |
| <u>Item 10.</u>        | <u>Directors, Executive Officers and Corporate Governance</u>   | <u>88</u> |
| <u>Item 11.</u>        | <u>Executive Compensation</u>   | <u>88</u> |
| <u>Item 12.</u>        | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>               | <u>88</u> |
| <u>Item 13.</u>        | <u>Certain Relationships and Related Transactions, and Director Independence</u>                                    | <u>88</u> |
| <u>Item 14.</u>        | <u>Principal Accountant Fees and Services</u>   | <u>88</u> |
| <b><u>PART IV</u></b>  |   |           |
| <u>Item 15.</u>        | <u>Exhibits and Financial Statement Schedules</u>   | <u>89</u> |

Table of Contents

PART I

Forward-Looking Statements

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

The forward-looking statements contained in this annual 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 annual 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 annual report include estimates regarding:

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

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

- demand for our products;
- frequency of major power outages;
- availability, cost and quality of raw materials and key components used producing our products;
- the possibility that the expected synergies, efficiencies and cost savings of the acquisition of the Magnum Products business will not be realized, or will not be realized within the expected time period;
- the risk that the Magnum Products business will not be integrated successfully;
- competitive factors in the industry in which we operate;
- our dependence on our distribution network;
- our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;
- our ability to adjust to operating as a public company;

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

## Table of Contents

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in these forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in Item 1A of this Annual Report on Form 10-K.

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

### Item 1. Business

We are a leading designer and manufacturer of a wide range of generators and other engine powered products for the residential, light commercial, industrial and construction markets. We are the only significant market participant focused predominantly on these products, and we have one of the leading market positions in the power equipment markets in the United States and Canada. We design, manufacture, source and modify engines, alternators, automatic transfer switches and other components necessary for our products. Our products are fueled by natural gas, liquid propane, gasoline, diesel and Bi-Fuel™ and are available through a broad network of independent dealers, retailers, wholesalers, and equipment rental companies.

We have what we believe is an industry leading, multi-layered distribution network, and our products are available in thousands of outlets across the United States and Canada. We distribute our products through independent residential and industrial dealers, electrical wholesalers, national accounts, private label arrangements, retailers, catalogs, e-commerce merchants, equipment rental companies, equipment dealers and construction companies. We currently sell our products primarily in North America. We have a significant market share in the residential and light commercial generator markets, which we believe are currently under penetrated. We believe that our leading market position is largely attributable to our strategy of providing a broad product line of high-quality, innovative and affordable products through our extensive and multi-layered distribution network. In addition, through our acquisition of Magnum Products, we are a leading provider of light towers and mobile generators.

We own and operate four manufacturing plants and one distribution facility in Eagle, Wisconsin, Waukesha, Wisconsin, Berlin, Wisconsin and Whitewater, Wisconsin, totaling approximately 1,200,000 total square feet. We also maintain inventory warehouses in the United States that accommodate material storage and rapid response requirements of our customers.

### History

Generac Holdings Inc. (Generac) is a Delaware corporation that was founded in 2006. Generac Power Systems, Inc., or Generac Power Systems, our principal operating subsidiary, is a Wisconsin corporation, which was founded in 1959 to market a line of affordable portable generators that offered superior performance and features. We expanded beyond portable generators in 1980 into the industrial market with the introduction of our first stationary generators that provided up to 200 kW. We entered the residential market in 1989 with a residential standby generator, and expanded our product development and global distribution system in the 1990s, forming a series of alliances that tripled our higher output generator net sales. In 1998, we sold our Generac® portable products business to the Beacon Group, a private equity firm, which eventually sold this business to Briggs & Stratton. Our growth accelerated in 2000 as we expanded our automatic residential standby generator product offering, implemented our multi-layered distribution philosophy, and introduced our quiet-running QT Series generators in 2005, accelerating our penetration in the commercial market. In 2008, we successfully expanded our position in the portable generator market after the expiration of our non-compete agreement with the Beacon Group entered into in connection with the

aforementioned Beacon Group transaction. In late 2011, our subsidiary Magnum Power Products, LLC acquired the assets of the Magnum Products business (Magnum or Magnum Products) which is the number one light tower manufacturer in the U.S. and has a growing share of the mobile generator market. Today, we manufacture a full line of power products for a wide variety of applications and markets. Our success is built on engineering expertise, manufacturing excellence and our innovative approaches to the market.

## Table of Contents

### CCMP transactions

In November 2006, affiliates of CCMP Capital Advisors, LLC, or CCMP, together with certain other investors and members of our management, purchased an aggregate of \$689 million of our equity capital. In addition, on November 10, 2006, Generac Power Systems borrowed an aggregate of \$1.38 billion, consisting of an initial drawdown of \$950 million under a \$1.1 billion first lien secured credit facility and \$430 million under a \$430 million second lien secured credit facility. With the proceeds from these equity and debt financings, together with cash on hand at Generac Power Systems, we (1) acquired all of the capital stock of Generac Power Systems and repaid certain pre-transaction indebtedness of Generac Power Systems for \$2.0 billion, (2) paid \$66 million in transaction costs related to the transaction and (3) retained \$3.0 million for general corporate purposes.

We refer to the foregoing transactions collectively as the “CCMP Transactions.”

### Initial public offering and corporate reorganization

On February 17, 2010, we completed our initial public offering (IPO) of 18,750,000 shares of our common stock at a price of \$13.00 per share. In addition, on March 18, 2010, the underwriters exercised their option and purchased an additional 1,950,500 shares of our common stock from us. We received approximately \$224.1 million in net proceeds at the initial closing, and approximately \$23.8 million in net proceeds from the underwriters’ option exercise, after deducting the underwriting discount and total expenses related to the offering. The proceeds from the initial closing of the IPO were used entirely to pay down our second lien credit facility in full and to repay a portion of our first lien credit facility. Proceeds from the option exercise were used for general corporate purposes, including additional pre-payment of the first lien credit facility.

Our capitalization prior to the IPO consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. In connection with the IPO, we effected a corporate reorganization in which, after giving effect to a 3.294 for one reverse Class A Common Stock split, our Class B Common Stock and Series A Preferred Stock was converted into Class A Common Stock and our Class A Common Stock was then reclassified as common stock. Following the IPO, we have only one class of common stock outstanding. We refer to these transactions, as the “Corporate Reorganization.” For more information regarding our Corporate Reorganization, see “Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations – Corporate reorganization.”

### Our products

We design, engineer and manufacture generators with an output of between 800W and 9mW, as well as other engine powered products such as light towers, pumps and power washers. In the manufacturing process, we design, manufacture, source and modify engines, alternators, transfer switches and other components necessary to production. We classify our products into three classes based on similar range of power output geared for varying end customer uses: residential power products; commercial and industrial power products; and other products. The following summary outlines our portfolio of products, including their key attributes and customer applications.

#### Residential power products

Our automatic residential standby generators range in output from 6kW to 60kW, with manufacturer's suggested retail prices, or MSRPs, from approximately \$1,800 to \$15,000. They operate on either natural gas or liquid propane and are permanently installed with an automatic transfer switch, which we also manufacture. Air-cooled residential standby generators range in outputs from 6kW to 20kW, are available in steel and aluminum enclosures and serve as an emergency backup for small to medium homes. Liquid-cooled generators serve as emergency backup for larger homes and small businesses and range in output from 20kW to 60kW. Liquid-cooled brands include the Guardian® Series



and the premium QuietSource® Series, which have a quiet, low-speed engine and a standard aluminum enclosure.

We provide portable generators fueled by gasoline that range in size from 800W to 17,500W. These products serve as an emergency home backup and are used for construction and recreational purposes. Following the expiration of a non-compete agreement in 2007, we expanded our portable product offering to introduce portable generators below 12,500W. We currently have four portable product lines: the GP series, targeted at homeowners, ranging from 1,850W to 17,500W; the XG series, targeted at the premium homeowner markets, ranging from 4,000 to 10,000W; the XP series, targeted at the professional contractor market, ranging from 4,000 to 8,000W; and the iX series, targeted at the recreational market, ranging from 800W to 2,000W. With our acquisition of Gen-Tran in February 2012, we now offer manual transfer switches to supplement our portable generator product offering.

## Table of Contents

Residential power products comprised 63.0%, 62.9% and 62.0%, respectively, of total net sales in 2009, 2010 and 2011.

### Industrial and commercial power products

Our light-commercial standby generators include a full range of affordable generators from 22kW to 150kW and related transfer switches, providing three-phase power sufficient for most small and mid-sized businesses including grocery stores, convenience stores, restaurants, gas stations, pharmacies, retail banks and small health care facilities. Our light-commercial generators run on natural gas or liquid propane thereby eliminating the fuel spillages, spoilage, environmental or odor concerns common with traditional diesel units.

We manufacture a broad line of standard and configured standby generators and related transfer switches for industrial applications. Our single-engine industrial generators range in output from 10kW to 600kW with our Modular Power System (MPS) technology extending our product range up to 9mW. We offer four fuel options including diesel, natural gas, liquid propane or Bi-Fuel™. Bi-Fuel™ generators operate on a combination of both diesel and natural gas to allow our customers the advantage of multiple fuel sources and extended run times. These units are primarily used as emergency backup for large healthcare, telecom, datacom, commercial office, municipal and manufacturing customers.

Our MPS technology combines the power of several smaller generators to produce the output of a larger generator, providing our customers with redundancy and scalability in a cost-effective manner. For larger industrial applications, our MPS products offer customers an efficient, affordable way to scale their standby power needs. By offering a series of smaller Generac generators integrated with Generac's proprietary PowerManager control system, we provide a lower cost alternative to traditional large, single-engine generators. The MPS product line also offers superior reliability given its built-in redundancy which allows individual units to be taken off-line for routine maintenance while retaining coverage for critical circuits.

We provide the telecommunications market our full range of generator systems, ranging from 20kW air-cooled generators to 3mW MPS.

Our light towers and mobile generators provide temporary lighting and power for various end markets, such as road and commercial construction, energy, mining, military and special events. We also manufacture mobile pumps which utilize wet and dry-priming pump systems for a wide variety of wastewater applications.

Industrial and commercial power products comprised 31.9%, 31.0% and 31.6%, respectively, of total net sales in 2009, 2010 and 2011.

### Other power products

We sell aftermarket service parts to our dealers and proprietary engines to third-party original equipment manufacturers, or OEMs. We also sell RV generators, which are available in gasoline, liquid propane and diesel fuel models, directly to OEMs as well as aftermarket dealers.

Other power products comprise 5.1%, 6.1% and 6.4%, respectively, of total net sales in 2009, 2010 and 2011.

### Distribution channels and customers

We distribute our product through several channels to increase awareness of our product categories and the Generac® and Magnum® brands, and to ensure our products reach a broad customer base. This distribution network includes

independent residential and industrial dealers, wholesalers, national accounts, private label arrangements, retailers, catalogs, e-commerce merchants, equipment rental companies, equipment dealers and construction companies. We believe our distribution network is a competitive advantage that has strengthened over the last decade by expanding our network from our base of industrial dealers to include other channels of distribution as product offerings have increased. Our network is well balanced with no single sales channel providing more than 25% of our sales and no customer providing more than 8% of our sales in 2011.

## Table of Contents

Our dealer network, which is located principally in the United States and Canada, is the industry's largest network of independent generator contractors.

Our residential/commercial dealer network sells, installs and services our residential and light-commercial products to end users. We have developed a number of proprietary dealer management programs to evaluate, manage and incentivize our dealers, which we believe has an important impact on the high level of customer service we provide to end customers. These programs include both technical and sales training, under which we train new and existing dealers about our products, service and installation. We regularly perform market analyses to determine if a given market is either under-served or has poor residential dealer representation. Within these locations, we selectively add distribution or invest resources in existing dealer support and training to improve dealer performance.

Our industrial dealer network provides industrial and commercial end-users with on-going, local and nationwide product support. Our industrial dealers maintain the local relationships with commercial electrical contractors, specifying engineers and national account regional buying offices. Our sales group works in conjunction with our industrial dealers to ensure that national accounts receive engineering support, competitive pricing and nationwide service. We promote our industrial generators through the use of product demonstrations, specifying engineer education events, dealer forums and training. In recent years, we have been particularly focused on expanding our dealer network in Latin America in order to expand our international sales opportunities.

Our wholesaler network consists of selling branches of both national and local distribution houses for electrical and HVAC products. Our wholesalers distribute our residential and light-commercial generators and are a key introduction to the standby generator category for electrical and HVAC contractors who may not be Generac dealers.

On a selective basis, we have established private label and licensing arrangements with third party partners to provide residential, light-commercial and industrial generators. The partners include leading home equipment, electrical equipment and construction machinery companies, each of which provides access to incremental channels of distribution for our products. We have agreements in place with these partners having terms of between three and four years and further establishing additional terms and conditions of these arrangements.

Our retail distribution network includes thousands of locations and includes regional and national home improvement chains, retailers, clubs, buying groups and farm supply stores. These physical retail locations are supplemented by a number of catalogue and e-commerce retailers. This network primarily sells our residential standby, portable and light-commercial generators. In some cases, we have worked with our retail partners to create installation programs using our residential dealers to support the sale and installation of standby generator products sold at retail. We also use a combination of display units and advertising through our retail accounts to promote awareness for our products.

The distribution for our mobile products includes international, national and regional equipment rental companies, equipment dealers and construction companies.

Additionally, we sell certain generators and engines directly to OEM manufacturers and after-market dealers for use in the lawn and garden and RV markets.

## Manufacturing

Our excellence in manufacturing reflects our philosophy of high standards, continuous improvement and commitment to quality. Our facilities showcase our advanced manufacturing techniques and demonstrate the effectiveness of lean manufacturing.

We continually seek to reduce manufacturing costs while improving product quality. We deliver an affordable product to our customers through our value engineering philosophy, our strategic foreign sourcing, our scale, and adherence to lean manufacturing principles. We believe we have sufficient capacity to achieve our business goals for the near term.

Our product quality is essential to maintaining a leading market position. Incoming shipments from our suppliers are tested to ensure engineering specifications are met. Purchased components are tested for quality at the supplier's factory and prior to entering production lines and are continuously tested throughout the manufacturing process. Internal product and production audits are performed to ensure a reliable product and process. We test finished products under a variety of simulated conditions at each of our manufacturing facilities.

## Table of Contents

### Research and development and intellectual property

Our primary focus on generators and engine powered equipment drives technological innovation, specialized engineering and manufacturing competencies. Research and development is a core competency and includes a staff of over 150 engineers working on numerous active projects. Our sponsored research and development expense was \$10.8 million, \$14.7 million and \$16.5 million for the years ended December 2009, 2010 and 2011, respectively. Research and development is conducted at each of our manufacturing facilities and additionally at our technical center in Suzhou, China with dedicated teams for each product line. Research and development is focused on developing new technologies and product enhancements as well as maintaining product competitiveness by improving manufacturing costs, safety characteristics, reliability and performance while ensuring compliance with governmental standards. We have had over 30 years of experience using natural gas engines and have developed specific expertise with fuel systems and emissions technology. In the residential and light commercial markets, we have developed proprietary engines, cooling packages, controls, fuel systems and emissions systems. We believe that our expertise in engine powered equipment gives us the capability to develop new products that will allow continued diversification in our end markets.

We rely on a combination of patents and trademarks to establish and protect our proprietary rights. Our commitment to research and development has resulted in a portfolio of approximately 90 U.S. and international patents and patent applications. Our patents expire between 2016 and 2028 and protect certain features and technologies we have developed for use in our products including fuel systems, air flow, electronics and controls, noise reduction and air-cooled engines. U.S. trademark registrations generally have a perpetual duration if they are properly maintained and renewed. New U.S. patents that are issued generally have a life of 20 years from the date the patent application is initially filed. We believe the existence of these patents and trademarks, along with our ongoing processes to register additional patents and trademarks, protect our intellectual property rights and enhance our competitive position. We also use proprietary manufacturing processes that require customized equipment.

### Suppliers of raw materials

Our primary raw material inputs are steel, copper and aluminum, all of which are purchased from third parties and, in many cases, as part of machined or manufactured components. We have developed an extensive network of reliable, low-cost suppliers in the United States and abroad. Our strategic global sourcing function continuously evaluates the cost structure of our products and capabilities of our supply chain, and sources components accordingly based on this evaluation. In 2011, we sourced more than half of our components from outside the United States.

### Competition

The market for onsite standby generators is competitive. We face competition from a variety of large diversified industrial companies as well as smaller generator manufacturers abroad. However, most of the traditional participants in the standby generator market compete on a more specialized basis, focused on specific applications within their larger diversified product mix. We are the only significant market participant focused predominantly on standby and portable generators with broad capabilities across the residential, industrial and light-commercial generator markets. We believe that our engineering capabilities and core focus on generators provide us with manufacturing flexibility and enable us to maintain a first-mover advantage over our competition for product innovation. We also believe our broad product offering and diverse distribution model provide for additional advantages as well.

In the market for standby commercial and industrial generators, our primary competitors are Caterpillar, Cummins, Kohler and MTU, most of which focus on the market for diesel generators as they are also diesel engine manufacturers. In the market for residential standby generators, our primary competitors include Briggs & Stratton, Cummins (Onan division) and Kohler, which also have broad operations in other manufacturing businesses. In the

portable generator market, our primary competitors include Briggs & Stratton, Honda and Techtronics International (TTI), along with a number of smaller domestic and foreign competitors. In the market for mobile generators, our primary competitors are Doosan/IR, Aggreko, Caterpillar and Wacker. Our competitors in the market for light towers include Terex, Allmand and Wacker.

There are a number of other standby generator manufacturers located outside North America, but most supply their products mainly to their respective regional markets. In a continuously evolving sector, we believe our size and broad capabilities make us well positioned to remain competitive.

We compete primarily on the basis of brand reputation, quality, reliability, pricing, innovative features, breadth of product and product availability.

Table of Contents

## Employees

As of December 31, 2011, we had 2,223 employees (2,021 full time and 202 part-time and temporary employees). Of those, 1,364 employees were directly involved in manufacturing at our manufacturing facilities.

We have had an “open shop” bargaining agreement for the past 45 years. Our current agreement is with the Communication Workers of America, Local 4603. The current agreement, which expires October 17, 2016, covers our Waukesha and Eagle facilities. Currently, less than 2% of our workforce is a member of a labor union. Our facilities in Whitewater, Wisconsin and Berlin, Wisconsin are not unionized.

## Regulation, including environmental matters

As a manufacturing company, our operations are subject to a variety of foreign, federal, state and local environmental, health and safety laws and regulations including those governing, among other things, emissions to air, discharges to water, noise and the generation, handling, storage, transportation, treatment and disposal of waste and other materials. In addition, our products are subject to various laws and regulations relating to, among other things, emissions and fuel requirements, as well as labeling and marketing.

Our products are regulated by the U.S. Environmental Protection Agency (EPA), California Air Resources Board (CARB) and various other state and local air quality management districts. These governing bodies continue to pass regulations that require us to meet more stringent emission standards, and all of our engines and engine-driven products are regulated within the United States and its territories. Other countries have various degrees of regulation depending upon product application and fuel types. New regulations could require us to redesign our products and could affect market growth for our products.

## Segment information

We refer you to Note 2, “Segment Reporting,” of our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for information about our business segment and geographic areas.

## Executive officers

The following table sets forth information regarding our executive officers:

| Name                 | Age | Position                                       |
|----------------------|-----|--|
| Aaron P. Jagdfeld    | 40  | Chief Executive Officer and Director           |
| York A. Ragen        | 40  | Chief Financial Officer                        |
| Dawn A. Tabat        | 59  | Chief Operating Officer                        |
| Terrence J. Dolan    | 46  | Executive Vice President, Industrial Products  |
| Russell S. Minick    | 51  | Executive Vice President, Residential Products |
| Allen A. Gillette    | 55  | Senior Vice President, Engineering             |
| Roger W. Schaus, Jr. | 57  | Senior Vice President, Service Operations      |



R o g e r F .                      Senior Vice President,  
Pascavis                              51      Operations

Aaron P. Jagdfeld has served as our Chief Executive Officer since September 2008 and as a director since November 2006. Prior to becoming Chief Executive Officer, Mr. Jagdfeld worked for Generac for 15 years. He began his career in the finance department in 1994 and became our Chief Financial Officer in 2002. In 2007, he was appointed president and was responsible for sales, marketing, engineering and product development. Prior to joining Generac, Mr. Jagdfeld worked in the audit practice of the Milwaukee, Wisconsin office of Deloitte and Touche. Mr. Jagdfeld holds a Bachelor of Business Administration in Accounting from the University of Wisconsin-Whitewater.

Table of Contents

York A. Ragen has served as our Chief Financial Officer since September 2008. Prior to becoming Chief Financial Officer, Mr. Ragen held Director of Finance and Vice President of Finance positions at Generac. Prior to joining Generac in 2005, Mr. Ragen was Vice President, Corporate Controller at APW Ltd., a spin-off from Applied Power Inc., now known as Actuant Corporation. Mr. Ragen began his career in the Audit division of Arthur Andersen's Milwaukee office. Mr. Ragen holds a Bachelor of Business Administration in Accounting from the University of Wisconsin-Whitewater.

Dawn A. Tabat has served as our Chief Operating Officer since 2002. Ms. Tabat joined Generac in 1972 and served as Personnel Manager and Personnel Director before being promoted to Vice President of Human Resources in 1992. During this period, Ms. Tabat was responsible for creating the human resource function within Generac, including recruiting, compensation, training and workforce relations. In her current position, Ms. Tabat oversees manufacturing, logistics, global supply chain, quality, safety and information services.

Terrence J. Dolan began serving as our Executive Vice President of Industrial Products in October 2011. Prior to becoming Executive Vice President of Industrial Products, he served as our Senior Vice President of Sales from January 2010 to October 2011. Prior to joining Generac, Mr. Dolan was Senior Vice President of Business Development and Marketing at Boart Longyear from 2007 to 2008, Vice President of Sales and Marketing at Ingersoll Rand from 2002 to 2007, and Director of Strategic Accounts at Case Corporation from 1991 to 2001. Mr. Dolan holds a B.A. in Management and Communications from Concordia University.

Russell S. Minick joined Generac in August 2011, and was named Executive Vice President of Residential Products in October 2011. Prior to joining Generac, Mr. Minick was President & CEO of Home Care Products for Electrolux from 2006 to 2011, President of The Gunlocke Company at HNI Corporation from 2003 to 2006, Senior Vice President of Sales, Marketing and Product Development at True Temper Sports from 2002 to 2003, and General Manager of Extended Warranty Operations for Ford Motor Company from 1998 to 2002. Mr. Minick is a graduate of the University of Northern Iowa, and holds a degree in marketing.

Allen A. Gillette is our Senior Vice President of Engineering. Mr. Gillette joined Generac in 1998 and has served as Engineering Manager, Director of Engineering and Vice President of Engineering. Prior to joining Generac, Mr. Gillette was Manager of Engineering at Transamerica Delaval Enterprise Division, Chief Engineer—High-Speed Engines at Ajax-Superior Division and Manager of Design & Development, Cooper-Bessemer Reciprocating Products Division. Mr. Gillette holds an M.S. in Mechanical Engineering from Purdue University and a B.S. in Mechanical Engineering from Gonzaga University.

Roger W. Schaus, Jr. serves as our Senior Vice President of Service Operations. Mr. Schaus joined Generac in 1988 and has served as Director of Manufacturing Services, Vice President of Manufacturing Services and Senior Vice President of Operations. Prior to joining Generac, Mr. Schaus was a Manufacturing Area Manager for Harley Davidson Motor Company in Wauwatosa, Wisconsin and a Plant Manager for Custom Products in Menomonee Falls, Wisconsin. Mr. Schaus holds a B.S. in Agricultural Economics from the University of Wisconsin, Madison.

Roger F. Pascavis has served as our Senior Vice President of Operations since January 2008. Mr. Pascavis joined Generac in 1995 and has served as Director of Materials and Vice President of Operations. Prior to joining Generac, Mr. Pascavis was a Plant Manager for MTI in Waukesha, Wisconsin. Mr. Pascavis holds a B.S. in Industrial Technology from the University of Wisconsin, Stout and an M.B.A. from Lake Forest Graduate School of Management.

Item 1A. Risk Factors

You should carefully consider the following risks. These risks could materially affect our business, results of operations or financial condition, cause the trading price of our common stock to decline materially or cause our actual results to differ materially from those expected or those expressed in any forward-looking statements made by us or on our behalf. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under “Forward-Looking Statements” and the risks of our businesses described elsewhere in this Report.

Risk factors related to our business and industry

Demand for our products is significantly affected by unpredictable major power-outage events that can lead to substantial variations in, and uncertainties regarding, our financial results from period to period.

Sales of our products are subject to consumer buying patterns, and demand for our products is affected by power outage events caused by thunderstorms, hurricanes, ice storms, blackouts and other grid reliability issues. The impact of these outage events on our sales can vary depending on the location and severity of the outages. Sustained periods without major power disruptions can lead to reduced consumer awareness of the benefits of standby and portable generator products and can result in reduced sales growth rates and excess inventory. The lack of major power-outage events can affect our net sales in the years following a given storm season. Unpredictable fluctuations in demand are therefore part of managing our business, and these fluctuations could have an adverse effect on our net sales and profits. Despite their unpredictable nature, we believe major power outages create awareness and accelerate adoption for our home standby products.

## Table of Contents

Demand for our products is significantly affected by durable goods spending by consumers and businesses and other macroeconomic conditions.

Our business is affected by general economic conditions, and uncertainty or adverse changes such as the prolonged downturn in U.S. residential investment and the impact of more stringent credit standards could lead to a decline in demand for our products and pressure to reduce our prices. Our sales of light-commercial and industrial generators are affected by conditions in the non-residential construction sector and by the capital investment trends for small and large businesses and municipalities. If these businesses and municipalities cannot access credit markets or do not utilize discretionary funds to purchase our products as a result of the economy or other factors, our business could suffer and our ability to realize benefits from our strategy of increasing sales in the light-commercial and industrial sectors through, among other things, our focus on innovation and product development, including natural gas engine and modular technology, could be adversely affected. In addition, consumer confidence and home remodeling expenditures have a significant impact on sales of our residential products, and prolonged periods of weakness in consumer durable goods spending could have a material impact on our business. Typically, we do not have contracts with our customers, and we cannot guarantee that our current customers will continue to purchase our products. If general economic conditions or consumer confidence were to worsen, or if the non-residential construction sector or rate of capital investments were to decline, our net sales and profits would likely be adversely affected. Additionally, timing of capital spending by our national account customers can vary from quarter-to-quarter based on capital availability and internal capital spending budgets.

Decreases in the availability and quality, or increases in the cost, of raw materials and key components we use could materially reduce our earnings.

The principal raw materials that we use to produce our products are steel, copper and aluminum. We also source a significant number of component parts from third parties that we utilize to manufacture our products. The prices of those raw materials and components are susceptible to significant fluctuations due to trends in supply and demand, transportation costs, government regulations and tariffs, price controls, economic conditions and other unforeseen circumstances beyond our control. We do not have long-term supply contracts in place to ensure the raw materials and components we use are available in necessary amounts or at fixed prices. If we are unable to mitigate raw material or component price increases through product design improvements, price increases to our customers, manufacturing productivity improvements, or hedging transactions, our profitability could be adversely affected. Also, our ability to continue to obtain quality materials and components is subject to the continued reliability and viability of our suppliers, including in some cases, suppliers who are the sole source of certain important components. If we are unable to obtain adequate, cost efficient or timely deliveries of required raw materials and components, we may be unable to manufacture sufficient quantities of products on a timely basis. This could cause us to lose sales, incur additional costs, delay new product introductions or suffer harm to our reputation.

The industry in which we compete is highly competitive, and our failure to compete successfully could adversely affect our results of operations and financial condition.

We operate in markets that are highly competitive. Some of our competitors have established brands and are larger in size or are divisions of large diversified companies and have substantially greater financial resources. Some of our competitors may be willing to reduce prices and accept lower margins in order to compete with us. In addition, we could face new competition from large international or domestic companies with established industrial brands that enter our end markets. Demand for our products may also be affected by our ability to respond to changes in design and functionality, to respond to downward pricing pressure, and to provide shorter lead times for our products than our competitors. If we are unable to respond successfully to these competitive pressures, we could lose market share, which could have an adverse impact on our results. For more information, see “Item 1—Business—Competition.”

Our industry is subject to technological change, and our failure to continue developing new and improved products and to bring these products rapidly to market could have an adverse impact on our business.

New products, or refinements and improvements of existing products, may have technical failures, their introduction may be delayed, they may have higher production costs than originally expected or they may not be accepted by our customers. If we are not able to anticipate, identify, develop and market high quality products in line with technological advancements that respond to changes in customer preferences, demand for our products could decline and our operating results could be adversely affected.

Table of Contents

We rely on independent dealers and distribution partners, and the loss of these dealers and distribution partners, or of any of our sales arrangements with significant private label, telecommunications, retail or equipment rental customers, would adversely affect our business.

In addition to our direct sales force and manufacturer sales representatives, we depend on the services of independent distributors and dealers to sell our products and provide service and aftermarket support to our end customers. We also rely upon our distribution channels to drive awareness for our product categories and our brands. In addition, we sell our products to end users through private label arrangements with leading home equipment, electrical equipment and construction machinery companies, arrangements with top retailers and equipment rental companies, and our direct national accounts with telecommunications and industrial customers. Our distribution agreements and any contracts we have with large telecommunications, retail and other customers are typically not exclusive, and many of the distributors and customers with whom we do business offer products and services of our competitors. Impairment of our relationships with our distributors, dealers or large customers, loss of a substantial number of these distributors or dealers or of one or more large customers, or an increase in our distributors' or dealers' sales of our competitors' products to our customers or of our large customers' purchases of our competitors' products could materially reduce our sales and profits. Also, our ability to successfully realize our growth strategy is dependent in part on our ability to identify, attract and retain new distributors at all layers of our distribution platform, and we cannot be certain that we will be successful in these efforts.

Our business could be negatively impacted if we fail to adequately protect our intellectual property rights or if third parties claim that we are in violation of their intellectual property rights.

We view our intellectual property rights as important assets. We seek to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing and confidentiality agreements. These protections may not be adequate to prevent third parties from using our intellectual property without our authorization, breaching any confidentiality agreements with us, copying or reverse engineering our products, or developing and marketing products that are substantially equivalent to or superior to our own. The unauthorized use of our intellectual property by others could reduce our competitive advantage and harm our business. If it became necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly and we may not prevail. We cannot guarantee that any patents, issued or pending, will provide us with any competitive advantage or will not be challenged by third parties. Moreover, the expiration of our patents may lead to increased competition with respect to certain products.

In addition, we cannot be certain that we do not or will not infringe third parties' intellectual property rights. Any such claim, even if it is without merit, may be expensive and time-consuming to defend, subject us to damages, cause us to cease making, using or selling certain products that incorporate the disputed intellectual property, require us to redesign our products, divert management time and attention and/or require us to enter into costly royalty or licensing arrangements. Furthermore, in connection with our sale of Generac Portable Products to the Beacon Group in 1998, we granted the Beacon Group an exclusive perpetual license for the use of the "Generac Portable Products" trademark in connection with the manufacture and sale of certain engine driven consumer products. This perpetual license was eventually transferred to Briggs and Stratton (Briggs) when the Beacon Group sold that business to Briggs. Currently, this trademark is not being used in commerce. However, in the event that the Beacon Group or Briggs use this trademark in the future, we could suffer competitive confusion and our business could be negatively impacted.

Our operations are subject to various environmental, health and safety laws and regulations, and non-compliance with or liabilities under such laws and regulations could result in substantial costs, fines, sanctions and claims.

Our operations are subject to a variety of foreign, federal, state and local environmental, health and safety laws and regulations including those governing, among other things, emissions to air, discharges to water, noise, the generation,

handling, storage, transportation, treatment and disposal of waste and other materials. In addition, under federal and state environmental laws, we could be required to investigate, remediate and/or monitor the effects of the release or disposal of materials both at sites associated with past and present operations and at third-party sites where wastes generated by our operations were disposed. This liability may be imposed retroactively and whether or not we caused, or had any knowledge of, the existence of these materials and may result in our paying more than our fair share of the related costs. Violations of or liabilities under such laws and regulations could result in substantial costs, fines and civil or criminal proceedings or personal injury and workers' compensation claims.

Table of Contents

Our products are subject to substantial government regulation.

Our products are subject to extensive statutory and regulatory requirements governing, among other things, emissions and noise, including standards imposed by the federal Environmental Protection Agency, or EPA, state regulatory agencies, such as CARB, and other regulatory agencies around the world. These laws are constantly evolving and many are becoming increasingly stringent. Changes in applicable laws or regulations, or in the enforcement thereof, could require us to redesign our products and could adversely affect our business or financial condition in the future. Developing and marketing products to meet such new requirements could result in substantial additional costs that may be difficult to recover in some markets. In some cases, we may be required to modify our projects or develop new products to comply with new regulations, particularly those relating to air emissions. For example, we were required to modify our spark-ignited air-cooled gaseous engines to comply with the 2011 EPA and CARB regulations, as well as the continued implementation of Tier 4 nonroad diesel engine changes associated with the Magnum acquisition. Typically, additional costs associated with significant compliance modifications are passed on to the market. While we have been able to meet previous deadlines, failure to comply with other existing and future regulatory standards could adversely affect our position in the markets we serve.

We may incur costs and liabilities as a result of product liability claims.

We face a risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in injury or other damage. Although we currently maintain product liability insurance coverage, we may not be able to obtain such insurance on acceptable terms in the future, if at all, or obtain insurance that will provide adequate coverage against potential claims. Product liability claims can be expensive to defend and can divert the attention of management and other personnel for long periods of time, regardless of the ultimate outcome. A significant unsuccessful product liability defense could have a material adverse effect on our financial condition and results of operations. In addition, we believe our business depends on the strong brand reputation we have developed. If our reputation is damaged, we may face difficulty in maintaining our market share and pricing with respect to some of our products, which could reduce our sales and profitability.

The loss of any key members of our senior management team or key employees could disrupt our operations and harm our business.

Our success depends, in part, on the efforts of certain key individuals, including the members of our senior management team, who have significant experience in the power products industry. If, for any reason, our senior executives do not continue to be active in management, or if our key employees leave our company, our business, financial condition or results of operations could be adversely affected. Failure to continue to attract these individuals at reasonable compensation levels could have a material adverse effect on our business, liquidity and results of operations. Although we do not anticipate that we will have to replace any of these individuals in the near future, the loss of the services of any of our key employees could disrupt our operations and have a material adverse effect on our business.

Disruptions caused by labor disputes or organized labor activities could harm our business.

We may from time to time experience union organizing activities in our non-union facilities. Disputes with the current labor union or new union organizing activities could lead to work slowdowns or stoppages and make it difficult or impossible for us to meet scheduled delivery times for product shipments to our customers, which could result in loss of business. In addition, union activity could result in higher labor costs, which could harm our financial condition, results of operations and competitive position.

We may experience material disruptions to our manufacturing operations.



While we seek to operate our facilities in compliance with applicable rules and regulations and take measures to minimize the risks of disruption at our facilities, a material disruption at one of our manufacturing facilities could prevent us from meeting customer demand, reduce our sales and/or negatively impact our financial results. Any of our manufacturing facilities, or any of our machines within an otherwise operational facility, could cease operations unexpectedly due to a number of events, including:

- equipment or information technology infrastructure failure;

Table of Contents

- disruptions in the transportation infrastructure including roads, bridges, railroad tracks;
  - fires, floods, tornados, earthquakes, or other catastrophes; and
    - other operational problems.

In addition, the vast majority of our manufacturing and production facilities are located in Wisconsin within a 100-mile radius. We could experience prolonged periods of reduced production due to unforeseen events occurring in or around our manufacturing facilities in Wisconsin. In the event of a business interruption at our Wisconsin facilities, we may be unable to shift manufacturing capabilities to alternate locations, accept materials from suppliers or meet customer shipment needs, among other severe consequences. Such an event could have a material and adverse impact on our financial condition and results of our operations.

A significant portion of our purchased components are sourced in foreign countries, exposing us to additional risks that may not exist in the United States.

We source a significant portion of our purchased components overseas, primarily in Asia and Europe. Our international sourcing subjects us to a number of potential risks in addition to the risks associated with third-party sourcing generally. Such risks include:

- inflation or changes in political and economic conditions;
  - unstable regulatory environments;
  - changes in import and export duties;
- domestic and foreign customs and tariffs;
  - currency rate fluctuations;
    - trade restrictions;
    - labor unrest;
- logistical and communications challenges; and
  - other restraints and burdensome taxes.

These factors may have an adverse effect on our ability to efficiently and cost effectively source our purchased components overseas. In particular, if the U.S. dollar were to depreciate significantly against the currencies in which we purchase raw materials from foreign suppliers, our cost of goods sold could increase materially, which would adversely affect our results of operations.

## Table of Contents

As a U.S. corporation that sources components in foreign countries, we are subject to the Foreign Corrupt Practices Act. A determination that we violated this act may affect our business and operations adversely.

As a U.S. corporation, we are subject to the regulations imposed by the U.S. Foreign Corrupt Practices Act, or the FCPA, which generally prohibits U.S. companies and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business. Any determination that we have violated the FCPA could have a material adverse effect on our financial position, operating results and cash flows.

We have significant tax assets, usage of which may be subject to limitations in the future.

As of December 31, 2011, we had approximately \$127.1 million of net operating loss carryforwards for U.S. federal income tax purposes. Any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carryforwards to offset future federal income tax liabilities.

Our total assets include goodwill and other indefinite-lived intangibles. If we determine these have become impaired in the future, net income could be materially adversely affected.

Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. Indefinite-lived intangibles are comprised of certain trade names. At December 31, 2011, goodwill and other indefinite-lived intangibles totaled \$695.9 million, most of which arose from the CCMP Transactions. We review goodwill and other intangibles at least annually for impairment and any excess in carrying value over the estimated fair value is charged to the results of operations. A reduction in net income resulting from the write-down or impairment of goodwill or indefinite-lived intangibles, such as the \$9.4 million non-cash charge recorded in the fourth quarter of 2011 primarily related to the write down of a certain trade name as we strategically transition to the Generac brand, could have a material adverse effect on our financial statements.

Goodwill and identifiable intangible assets are recorded at fair value on the date of acquisition. In accordance with FASB ASC (Accounting Standards Codification) Topic 350-20, goodwill and indefinite lived intangibles are reviewed at least annually for impairment and definite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Future impairment may result from, among other things, deterioration in the performance of the acquired business or product line, adverse market conditions and changes in the competitive landscape, adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business or product line, and a variety of other circumstances. The amount of any impairment is recorded as a charge to the statement of operations. We may never realize the full value of our intangible assets. Any future determination requiring the write-off of a significant portion of intangible assets would have an adverse effect on our financial condition and results of operations. See "Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations" for details.

We may need additional capital to finance our growth strategy or to refinance our existing credit facilities, and we may not be able to obtain it on acceptable terms, or at all, which may limit our ability to grow.

We may require additional financing to expand our business. Financing may not be available to us or may be available to us only on terms that are not favorable. The terms of our senior secured credit facilities limit our ability to incur additional debt. In addition, economic conditions, including a downturn in the credit markets, could impact our ability to finance our growth on acceptable terms or at all. If we are unable to raise additional funds or obtain capital on acceptable terms, we may have to delay, modify or abandon some or all of our growth strategies. In February 2012, we completed the planned refinancing of our former credit facility, and the new credit facility is comprised of a \$150

million unfunded Revolver, a \$325 million Term Loan A and \$250 million Term Loan B. The Revolver and Term Loan A both have a five (5) year term, with interest payable on a leveraged-based pricing grid starting at LIBOR plus 2.25%. The Term Loan B matures in seven (7) years and accrues interest at LIBOR plus 2.75% with a LIBOR floor of 1.0%. For more information regarding the refinance of our credit facility see “Item 8 – Financial Statements and Supplementary Data – “16. Subsequent Events.” In the future, if we are unable to refinance such facilities on acceptable terms, our liquidity could be adversely affected.

Table of Contents

We are unable to determine the specific impact of changes in selling prices or changes in volumes of our products on our net sales.

Because of the wide range of products that we sell, the level of customization for many of our products, the frequent rollout of new products and the fact that we do not apply pricing changes uniformly across our entire portfolio of products, we are unable to determine with specificity the effect of volume changes or changes in selling prices on our net sales.

We may not realize all of the anticipated benefits of our acquisition of the Magnum Products business or those benefits may take longer to realize than expected. We may also encounter significant unexpected difficulties in integrating the two businesses.

Our ability to realize the anticipated benefits of the Magnum Products acquisition, which was consummated on October 3, 2011, will depend, to a large extent, on our ability to integrate the Magnum Products business with our business. The combination of two independent businesses is a complex, costly and time-consuming process. As a result, we will be required to devote significant management attention and resources to integrating the business practices and operations of the Magnum Products business with ours. The integration process may disrupt our business and, if implemented ineffectively, would preclude realization of the full benefits expected by us. Our failure to meet the challenges involved in integrating the Magnum Products business into our existing operations or otherwise to realize the anticipated benefits of the transaction could cause an interruption of, or a loss of momentum in, our activities and could adversely affect our results of operations.

In addition, the overall integration of the Magnum Products business may result in material unanticipated problems, expenses, liabilities, competitive responses, loss of customer relationships, and diversion of management's attention, and may cause our stock price to decline.

The difficulties of combining the operations of the companies include, among others:

- managing a larger company;
- maintaining employee morale and retaining key management and other employees;
- integrating two business cultures, which may prove to be incompatible;
- the possibility of faulty assumptions underlying expectations regarding the integration process;
  - retaining existing customers and attracting new customers;
- consolidating corporate and administrative infrastructures and eliminating duplicative operations;
- the diversion of management's attention from ongoing business concerns and performance shortfalls as a result of the diversion of management's attention to the acquisition;
  - unanticipated issues in integrating information technology, communications and other systems;
    - unanticipated changes in applicable laws and regulations;
- managing tax costs or inefficiencies associated with integrating the operations of the combined company;

- unforeseen expenses or delays associated with the acquisition;
- difficulty comparing financial reports due to differing financial and/or internal reporting systems; and

## Table of Contents

- making any necessary modifications to internal financial control standards to comply with the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated thereunder.

Many of these factors will be outside of our control and any one of them could result in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy, which could materially impact our business, financial condition and results of operations. In addition, even if the operations of the Magnum Products business are integrated successfully with our operations, we may not realize the full benefits of the transaction, including the synergies, cost savings or sales or growth opportunities that we expect. These benefits may not be achieved within the anticipated time frame, or at all. Or, additional unanticipated costs may be incurred in the integration of our businesses. All of these factors could cause dilution to our earnings per share, decrease or delay the expected accretive effect of the acquisition, and cause a decrease in the price of our common stock. As a result, we cannot assure you that the combination of the Magnum Products business with our business will result in the realization of the full benefits anticipated from the transaction.

### Risks related to our common stock

If securities or industry analysts do not publish research or reports about our business, if they adversely change their recommendations regarding our common stock or if our results of operations do not meet their expectations, our common stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. Moreover, if one or more of the analysts who cover us downgrade recommendations regarding our stock, or if our results of operations do not meet their expectations, our stock price could decline and such decline could be material.

Anti-takeover provisions in our amended and restated certificate of incorporation and by-laws could prohibit a change of control that our stockholders may favor and could negatively affect our stock price.

Provisions in our amended and restated certificate of incorporation and by-laws may make it more difficult and expensive for a third party to acquire control of us even if a change of control would be beneficial to the interests of our stockholders. These provisions could discourage potential takeover attempts and could adversely affect the market price of our common stock. These provisions may also prevent or frustrate attempts by our stockholders to replace or remove our management. For example, our amended and restated certificate of incorporation and by-laws:

- permit our board of directors to issue preferred stock with such terms as they determine, without stockholder approval;
- provide that only one-third of the members of the board are elected at each stockholders meeting and prohibit removal without cause;
  - require advance notice for stockholder proposals and director nominations; and
  - contain limitations on convening stockholder meetings.

These provisions make it more difficult for stockholders or potential acquirers to acquire us without negotiation and could discourage potential takeover attempts and could adversely affect the market price of our common stock.





## Table of Contents

### Risks related to our capital structure

We have a significant amount of indebtedness which could adversely affect our cash flow and our ability to remain in compliance with debt covenants and make payments on our indebtedness.

We have a significant amount of indebtedness. As of December 31, 2011, we had total indebtedness of \$597.9 million. As of February 9, 2012 our total indebtedness was further reduced to \$575.0 million. While we reduced this amount of debt during 2010, 2011 and 2012 through the use of the proceeds of our IPO and of cash on hand, including an additional prepayment of debt of \$74.2 million in December of 2010, \$24.7 million in April of 2011, \$34.6 million in December of 2011 and \$22.9 million in February 2012 (as discussed elsewhere in this report under “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations”), we still have a significant amount of indebtedness. Our significant level of indebtedness increases the possibility that we may be unable to generate cash sufficient to pay, when due, the principal of, interest on or other amounts due in respect of our indebtedness. Our significant indebtedness, combined with our lease and other financial obligations and contractual commitments could have other important consequences. For example, it could:

- make it more difficult for us to satisfy our obligations with respect to our indebtedness, including financial and other restrictive covenants, which could result in an event of default under the agreements governing our indebtedness;
- make us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulation;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flows to fund working capital, capital expenditures, acquisitions and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
  - place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional amounts for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy or other purposes.

Any of the above-listed factors could materially adversely affect our business, financial condition, results of operations and cash flows. While we maintain interest rate swaps covering a significant portion of our outstanding debt, our interest expense could increase if interest rates increase because debt under our senior secured credit facilities bears interest at a variable rate. If we do not have sufficient earnings to service our debt, we may be required to refinance all or part of our existing debt, sell assets, borrow more money or sell securities, none of which we can guarantee we will be able to do.

The terms of our senior secured credit facilities restrict our current and future operations, particularly our ability to respond to changes in our business or to take certain actions.

Our former senior secured credit facilities contained, and any future indebtedness of ours or our subsidiaries would likely contain, a number of restrictive covenants that impose significant operating and financial restrictions on us and our subsidiaries, including restrictions on our ability to engage in acts that may be in our best long-term interests. Our new senior secured credit facilities entered into on February 9, 2012 include certain financial covenants.

The new credit facility requires Generac Power Systems to maintain a maximum leverage ratio (as defined in the senior secured credit facility) of 4.00 to 1.00 from the periods June 30, 2012 to September 30, 2012, and 3.75 to 1.00 thereafter. As of December 31, 2011, Generac Power Systems' leverage ratio was 2.83. In addition, the new credit facility requires Generac Power Systems to maintain a minimum interest coverage ratio (as defined in the senior secured credit facility) of 2.50 to 1.00 from June 30, 2012 to September 30, 2012, 2.75 to 1.00 from December 31, 2012 to June 30, 2013, 3.00 to 1.00 from September 30, 2013 to June 30, 2014 and 3.25 to 1.00 thereafter. As of December 31, 2011, Generac Power Systems' interest coverage ratio was 8.55. Failure to comply with such covenants would result in an event of default under our new senior secured credit facilities unless waived by our lenders.

Our new senior secured credit facilities require us to use a portion of excess cash flow and proceeds of certain asset sales that are not reinvested in our business and other dispositions to repay indebtedness under our senior secured credit facilities.

Table of Contents

Our new senior secured credit facilities also include covenants restricting, among other things, our ability to:

- incur liens;
- incur or assume additional debt or guarantees or issue preferred stock;
- pay dividends, or make redemptions and repurchases, with respect to capital stock;
- prepay, or make redemptions and repurchases of, subordinated debt;
  - make loans and investments;
  - make capital expenditures;
- engage in mergers, acquisitions, asset sales, sale/leaseback transactions and transactions with affiliates;
  - change the business conducted by us or our subsidiaries; and
  - amend the terms of subordinated debt.

The operating and financial restrictions and covenants in our new senior secured credit facilities and any future financing agreements may adversely affect our ability to finance future operations or capital needs or to engage in other business activities. A breach of any of the restrictive covenants in our new senior secured credit facilities would result in a default under our new senior secured credit facilities. If any such default occurs, the lenders under our new senior secured credit facilities may elect to declare all outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable, or enforce their security interest, any of which would result in an event of default. The lenders will also have the right in these circumstances to terminate any commitments they have to provide further borrowings.

Our principal stockholder continues to have substantial control over us.

Affiliates of CCMP collectively beneficially own approximately 59.0% of our outstanding common stock. As a consequence, CCMP or its affiliates are able to exert a significant degree of influence or actual control over our management and affairs and will control matters requiring stockholder approval, including the election of directors, a merger, consolidation or sale of all or substantially all of our assets, and any other significant transaction. The interests of this stockholder may not always coincide with our interests or the interests of our other stockholders. For instance, this concentration of ownership may have the effect of delaying or preventing a change in control of us otherwise favored by our other stockholders and could depress our stock price.

Because affiliates of CCMP control more than 50% of the voting power of our common stock, we are a “controlled company” within the meaning of the NYSE's Listed Company Manual. Under the NYSE's Listed Company Manual, a controlled company may elect not to comply with certain NYSE corporate governance requirements, including requirements that: (1) a majority of the board of directors consist of independent directors; (2) compensation of officers be determined or recommended to the board of directors by a majority of its independent directors or by a compensation committee that is composed entirely of independent directors; and (3) director nominees be selected or recommended by a majority of the independent directors or by a nominating committee composed solely of independent directors. Because we have taken advantage of the controlled company exemption to certain NYSE corporate governance requirements, our stockholders do not have the same protections afforded to stockholders of companies that are subject to all of the NYSE corporate governance requirements.



Table of Contents

Conflicts of interest may arise because some of our directors are principals of our principal stockholder.

Representatives of CCMP and its affiliates occupy seats on our board of directors. CCMP or its affiliates could invest in entities that directly or indirectly compete with us or companies in which CCMP or its affiliates are currently invested may already compete with us. As a result of these relationships, when conflicts arise between the interests of CCMP or its affiliates and the interests of our stockholders, these directors may not be disinterested. The representatives of CCMP and its affiliates on our board of directors, by the terms of our amended and restated certificate of incorporation, are not required to offer us any transaction opportunity of which they become aware and could take any such opportunity for themselves or offer it to other companies in which they have an investment, unless such opportunity is expressly offered to them solely in their capacity as our directors.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

We own and operate manufacturing and distribution facilities located in Eagle, Wisconsin, Waukesha, Wisconsin, Whitewater, Wisconsin and Berlin, Wisconsin, which total approximately 1.2 million square feet. We also operate a dealer training center at our Eagle, Wisconsin facility, which allows us to train new industrial and residential dealers on the service and installation of our products and provide existing dealers with training on product innovations. We also have inventory warehouses in the United States that accommodate material storage and rapid response requirements of our customers.

The following table shows the location and activities of our operations:

| Location          | O w n e d |                 | Activities   |
|-------------------|-----------|-----------------|--|
|                   | Leased    | /Square Footage |  |
| Waukesha, WI      | Owned     | 307,250         | Corporate headquarters and manufacturing of liquid-cooled generators and transfer switches and storage |
| Eagle, WI         | Owned     | 236,000         | Manufacturing of liquid-cooled generators and metal fabrication  |
| Eagle, WI         | Owned     | 6,000           | Training facility  |
| Whitewater, WI    | Owned     | 295,000         | Manufacturing of vertically integrated engines and generators  |
| Berlin, WI        | Owned     | 129,000         | Manufacturing of mobile generators, light towers, pumps and metal fabrication                          |
| Berlin, WI        | Leased    | 122,500         | R&D, shipping, storage facilities, manufacturing   |
| Whitewater, WI    | Owned     | 196,000         | Distribution center  |
| Fort Atkinson, WI | Leased    | 183,640         | Storage facility   |
| Edgerton, WI      | Leased    | 242,100         | Storage facility   |
| Maquoketa, IA     | Owned     | 137,000         | Inventory warehouse and rental property  |
| Nor Cross, GA     | Leased    | 12,555          | Dealer facility, sales, distribution, training   |
| Cooler, GA        | Leased    | 2,500           | Dealer facility, sales, distribution, training   |
| Alpharetta, GA    | Leased    | 13,000          | Manufacturing, sales, distribution, light assembly and packaging                                       |

As of December 31, 2011, substantially all of our owned properties are subject to mortgages under our senior secured credit facilities.



Table of Contents

## Item 3. Legal Proceedings

From time to time, we are involved in legal proceedings primarily involving product liability and employment matters and general commercial disputes arising in the ordinary course of our business. As of December 31, 2011, we believe that there is no litigation pending that would have a material effect on our results of operations or financial condition.

## Item 4. Mine Safety Disclosures.

Not Applicable.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Price Range of Common Stock

Shares of our common stock are traded on the NYSE under the symbol "GNRC." The following table sets forth the high and low sales prices reported on the NYSE for our common stock by fiscal quarter during 2011 and 2010, respectively.

|   | 2011    |         |
|---|---------|---------|
|   | High    | Low     |
| Fourth Quarter                              | \$29.06 | \$18.29 |
| Third Quarter                               | \$21.41 | \$15.41 |
| Second Quarter                              | \$21.10 | \$17.10 |
| First Quarter                               | \$20.85 | \$14.72 |
|   |         |         |
|   | 2010    |         |
|   | High    | Low     |
| Fourth Quarter                              | \$16.51 | \$13.04 |
| Third Quarter                               | \$15.08 | \$11.99 |
| Second Quarter                              | \$15.40 | \$10.65 |
| First Quarter (beginning February 11, 2010) | \$15.40 | \$12.84 |

Table of Contents

## Stock Performance Graph

The line graph below compares the cumulative total stockholder return on our common stock with the cumulative total return of the Standard & Poor's S&P 500 Index and S&P 500 Industrials Index for the year ended December 31, 2011. The graph and table assume that \$100 was invested on February 11, 2010 (first day of trading) in each of our common stock, the S&P 500 Index, S&P 500 Industrials Index, and that all dividends were reinvested. Cumulative total stockholder returns for our common stock, the S&P 500 Index, and the S&P 500 Industrials Index are based on our fiscal year.

ASSUMES \$100 INVESTED ON FEBRUARY 11, 2010

ASSUMES DIVIDEND REINVESTED  
FISCAL YEAR ENDING DECEMBER 31, 2011

| Company/<br>Market/<br>Peer Group | 2/11/2010 | 3/31/2010 | 6/30/2010 | 9/30/2010 | 12/31/2010 | 3/31/2011 | 6/30/2011 | 9/30/2011 | 12/31/2011 |
|-----------------------------------|-----------|-----------|-----------|-----------|------------|-----------|-----------|-----------|------------|
| Generac<br>Holdings<br>Inc.       | \$ 100.00 | \$ 109.11 | \$ 109.11 | \$ 106.23 | \$ 125.93  | \$ 158.02 | \$ 151.09 | \$ 146.50 | \$ 218.30  |
| S&P 500<br>Index                  | \$ 100.00 | \$ 108.73 | \$ 96.31  | \$ 107.18 | \$ 118.71  | \$ 125.73 | \$ 125.85 | \$ 108.40 | \$ 121.21  |
| S&P 500<br>Industrials<br>Index   | \$ 100.00 | \$ 113.00 | \$ 99.09  | \$ 113.27 | \$ 126.65  | \$ 137.74 | \$ 136.82 | \$ 108.06 | \$ 125.90  |



Table of Contents

Holdings

As of February 17, 2012, there were approximately 107 registered holders of record of Generac's common stock. A substantially greater number of holders of Generac common stock are "street name" or beneficial holders, whose shares are held of record by banks, brokers, and other financial institutions.

Dividends

We did not declare or pay cash dividends in 2011. We currently do not have plans to pay any dividends on our common stock in the near term. However, in the future, subject to factors such as general economic and business conditions, our financial condition and results of operations, our capital requirements, our future liquidity and capitalization and such other factors that our board of directors may deem relevant, we may change this policy and choose to pay dividends. Our ability to pay dividends on our common stock is currently restricted by the terms of our senior secured credit facilities and may be further restricted by any future indebtedness we incur. Our business is conducted through our principal operating subsidiary, Generac Power Systems. Dividends from, and cash generated by Generac Power Systems will be our principal sources of cash to repay indebtedness, fund operations and pay dividends. Accordingly, our ability to pay dividends to our stockholders is dependent on the earnings and distributions of funds from Generac Power Systems.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by this item will be included in our 2012 Proxy Statement and is incorporated herein by reference.

Recent Sales of Unregistered Securities

None.

Use of Proceeds from Registered Securities

Not applicable.

Item 6. Selected Financial Data

The following table sets forth our selected historical consolidated financial data for the periods and at the dates indicated. The selected historical consolidated financial data for the years ended December 31, 2009, 2010 and 2011 are derived from our audited consolidated financial statements included elsewhere in this annual report. The selected historical consolidated financial data for the years ended December 31, 2007 and December 31, 2008 are derived from our audited historical financial statements not included in this annual report.

The results indicated below and elsewhere in this annual report are not necessarily indicative of our future performance. You should read this information together with "Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included in Item 8 of this Annual Report on Form 10-K.

Table of Contents

|  | Year ended<br>December<br>31, 2007 | Year ended<br>December<br>31, 2008 | Year ended<br>December<br>31, 2009 | Year ended<br>December<br>31, 2010 | Year ended<br>December<br>31, 2011 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| (Dollars in thousands, except per share data)                              |                                    |                                    |                                    |                                    |                                    |
| Statement of operations data:  |                                    |                                    |                                    |                                    |                                    |
| Net sales  | \$555,705                          | \$574,229                          | \$588,248                          | \$592,880                          | \$791,976                          |
| Costs of goods sold  | 333,428                            | 372,199                            | 352,398                            | 355,523                            | 497,322                            |
| Gross profit   | 222,277                            | 202,030                            | 235,850                            | 237,357                            | 294,654                            |
| Operating expenses:  |                                    |                                    |                                    |                                    |                                    |
| Selling and service  | 52,652                             | 57,449                             | 59,823                             | 57,954                             | 77,776                             |
| Research and development   | 9,606                              | 9,925                              | 10,842                             | 14,700                             | 16,476                             |
| General and administrative   | 17,581                             | 15,869                             | 14,713                             | 22,599                             | 30,012                             |
| Amortization of intangibles (1)  | 47,602                             | 47,602                             | 51,960                             | 51,808                             | 48,020                             |
| Goodwill and trade name impairment charge<br>and trade name write-down (2) | —                                  | 583,486                            | —                                  | —                                  | 9,389                              |
| Total operating expenses   | 127,441                            | 714,331                            | 137,338                            | 147,061                            | 181,673                            |
| Income (loss) from operations  | 94,836                             | (512,301 )                         | 98,512                             | 90,296                             | 112,981                            |
| Other income (expense):  |                                    |                                    |                                    |                                    |                                    |
| Interest expense   | (125,366 )                         | (108,022 )                         | (70,862 )                          | (27,397 )                          | (23,718 )                          |
| Gain on extinguishment of debt (3)   | 18,759                             | 65,385                             | 14,745                             | —                                  | —                                  |
| Write-off of deferred financing costs related<br>to debt extinguishment    | —                                  | —                                  | —                                  | (4,809 )                           | (377 )                             |
| Investment income  | 2,682                              | 600                                | 2,205                              | 235                                | 110                                |
| Costs related to acquisition   | —                                  | —                                  | —                                  | —                                  | (875 )                             |
| Other, net   | (1,196 )                           | (1,217 )                           | (1,206 )                           | (1,105 )                           | (1,155 )                           |
| Total other expense, net   | (105,121 )                         | (43,254 )                          | (55,118 )                          | (33,076 )                          | (26,015 )                          |
| Income (loss) before provision (benefit) for<br>income taxes               | (10,285 )                          | (555,555 )                         | 43,394                             | 57,220                             | 86,966                             |
| Provision (benefit) for income taxes (4)                                   | (571 )                             | 400                                | 339                                | 307                                | (237,677 )                         |
| Net income (loss)  | \$(9,714 )                         | \$(555,955 )                       | \$43,055                           | \$56,913                           | \$324,643                          |
| Income (loss) per share - diluted:   |                                    |                                    |                                    |                                    |                                    |
| Class A Common Stock (5)   | (34,994 )                          | (357,628 )                         | (41,111 )                          | (1.65 )                            | 4.79                               |
| Class B Common Stock (5)   | 3,462                              | 3,780                              | 4,171                              | 505                                | n/a                                |
| Statement of cash flows data:  |                                    |                                    |                                    |                                    |                                    |
| Depreciation   | 6,181                              | 7,168                              | 7,715                              | 7,632                              | 8,103                              |
| Amortization   | 47,602                             | 47,602                             | 51,960                             | 51,808                             | 48,020                             |
| Expenditures for property and equipment                                    | (13,191 )                          | (5,186 )                           | (4,525 )                           | (9,631 )                           | (12,060 )                          |
| Other financial data:  |                                    |                                    |                                    |                                    |                                    |
| Adjusted EBITDA (6)  | 158,148                            | 129,858                            | 159,087                            | 156,249                            | 188,476                            |
| Adjusted Net Income (7)  | 21,931                             | 13,758                             | 83,643                             | 115,954                            | 147,176                            |
|  | As of<br>December<br>31, 2007      | As of<br>December<br>31, 2008      | As of<br>December<br>31, 2009      | As of<br>December<br>31, 2010      | As of<br>December<br>31, 2011      |
| (Dollars in thousands)   |                                    |                                    |                                    |                                    |                                    |
| Balance sheet data:  |                                    |                                    |                                    |                                    |                                    |
| Current assets   | \$217,750                          | \$274,997                          | \$345,017                          | \$272,519                          | \$383,265                          |
| Property, plant and equipment, net   | 78,982                             | 76,674                             | 73,374                             | 75,287                             | 84,384                             |

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

|  |             |             |             |             |             |
|--|-------------|-------------|-------------|-------------|-------------|
| Goodwill   | 1,029,068   | 525,875     | 525,875     | 527,148     | 547,473     |
| Other intangibles and other assets                               | 582,859     | 448,668     | 392,977     | 334,929     | 537,671     |
| Total assets   | \$1,908,659 | \$1,326,214 | \$1,337,243 | \$1,209,883 | \$1,552,793 |
| Total current liabilities  | \$94,690    | \$127,981   | \$131,971   | \$86,685    | \$165,390   |
| Long-term debt, less current portion                             | 1,280,750   | 1,121,437   | 1,052,463   | 657,229     | 575,000     |
| Other long-term liabilities                                      | 27,439      | 43,539      | 17,418      | 24,902      | 43,514      |
| Redeemable stock (8)   | 747,070     | 843,451     | 878,205     | —           | —           |
| Total liabilities, redeemable stock and stockholders' equity (8) | \$1,908,659 | \$1,326,214 | \$1,337,243 | \$1,209,883 | \$1,552,793 |

Table of Contents

(1) Our amortization of intangibles expenses include the straight-line amortization of customer lists, patents and other finite-lived intangibles assets.

(2) As of October 31, 2008, as a result of our annual goodwill and tradename impairment test, we determined that an impairment of goodwill and trade names existed, and we recognized a non-cash charge of \$583.5 million in 2008. During the fourth quarter of 2011, the Company decided to strategically transition certain products to their more widely known Generac brand. Based on this decision, the Company recorded a \$9.4 million non-cash charge which primarily related to the write down of the impacted trade name to net realizable value. In addition, the Company performed its annual goodwill and tradename impairment test as of October 31, 2011. Except as noted, no impairment was indicated.

(3) During 2007, affiliates of CCMP acquired \$80.3 million principal amount of second lien term loans for approximately \$60.0 million. CCMP's affiliates exchanged this debt for additional shares of our Class B Common Stock. The fair value of the shares exchanged was \$60.0 million. We recorded this transaction as additional Class B Common Stock of \$60.0 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$18.8 million, which includes a write-off of deferred financing fees and other closing costs in the consolidated statement of operations for the year ended December 31, 2007.

During 2008, affiliates of CCMP acquired \$148.9 million principal amount of second lien term loans for approximately \$81.1 million. CCMP's affiliates exchanged this debt for additional shares of our Class B Common Stock and Series A Preferred Stock. The fair value of the shares exchanged was \$81.1 million. We recorded this transaction as Series A Preferred Stock of \$62.9 million and Class B Common Stock of \$18.2 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$65.4 million, which includes a write-off of deferred financing fees and other closing costs in the consolidated statement of operations for the year ended December 31, 2008.

During 2009, affiliates of CCMP acquired \$9.9 million principal amount of first lien term loans and \$20.0 million principal amount of second lien term loans for approximately \$14.8 million. CCMP's affiliates exchanged this debt for 1,475.4596 shares of Series A Preferred Stock. The fair value of the shares exchanged was \$14.8 million. We recorded this transaction as additional Series A Preferred Stock of \$14.8 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$14.7 million, which includes a write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the year ended December 31, 2009.

(4) The 2011 net tax benefit of \$237.7 million includes a tax benefit of \$271.4 million recorded due to the reversal of valuation allowances recorded on the Company's net deferred tax assets. See discussion in Item 8 – Financial Statements and Supplementary Data – Note 9 for additional information.

(5) Diluted earnings per share reflects the impact of the reverse stock split which occurred immediately prior to the initial public offering as discussed in “Item 8 – Financial Statements and Supplementary Data – Note 1”. At the time of the IPO on February 17, 2010, all shares of Class B common stock were converted into shares of Class A common stock, and the Class A common stock became the one class of outstanding common stock. See discussion of the IPO in Part 1, Item 1 – Initial Public Offering and Corporate Reorganization.

(6) Adjusted EBITDA represents net income (loss) before interest expense, taxes, depreciation and amortization, as further adjusted for the other items reflected in the reconciliation table set forth below. This presentation is

substantially consistent with the presentation used in our senior secured credit facilities (Covenant EBITDA), except that we do not give effect to certain additional adjustments that are permitted under those facilities which, if included, would increase the amount reflected in this table. For a description of the additional adjustments permitted for Covenant EBITDA under our senior secured credit facilities, see "Item 7 - Management's discussion and analysis of financial condition and results of operations—Liquidity and capital resources—Senior secured credit facilities—Covenant compliance." The definition of Adjusted EBITDA in the new February 2012 credit agreement is substantially the same as the definition in the previous 2006 credit agreement.

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

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
- to allocate resources to enhance the financial performance of our business;

Table of Contents

- 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 Proxy Statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
- in communications with our board of directors and investors concerning our financial performance.

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

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

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

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

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

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

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

Table of Contents

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

Furthermore, as noted above, one of our uses of Adjusted EBITDA is as a benchmark for determining elements of compensation for our senior executives. At the same time, some or all of these senior executives have responsibility for monitoring our financial results generally, including the items that are included as adjustments in calculating Adjusted EBITDA (subject ultimately to review by our board of directors in the context of the board's review of our quarterly financial statements). While many of the adjustments (for example, transaction costs and credit facility fees and sponsor fees), involve mathematical application of items reflected in our financial statements, others (such as business optimization adjustments) involve a degree of judgment and discretion. While we believe that all of these adjustments are appropriate, and while the quarterly calculations are subject to review by our board of directors in the context of the board's review of our quarterly financial statements and certification by our chief financial officer in a compliance certificate provided to the lenders under our senior secured credit facilities, this discretion may be viewed as an additional limitation on the use of Adjusted EBITDA as an analytical tool.

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

Our former senior secured credit facility required Generac Power Systems, Inc. to maintain a leverage ratio of consolidated total debt, net of unrestricted cash and marketable securities, to Covenant EBITDA at a level that varied over time. As of December 31, 2011, Generac Power Systems, Inc.'s ratio was 2.83 to 1.00, which was below the covenant requirement of 4.75 to 1.00. Generac Holdings Inc. net debt to adjusted EBITDA ratio as of December 31, 2011 was 2.65x. Our credit agreement does not permit us to net cash and cash equivalents held by the Generac Holdings Inc. entity against our debt balance for covenant purposes. Our new senior secured credit facilities entered into on February 9, 2012 also include certain financial covenants. The new credit facility requires Generac Power Systems to maintain a maximum leverage ratio (as defined in the senior secured credit facility) of 4.00 to 1.00 from the periods June 30, 2012 to September 30, 2012, and 3.75 to 1.00 thereafter. In addition, the new credit facility requires Generac Power Systems to maintain a minimum interest coverage ratio (as defined in the senior secured credit facility) of 2.50 to 1.00 from June 30, 2012 to September 30, 2012, 2.75 to 1.00 from December 31, 2012 to June 30, 2013, 3.00 to 1.00 from September 30, 2013 to June 30, 2014 and 3.25 to 1.00 thereafter. Failure to comply with this covenant would result in an event of default under our new senior secured credit facility unless waived by our lenders. An event of default under our new senior secured credit facility could result in the acceleration of our indebtedness under the facility, and we may be unable to repay the amounts due.

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



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

|  | Year ended<br>December<br>31, 2007 | Year ended<br>December<br>31, 2008 | Year ended<br>December<br>31, 2009 | Year ended<br>December<br>31, 2010 | Year ended<br>December<br>31, 2011 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| (Dollars in thousands)   |                                    |                                    |                                    |                                    |                                    |
| Net income (loss)  | \$(9,714 )                         | \$(555,955 )                       | \$43,055                           | \$56,913                           | \$324,643                          |
| Interest expense   | 125,366                            | 108,022                            | 70,862                             | 27,397                             | 23,718                             |
| Depreciation and amortization  | 53,783                             | 54,770                             | 59,675                             | 59,440                             | 56,123                             |
| Income taxes provision (benefit)   | (571 )                             | 400                                | 339                                | 307                                | (237,677 )                         |
| Non-cash impairment and other charges<br>(income)(a)                       | 5,328                              | 585,634                            | (1,592 )                           | (361 )                             | 10,400                             |
| Non-cash share-based compensation<br>expense(b)                            | —                                  | —                                  | —                                  | 6,363                              | 8,646                              |
| Write-off of deferred financing costs related<br>to debt extinguishment(c) | —                                  | —                                  | —                                  | 4,809                              | 377                                |
| Transaction costs and credit facility fees(d)                              | 1,044                              | 1,319                              | 1,188                              | 1,019                              | 1,719                              |
| Non-cash gains(e)  | (18,759 )                          | (65,385 )                          | (14,745 )                          | —                                  | —                                  |
| Business optimization expenses(f)  | 1,944                              | 971                                | —                                  | 108                                | 277                                |
| Sponsor fees(g)  | 500                                | 500                                | 500                                | 56                                 | —                                  |
| Letter of credit fees(h)   | 335                                | 169                                | 135                                | (26 )                              | (33 )                              |
| Other state franchise taxes(i)   | —                                  | 53                                 | 72                                 | 317                                | 342                                |
| Holding company interest income(j)   | (1,108 )                           | (640 )                             | (402 )                             | (93 )                              | (59 )                              |
| Adjusted EBITDA  | \$158,148                          | \$129,858                          | \$159,087                          | \$156,249                          | \$188,476                          |

(a) Represents the following non-cash charges:

Table of Contents

- for the year ended December 31, 2007, primarily a \$3.9 million charge for the step-up in book value of inventory as a result of the application of purchase accounting in connection with the CCMP Transactions. Also includes \$1.4 million of other charges, including a write-off of a pre-CCMP Transactions receivable, stock compensation expense, unsettled mark-to-market losses on copper forward contracts and losses on disposals of assets;
- for the year ended December 31, 2008, primarily \$503.2 million in goodwill impairment charges and \$80.3 million in trade name impairment charges described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical accounting policies—Goodwill and other intangible assets." \$1.6 million of the amount is comprised of unsettled mark to market losses on copper forward contracts, a write-off of pre-CCMP Transactions bad debts and losses on disposals of assets. Separately, the amount also includes a write-off of certain inventory;
- for the years ended December 31, 2010 and 2009, primarily unrealized mark-to-market adjustments on copper and Euro forward contracts and loss on disposal of assets;
- for the years ended December 31, 2011, primarily \$9.4 million trade name write-down described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical accounting policies—Goodwill and other intangible assets." Also includes unrealized mark-to-market adjustment on copper forward contracts and loss on disposal of assets;

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

- The losses on disposals of assets in several periods described above result from the sale of assets that are no longer useful in our business and therefore represent losses that are not from our core operations;
- The write-offs of certain pre-CCMP Transaction bad debts in the years ended December 31, 2007 and 2008 are non-cash charges that we believe do not reflect cash outflows after our acquisition by CCMP;
- The adjustments for unrealized mark-to-market gains and losses on copper forward and Euro contracts represent non-cash items to reflect changes in the fair value of forward contracts that have not been settled or terminated. We believe that it is useful to adjust net income for these items because the charges do not represent a cash outlay in the period in which the charge is incurred, although Adjusted EBITDA must always be used together with our U.S. GAAP statements of operations and cash flows to capture the full effect of these contracts on our operating performance;
- The goodwill and trade name impairment charges recorded in the year ended December 31, 2008 and the trade name write-down recorded in the year ended December 31, 2011 are one-time items that we believe do not reflect our ongoing operations. These charges are explained in greater detail in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies—Goodwill and Other Intangible Assets";
- The small amount of stock compensation expense recorded in the year ended December 31, 2007 was a non-cash charge for compensation under our 2006 Management Equity Incentive Plan. We do not believe that equity awards and the related expense under our 2006 Management Equity Incentive Plan, which terminated in connection with our initial public offering, will be useful in predicting stock compensation expense that we will incur under the new equity incentive plan that we adopted in connection with the IPO. However, we do expect to incur stock compensation expense under the new plan, and you should see our Proxy Statement under captions "Compensation discussion and analysis—Components of compensation—Equity-based compensation" and "Executive compensation—2010 Equity incentive plan" for more information about that plan; and

- The write-off of certain pre-CCMP Transaction excess inventory recorded in the year ended December 31, 2008 was a non-cash charge that we believe does not reflect cash outflows after our acquisition by CCMP.
- (b) Represents share-based compensation expense to account for stock options, restricted stock and other stock awards over their vesting period.
- (c) Represents the write-off of a portion of deferred financing costs related to the repayment of debt.

Table of Contents

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

- administrative agent fees and revolving credit facility commitment fees under our senior secured credit facilities, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation;
- before 2011, transaction costs relating to repurchases of debt under our first and second lien credit facilities by affiliates of CCMP, which CCMP's affiliates contributed to our company in exchange for the issuances of securities, which repurchases we do not expect to recur;
- in the year ended December 31, 2011, transaction costs relating to the acquisition of the Magnum Products business

(e) represents the following non-cash gains:

- for all periods before 2010, represents non-cash gains on the extinguishment of debt repurchased by affiliates of CCMP, as described in note (d) above, which we do not expect to recur.

(f) Primarily represents severance costs incurred from restructuring-related activities. For the year ended December 31, 2007, consists of \$1.4 million of severance costs and \$0.6 million of other restructuring-related costs. We do not believe the charges for restructuring-related activities in the year ended December 31, 2007 reflect our ongoing operations. Although we have incurred severance costs in most of the periods set forth in the table above, it is difficult to predict the amounts of similar costs in the future, and we believe that adjusting for these costs aids in measuring the performance of our ongoing operations. We believe that these costs will tend to be immaterial to our results of operations in future periods.

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

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

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

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

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

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



Table of Contents

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

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

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

The following table presents a reconciliation of net income (loss) to Adjusted Net Income:

| (Dollars in thousands)   | Year ended<br>December<br>31, 2007 | Year ended<br>December<br>31, 2008 | Year ended<br>December<br>31, 2009 | Year ended<br>December<br>31, 2010 | Year ended<br>December<br>31, 2011 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Net income (loss)  | \$ (9,714 )                        | \$ (555,955 )                      | \$ 43,055                          | \$ 56,913                          | \$ 324,643                         |
| Provision (benefit) for income taxes                                 | (571 )                             | 400                                | 339                                | 307                                | (237,677 )                         |
| Income (loss) before provision (benefit) for income taxes            | (10,285 )                          | (555,555 )                         | 43,394                             | 57,220                             | 86,966                             |
| Amortization of intangible assets                                    | 47,602                             | 47,602                             | 51,960                             | 51,808                             | 48,020                             |
| Amortization of deferred loan costs                                  | 4,225                              | 3,905                              | 3,417                              | 2,439                              | 1,986                              |
| Write-off of deferred financing costs related to debt extinguishment | —                                  | —                                  | —                                  | 4,809                              | 377                                |
| Intangible impairment charge   | —                                  | 583,486                            | —                                  | —                                  | 9,389                              |
| Transaction costs and purchase accounting adjustments                | 3,925                              | —                                  | —                                  | —                                  | 875                                |
| Gain on extinguishment of debt                                       | (18,759 )                          | (65,385 )                          | (14,745 )                          | —                                  | —                                  |
| Adjusted net income before income taxes                              | 26,708                             | 14,053                             | 84,026                             | 116,276                            | 147,613                            |
| Cash income tax expense  | (4,777 )                           | (295 )                             | (383 )                             | (322 )                             | (437 )                             |
| Adjusted net income  | \$ 21,931                          | \$ 13,758                          | \$ 83,643                          | \$ 115,954                         | \$ 147,176                         |

(8) Includes our Series A Preferred Stock and Class B Common Stock. See Note 7 to our audited consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

#### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read together with "Item 6 - Selected Financial Data" and the consolidated financial statements and the related notes included in Item 8 of

this Annual Report on Form 10-K. This discussion contains forward-looking statements, based on current expectations and related to future events and our future financial performance, that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those set forth under “Item 1A - Risk Factors.”

## Table of Contents

### Overview

We are a leading designer and manufacturer of a wide range of generators and other engine powered products for the residential, light commercial, industrial and commercial markets. As the only significant market participant focused predominantly on these products, we have one of the leading market positions in the power equipment market in the United States and Canada. We design, manufacture, source and modify engines, alternators, automatic transfer switches and other components necessary for our products. Our generators and other products are fueled by natural gas, liquid propane, gasoline, diesel and Bi-Fuel™ and are available through a broad network of independent dealers, retailers and wholesalers and equipment rental companies.

### Business drivers and measures

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

### Industry trends

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

**Increasing penetration opportunity.** Although there have been recent increases in product costs for installed standby generators in the residential and light-commercial markets (driven in the last two years by raw material costs), these costs have declined overall over the last decade, and many potential customers are not aware of the costs and benefits of backup power solutions. We estimate that penetration rates for residential products are approximately 2.5% of U.S. single-family detached, owner-occupied households with a home value of over \$100,000, as defined by the U.S. Census Bureau's 2009 American Housing Survey for the United States, and penetration rates of many light-commercial outlets such as restaurants, drug stores, and gas stations are significantly lower than penetration of hospitals and industrial locations. We believe that by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby generators.

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

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

**Impact of business capital investment cycle.** The market for commercial and industrial stationary and mobile generators and other power equipment is affected by the capital investment cycle and overall non-residential construction and durable goods spending, as businesses either add new locations or make investments to upgrade existing locations or equipment. These trends can have a material impact on demand for these products. The capital investment cycle may differ for the various industrial and commercial end markets that we serve (industrial, telecommunications, distribution, retail, health care facilities, construction, energy and municipal infrastructure, among others). The market for these products is also affected by general economic conditions, credit availability and



trends in durable goods spending by businesses.

29

---

## Table of Contents

### Operational factors

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

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

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

### Other factors

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

**Factors influencing interest expense.** Interest expense can be impacted by a variety of factors, including market fluctuations in LIBOR, interest rate election periods, interest rate swap agreements and repayments of indebtedness. Interest expense decreased in 2011 compared to 2010, primarily due to approximately \$134 million of debt pre-payments made over the last thirteen months.

**Factors influencing provision for income taxes.** Because we made a Section 338(h)(10) election in connection with the CCMP Transactions, we have \$1.2 billion of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2011 that we expect to generate cash tax savings of \$470 million through 2021, assuming continued profitability and a 39% tax rate. The amortization of these assets for tax purposes is expected to be \$122 million annually through 2020 and \$102 million in 2021, which generates annual cash tax savings of \$48 million through 2020 and \$40 million in 2021, assuming profitability and a 39% tax rate. Additionally, we have federal net operating loss, or NOL, carry-forwards of \$127.1 million as of December 31, 2011, which we expect to generate an additional \$44 million of federal cash tax savings at a 35% rate when and if utilized. Based on current business plans, we believe that our cash tax obligations through 2021 will be significantly reduced by these tax attributes. However, any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carryforwards to offset future federal income tax liabilities.

In addition, as a result of the asset acquisition of Magnum, we have approximately \$57.0 million of tax deductible goodwill and intangible assets remaining as of December 31, 2011. We expect these assets to generate tax savings of \$22.2 million through 2026 assuming continued profitability and a 39% tax rate. The amortization of these assets for tax purposes is expected to be \$3.8 million annually through 2025 and \$2.9 million in 2026, which generates an additional annual cash tax savings of \$1.5 million through 2025 and \$1.1 million in 2026, assuming profitability and a 39% tax rate.

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

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

Table of Contents

Transactions with CCMP

In November 2006, affiliates of CCMP, together with certain other investors and members of our management, purchased an aggregate of \$689 million of our equity capital. In addition, on November 10, 2006, Generac Power Systems borrowed an aggregate of \$1.38 billion, consisting of an initial drawdown of \$950 million under a \$1.1 billion first lien secured credit facility and \$430 million under a \$430 million second lien secured credit facility. With the proceeds from these equity and debt financings, together with cash on hand at Generac Power Systems, we (1) acquired all of the capital stock of Generac Power Systems and repaid certain pre-transaction indebtedness of Generac Power Systems for \$2.0 billion, (2) paid \$66 million in transaction costs related to the transaction and (3) retained \$3 million for general corporate purposes. For additional information concerning these and other historical transactions with CCMP, see “Item 1—Business—History—CCMP transactions.”

During 2007, affiliates of CCMP acquired \$80.3 million principal amount of second lien term loans for approximately \$60.0 million. CCMP's affiliates exchanged this debt for additional shares of Class B Common Stock. The fair value of the shares exchanged was \$60.0 million. We recorded this transaction as additional Class B Common Stock of \$60.0 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$18.8 million, which includes the write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the year ended December 31, 2007.

During 2008, affiliates of CCMP acquired \$148.9 million principal amount of second lien term loans for approximately \$81.1 million. CCMP's affiliates exchanged \$24.0 million principal amount of this debt for additional shares of Class B Common Stock and \$124.9 million principal amount of this debt for shares of our Series A Preferred Stock. The fair value of the shares of our Class B Common Stock and Series A Preferred Stock so exchanged was \$18.2 million and \$62.9 million, respectively. We recorded this transaction as Series A Preferred Stock of \$62.9 million and Class B Common Stock of \$18.2 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$65.4 million, which includes the write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the year ended December 31, 2008.

As of September 30, 2008, we failed to satisfy the leverage ratio in our senior secured credit facilities. As permitted by the credit agreement, in November, 2008, this violation was remedied by an equity contribution of \$15,500,000 from affiliates of CCMP, in exchange for 1,550 shares of Series A Preferred stock.

During 2009, affiliates of CCMP acquired \$9.9 million principal amount of first lien term loans and \$20.0 million principal amount of second lien term loans for approximately \$14.8 million. CCMP's affiliates exchanged this debt for 1,475.4596 shares of Series A Preferred Stock. The fair value of the shares exchanged was \$14.8 million. We recorded this transaction as additional Series A Preferred Stock of \$14.8 million based on the fair value of the debt contributed by CCMP's affiliates, which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, we recorded a gain on extinguishment of debt of \$14.7 million, which includes a write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the year ended December 31, 2009.

In connection with such issuances of our Class B Common Stock to affiliates of CCMP in connection with debt exchanges in 2007 and 2008 and the satisfaction of preemptive rights under the shareholders' agreement that arose from such issuances, affiliates of CCMP sold some of the shares of our Class B Common Stock they were issued in connection with such debt exchanges to an entity affiliated with CCMP, certain other investors and certain members of our management and board of directors. In addition, in connection with such issuances of our Series A Preferred

Stock to affiliates and CCMP in connection with debt exchanges in 2008 and 2009 and the satisfaction of preemptive rights under the shareholders' agreement that arose from such issuances, during the year ended December 31, 2009, we issued 2,000 shares of Series A Preferred Stock for an aggregate purchase price of \$20.0 million in cash to an entity affiliated with CCMP and certain members of management and our board of directors, and affiliates of CCMP sold some of the shares of Series A Preferred Stock they were previously issued in connection with such debt exchanges to an entity affiliated with CCMP and a member of the board of directors at the same price.

#### Corporate reorganization

Our capitalization prior to the initial public offering consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. Our Series A Preferred Stock was entitled to a priority return preference equal to a 14% annual return on the amount originally paid for such shares and equity participation equal to 24.3% of the remaining equity value of the Company. Our Class B Common Stock was entitled to a priority return preference equal to a 10% annual return on the amount originally paid for such shares. In connection with the initial public offering, we undertook a corporate reorganization which gave effect to the conversion of our Series A Preferred Stock and Class B Common Stock into the same class of our common stock that was sold in our initial public offering while taking into account the rights and preference of those shares, including the priority returns of our Series A Preferred Stock and our Class B Common Stock and the equity participation rights of the Series A Preferred Stock. A reverse stock split was needed to reduce the number of shares to be issued to holders of our Class A and Class B Common Stock to the number that correctly reflected the proportionate interest of such stockholders in our company, taking into account the number of shares of common stock to be issued upon the conversion of our Series A Preferred Stock and the number and value of shares of common stock to be issued and sold to new investors in the initial public offering. We refer to these transactions as the "Corporate Reorganization." The specific steps in the Corporate Reorganization were as follows:

## Table of Contents

### Treatment of Class B Common Stock

Our certificate of incorporation prior to the offering provided for the mandatory conversion of our Class B Voting Common Stock to Class A Common Stock in the event of an initial public offering, so that our Class B Common Stock is converted into the same class of our common stock that is to be offered in an initial public offering taking into account of the value, rights and preferences of our Class B Common Stock. In accordance with the terms of our certificate of incorporation prior to the offering, at the time we entered into an underwriting agreement with respect to the initial public offering, each share of our Class B Common Stock automatically converted into a number of shares of our Class A Common Stock equal to one plus the quotient obtained by dividing (i)(x) the amount paid for such share of Class B Common Stock plus (y) an increase to such amount equal to 10% per annum calculated and compounded quarterly on the basis of a 360-day year of twelve 30-day months and which increased amount shall be deemed to have accrued on a daily basis (i.e., the “Class B Return”), by (ii) the public offering price (net of underwriting discounts and commissions). We refer to this as the “Class B Conversion.” Each share of our Class B Common Stock converted into 1,118.440 shares of our Class A Common Stock (i.e., the “Class B Conversion Ratio”). As a result of the Class B Conversion, we issued an aggregate of 88,484,700 shares of our Class A Common Stock.

### Reverse stock split

Immediately following the Class B Conversion, we effected a 3.294 for one reverse stock split of our then outstanding shares of Class A Common Stock, including those shares of our Class A Common Stock issued as part of the Class B Conversion, which decreased the number of shares of our Class A Common Stock immediately after the Class B Conversion from 88,490,028 shares to 26,861,523 shares. We refer to this as the “Reverse Stock Split.”

### Treatment of Series A Preferred Stock

The certificate of designations for our Series A Preferred Stock prior to our initial public offering provided for the mandatory conversion of the Series A Preferred Stock to Class A Common Stock in the event of an initial public offering, so that our Series A Preferred Stock is converted into the same class of our common stock that is to be offered in an initial public offering taking into account of the value, rights and preferences of our Series A Preferred Stock. In accordance with the terms of the certificate of designations to our Series A Preferred Stock and our certificate of incorporation prior to the offering, promptly following the time we entered into an underwriting agreement with respect to the initial public offering, each share of our Series A Preferred Stock automatically converted into a number of shares of our Class A Common Stock equal to the sum of (A) the quotient obtained by dividing (i)(w) the amount paid for such share of Series A Preferred Stock plus (x) an increase to such amount equal to 14% per annum calculated and compounded quarterly on the basis of a 360-day year of twelve 30-day months and which increased amount shall be deemed to have accrued on a daily basis (the “Series A Preferred Return”), by (ii) the public offering price (net of underwriting discounts and commissions), plus (B) the product of (y) a fraction, the numerator of which is one and the denominator of which is the number of shares of our Series A Preferred Stock outstanding at such time, and (z) an additional number of shares of our Class A Common Stock that, when added to the number of shares of our Class A Common Stock outstanding at such time, including after giving effect to the Class B Conversion and the Reverse Stock Split, equaled 24.3% of the number of shares of our Class A Common Stock outstanding at such time (excluding the shares issued pursuant to clause (A) above). We refer to this as the “Series A Preferred Conversion.” Each share of our Series A Preferred Stock converted into 1,724.976 shares of our Class A Common Stock (i.e., the “Series A Preferred Conversion Ratio”). As a result of the Series A Preferred Conversion, we issued an aggregate of 19,511,018 shares of our Class A Common Stock.

### Reclassification of Class A Common Stock

After giving effect to the Class B Conversion, the Reverse Stock Split and the Series A Preferred Conversion, there were 46,372,541 shares of Class A Common Stock which were reclassified as common stock.

#### Initial public offering

On February 17, 2010, the Company completed its initial public offering of 18,750,000 shares of its common stock at a price of \$13.00 per share. In addition, the underwriters exercised their option and purchased an additional 1,950,500 shares of the Company's common stock from the Company on March 18, 2010. We received a total of approximately \$247.9 million in net proceeds from the initial public offering and underwriters' option exercise, after deducting the underwriting discounts and expenses. Immediately following the Corporate Reorganization, the IPO and underwriters' option exercise, we had 67,529,290 total shares of common stock outstanding.

## Table of Contents

### Repayment of debt

In February 2010, we used \$221.6 million in net proceeds from the initial closing of the IPO to pay down our second lien term loan in full and to pay down a portion of our first lien term loan. In addition, in March 2010, December 2010, April 2011 and December 2011, we used \$138.5 million, \$74.2 million, \$24.7 million and \$34.6 million, respectively, of cash and cash equivalents on hand to further pay down our first lien term loan. As a result of these debt repayments, the outstanding balance on the first lien credit facility has been reduced to \$597.9 million as of December 31, 2011, and our second lien credit facility has been repaid in full and terminated. This reduction in debt will have a significant impact on cash flows as a result of lower interest expense in future periods, based on current LIBOR rates.

Additionally, in connection with our refinancing on February 9, 2012, we used \$22.9 million of cash and cash equivalents on hand to further pay down our first lien term loan. We classified this portion of debt as a current liability in our consolidated balance sheet at December 31, 2011.

### Components of net sales and expenses

#### Net sales

Substantially all of our net sales are generated through the sale of our generators and other engine powered products to the residential, commercial and industrial markets. We also sell engines to certain customers and service parts to our dealer network. Net sales are recognized upon shipment of products to our customers. Net sales also includes shipping and handling charges billed to customers which are recognized at the time of shipment of products to our customers. Related freight costs are included in cost of sales. Our generators and other products are fueled by natural gas, liquid propane, gasoline, diesel or Bi-Fuel™ systems with power output from 800W to 9mW. Our products are primarily manufactured and assembled at our Wisconsin facilities and distributed through thousands of outlets across the United States and Canada. Our smaller kW generators for the residential, portable and commercial markets are typically built to stock, while our larger kW products for the industrial markets are generally customized and built to order.

Our net sales are affected primarily by the U.S. economy as sales outside of the United States represent only approximately 5% of total net sales.

We are not dependent on any one channel or customer for our net sales, with no single customer representing more than 8% of our net sales for the year ended December 31, 2011 and our top ten customers representing less than 30% of our net sales for the same period.

#### Costs of goods sold

The principal elements of costs of goods sold in our manufacturing operations are component parts, raw materials, factory overhead and labor. Component parts and raw materials comprised over 80% of costs of goods sold for the year ended December 31, 2011. The principal component parts are engines and alternators. We design and manufacture air-cooled engines for certain of our products smaller than 20kW. We source engines for some of our smaller products and all of our products larger than 20kW. We design all the alternators for our units and manufacture alternators for certain of our units. We also manufacture other generator components where we believe we have a design and cost advantage. We source component parts from an extensive global network of reliable, low-cost suppliers.

The principal raw materials used in our manufacturing processes and in the manufacturing of the components we source are steel, copper and aluminum. We are susceptible to fluctuations in the cost of these commodities, impacting



our costs of goods sold. We seek to mitigate the impact of commodity prices on our business through a continued focus on product design improvements and price increases in our products. However, there is typically a lag between raw material price fluctuations and their effect on our costs of goods sold.

Other sources of costs include our manufacturing facilities, which require significant factory overhead, labor and shipping costs. Factory overhead includes utilities, support personnel, depreciation, general supplies and support and maintenance. Although we maintain a low-cost, largely non-union workforce and flexible manufacturing processes, our margins can be impacted when we cannot promptly decrease labor and manufacturing costs to match declines in net sales.

#### Operating expenses

Our operating expenses consist of costs incurred to support our marketing, distribution, engineering, information systems, human resources, finance, purchasing, risk management, legal and tax functions. All of these categories include personnel costs such as salaries, bonuses, employee benefit costs and taxes. We typically classify our operating expenses into four categories: selling and service, research and development, general and administrative, and amortization of intangibles.

## Table of Contents

**Selling and service.** Our selling and service expenses consist primarily of personnel expense, marketing expense, warranty expense and other sales expenses. Our personnel expense recorded in selling and services expenses includes the expense of our sales force responsible for our national accounts and other personnel involved in the marketing and sales of our products. Warranty expense, which is recorded at the time of sale, is estimated based on historical trends. Our marketing expenses include direct mail costs, printed material costs, product display costs, market research expenses, trade show expenses and media advertising. Marketing expenses generally increase as our sales efforts increase and are related to the launch of new product offerings and opportunities within selected markets or associated with specific events such as awareness marketing in areas impacted by storms, participation in trade shows and other events.

**Research and development.** Our research and development expenses support over 130 active research and development projects. We currently operate four advanced facilities and employ over 150 engineers who focus on new product development, existing product improvement and cost reduction. Our commitment to research and development has resulted in a significant portfolio of approximately 90 U.S. and international patents and patent applications. Our research and development costs are expensed as incurred.

**General and administrative.** Our general and administrative expenses include personnel costs for general and administrative employees, accounting and legal professional services fees, information technology costs, insurance, travel and entertainment expense and other corporate expense.

**Amortization of intangibles.** Our amortization of intangibles expenses include the straight-line amortization of customer lists, patents and other intangibles assets.

**Goodwill and trade name.** Goodwill primarily represents the excess of the amount paid to acquire us over the estimated fair value of the net tangible and intangible assets acquired as of the November 2006 date of the CCMP Transactions.

Other indefinite-lived intangible assets consist of trade names. The fair value of trade names is measured using a relief-from-royalty approach, which assumes the fair value of the trade name is the discounted cash flows of the amount that would be paid had we not owned the trade name and instead licensed the trade name from another company.

In 2011, we recorded a non-cash charge which primarily related to the write down of a certain trade name. Please see “Critical accounting policies—Goodwill and other intangible assets” for additional detail on this charge.

### Other income (expense)

Our other income (expense) includes the interest expense on the outstanding balances of our \$950.0 million first lien term loan, \$430.0 million second lien term loan and \$150.0 million revolving credit facility entered into in November 2006, and the amortization of debt financing costs. In February 2010, we used the net proceeds from the initial closing of the initial public offering to pay down our second lien term loan in full and to pay down a portion of our first lien term loan. In addition, in March 2010, December 2010, April 2011 and December 2011, we used cash and cash equivalents on hand to further pay down our first lien term loan principal. No amounts were outstanding under the revolving credit facility at December 31, 2011 and December 31, 2010. The amounts borrowed under our term loans bear interest at rates based upon either a base rate or LIBOR, plus an applicable margin. We also earn interest income on our cash and cash equivalents, which is included in other income (expense). We also recorded expenses related to interest rate swap agreements, which had a notional amount of \$300.0 million outstanding at December 31, 2010 at an average rate of 1.5%, and a notional amount of \$300.0 million outstanding at December 31, 2011 at an average rate of 1.5%. Other income (expense) may also include other financial items such as extinguishment of debt.

Costs related to acquisition. In 2011, our other expenses include one-time transaction-related expenses related to the acquisition of the Magnum business.

Table of Contents

## Results of operations

Year ended December 31, 2011 compared to year ended December 31, 2010

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

| (Dollars in thousands)                   | Year ended December 31, |            |
|--|-------------------------|------------|
|  | 2010                    | 2011       |
| Net sales                                | \$ 592,880              | \$ 791,976 |
| Costs of goods sold                      | 355,523                 | 497,322    |
| Gross profit                             | 237,357                 | 294,654    |
| Operating expenses:                      |                         |            |
| Selling and service                      | 57,954                  | 77,776     |
| Research and development                 | 14,700                  | 16,476     |
| General and administrative               | 22,599                  | 30,012     |
| Amortization of intangibles              | 51,808                  | 48,020     |
| Trade name write-down                    | -                       | 9,389      |
| Total operating expenses                 | 147,061                 | 181,673    |
| Income from operations                   | 90,296                  | 112,981    |
| Total other expense, net                 | (33,076 )               | (26,015 )  |
| Income before provision for income taxes | 57,220                  | 86,966     |
| Provision for income taxes               | 307                     | (237,677 ) |
| Net income                               | \$ 56,913               | \$ 324,643 |

| (Dollars in thousands)                 | Year ended December 31, |           |
|--|-------------------------|-----------|
|  | 2010                    | 2011      |
| Residential power products             | \$372,782               | \$491,016 |
| Commercial & Industrial power products | 183,555                 | 250,270   |
| Other                                  | 36,543                  | 50,690    |
| Net sales                              | \$592,880               | \$791,976 |

Net sales. Net sales increased \$199.1 million, or 33.6%, to \$792.0 million for the year ended December 31, 2011 from \$592.9 million for the year ended December 31, 2010. This increase was driven by a \$118.2 million, or a 31.7%, increase in residential product sales largely driven by demand created by the major power outages in the third and fourth quarters of 2011. The frequency and duration of these major outages in certain regions of the country led to a surge in demand for portable generators as well as increased awareness and accelerated adoption of home standby generators. Commercial and industrial product sales increased \$66.7 million, or 36.3%. Magnum Products contributed \$36.5 million during the fourth quarter of 2011. In addition, overall capital spending from our national account customers and strong demand for our large industrial systems also contributed to increased commercial and industrial sales. Other product sales increased \$14.1 million mainly due to stronger service parts sales as a result of the major power outage events during the second half of 2011. Magnum Products also contributed \$2.3 million to service parts sales during the fourth quarter of 2011.

Table of Contents

**Costs of goods sold.** Costs of goods sold increased \$141.8 million, or 39.9%, to \$497.3 million for the year ended December 31, 2011 from \$355.5 million for the year ended December 31, 2010. This increase was mainly driven by the increase in sales volume and the addition of Magnum Products during the fourth quarter.

**Gross profit.** Gross profit increased \$57.3 million, or 24.1%, to \$294.7 million for the year ended December 31, 2011 from \$237.4 million for the year ended December 31, 2010, primarily due to the factors affecting net sales and cost of goods sold described above. As a percent of net sales, gross profit margin for the year ended December 31, 2011 decreased to 37.2% from 40.0% for the year ended December 31, 2010. This decline is primarily attributable to a higher sales mix of lower margin portable generators during 2011 and the mix impact from the addition of the Magnum Products business during the fourth quarter of 2011. To a lesser extent, higher commodity costs versus the prior year also contributed to the year-over-year gross margin decline.

**Operating expenses.** Operating expenses increased \$34.6 million to \$181.7 million for the year ended December 31, 2011 from \$147.1 million for the year ended December 31, 2010. Selling and service expenses increased \$19.8 million due to higher variable operating expenses and incentive compensation as a result of higher sales experienced during 2011. General and administration costs increased \$7.4 million mainly due to increased incentive compensation and incremental stock-based compensation expense. Operating expenses also increased as a result of investments made in infrastructure in 2011 to support the strategic growth initiatives of the Company. In addition, in the fourth quarter of 2011 the Company recorded a \$9.4 million non-cash charge which primarily related to the write down of a certain trade name as we strategically transition to the Generac brand.

**Other expense.** Other expense decreased \$7.1 million, or 21.3%, to \$26.0 million for the year ended December 31, 2011 from \$33.1 million for the year ended December 31, 2010. This decrease was driven by a decline in interest expense of \$3.7 million as a result of approximately \$134 million of debt pre-payments made over the last thirteen months. In addition, there was a \$4.4 million decrease in the write-off of deferred financing costs related to debt extinguishment. Partially offsetting the aforementioned decreases are transaction costs related to the Magnum Products acquisition totaling \$0.9 million.

**Income tax expense.** Income tax expense decreased \$238.0 million to a benefit of \$237.7 million for the year ended December 31, 2011 from \$0.3 million for the year ended December 31, 2011 due to a reversal of the full valuation allowance on net deferred tax assets. See discussion in Item 8 – Financial Statements and Supplementary Data – Note 9 for additional information.

**Net income.** As a result of the factors identified above, we generated net income of \$324.6 million for the year ended December 31, 2011 compared to a net income of \$56.9 million for the year ended December 31, 2010. The increase in net income is due to the items previously described.

**Adjusted EBITDA.** Adjusted EBITDA increased to \$188.5 million, compared to \$156.2 million in 2010, due to the factors previously discussed.

**Adjusted net income.** Adjusted Net Income increased to \$147.2 million in 2011 compared to \$116.0 million in 2010, due to the factors discussed above.

Year ended December 31, 2010 compared to year ended December 31, 2009

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

| (Dollars in thousands) | Year ended December 31, |           |
|------------------------|-------------------------|-----------|
|                        | 2009                    | 2010      |
| Net sales              | \$588,248               | \$592,880 |

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

|  |           |           |
|--|-----------|-----------|
| Costs of goods sold                    | 352,398   | 355,523   |
| Gross profit                           | 235,850   | 237,357   |
| Operating expenses:                    |           |           |
| Selling and service                    | 59,823    | 57,954    |
| Research and development               | 10,842    | 14,700    |
| General and administrative             | 14,713    | 22,599    |
| Amortization of intangibles            | 51,960    | 51,808    |
| Total operating expenses               | 137,338   | 147,061   |
| Income (loss) from operations          | 98,512    | 90,296    |
| Total other expense, net               | (55,118 ) | (33,076 ) |
| Loss before provision for income taxes | 43,394    | 57,220    |
| Provision for income taxes             | 339       | 307       |
| Net loss                               | \$43,055  | \$56,913  |

Table of Contents

| (Dollars in thousands)                 | Year ended December 31, |           |
|--|-------------------------|-----------|
|  | 2009                    | 2010      |
| Residential power products             | \$370,740               | \$372,782 |
| Commercial & Industrial power products | 187,323                 | 183,555   |
| Other                                  | 30,185                  | 36,543    |
| Net sales                              | \$588,248               | \$592,880 |

Net sales. Net sales increased \$4.6 million, or 0.8%, to \$592.9 million for the year ended December 31, 2010 from \$588.2 million for the year ended December 31, 2009. This increase was driven by a \$2.0 million, or a 0.6%, increase in sales to the residential markets due to continued expansion of the Company's distribution network and successful new product launches, offset by continued weakness in U.S. residential investment. This residential product sales increase was offset by a \$3.8 million, or 2.0%, decline in industrial and commercial product sales as a result of market declines in non-residential construction and reduced capital spending by national account customers. Although a decrease for the full year, industrial and commercial product sales displayed strong momentum in the second half of fiscal 2010 as end markets recovered. Other product sales increased \$6.4 million as a result of stronger RV, OEM engine and service parts sales.

Costs of goods sold. Costs of goods sold increased \$3.1 million, or 0.9%, to \$355.5 million for the year ended December 31, 2010 from \$352.4 million for the year ended December 31, 2009. This increase was driven by a \$4.4 million increase in materials cost, primarily due to higher steel, copper and aluminum costs, as well as by the increase in sales volume, partially offset by lower manufacturing overhead costs.

Gross profit. Gross profit increased \$1.5 million, or 0.6%, to \$237.4 million for the year ended December 31, 2010 from \$235.9 million for the year ended December 31, 2009, primarily due to the factors affecting net sales and cost of goods sold described above. As a percentage of net sales, gross profit decreased slightly to 40.0% for the year ended December 31, 2010 from 40.1% for the year ended December 31, 2009.

Operating expenses. Operating expenses increased \$9.7 million to \$147.1 million for the year ended December 31, 2010 from \$137.3 million for the year ended December 31, 2009. This increase is due to incremental research and development costs of \$3.9 million related to ongoing product development. In addition, general and administrative expenses increased \$7.9 million, of which \$6.4 million was related to non-cash stock compensation expense recorded for the time vesting of equity awards granted in connection with the IPO. The remaining increase in administrative costs was associated with additional costs to operate as a public company.

Other expense. Other expense decreased \$22.0 million, or 40.0%, to \$33.1 million for the year ended December 31, 2010 from \$55.1 million for the year ended December 31, 2009. This decrease was driven by a decline in interest expense of \$43.5 million as a result of our reduction in indebtedness, lower LIBOR rates and the termination of certain interest rate swap agreements. Offsetting this interest expense decline in 2010, there was a prior year gain on extinguishment of debt of \$14.7 million that did not occur in 2010, as well as the current year write-off of deferred financing costs related to debt extinguishment of \$4.8 million.

Income tax expense. Income tax expense was \$0.3 million for the year ended December 31, 2010, unchanged from the year ended December 31, 2009. Income tax expense primarily relates to certain state income taxes based on profitability measures other than net income.

Net income. As a result of the factors identified above, we generated net income of \$56.9 million for the year ended December 31, 2010 compared to a net income of \$43.1 million for the year ended December 31, 2009. The increase in net income is due to the items previously described.

Adjusted EBITDA. Adjusted EBITDA decreased to \$156.2 million, compared to \$159.1 million in 2009, as modest sales growth and consistent gross margins were more than offset by increased investment in the business. Adjusted EBITDA margins declined slightly in fiscal 2010 to 26.4% compared to 27.0% in fiscal 2009.



Table of Contents

Adjusted net income. Adjusted Net Income increased to \$115.9 million in 2010 compared to \$83.6 million in 2009. The increase in adjusted net income was attributable to lower interest expense versus prior year offset by non-cash stock compensation expenses and reduced Adjusted EBITDA compared to fiscal 2009.

## Liquidity and financial position

Our primary cash requirements include the payment of our raw material and components suppliers, salaries & benefits, operating expenses, interest and principal payments on our debt, and capital expenditures. We finance our operations primarily through cash flow generated from operations and, if necessary, borrowings under our revolving credit facility. In November 2006, Generac Power Systems entered into a seven-year \$950.0 million first lien term loan, a seven-and-a-half year \$430.0 million second lien term loan, and a six-year \$150.0 million revolving credit facility. During 2010 and 2011, we used the net proceeds of our initial public offering and a substantial portion of our cash and cash equivalents on hand totaling \$493.8 million to pay down our second lien term loans in full and to repay a portion of our first lien term loan. As a result of these pay downs, the outstanding balance on the first lien credit facility has been reduced to \$597.9 million as of December 31, 2011, and our second lien credit facility has been repaid in full and terminated.

At December 31, 2011, we had cash and cash equivalents of \$93.1 million and \$144.2 million of availability under our revolving credit facility. Our total indebtedness was \$597.9 million at December 31, 2011.

On February 9, 2012, Generac Power Systems repaid an additional \$22.9 million against its first lien term loan and entered into a new credit agreement. The new credit agreement provides for borrowings under a new five-year \$150.0 million revolving credit facility, a five-year \$325.0 million tranche A term loan facility and a seven-year \$250.0 million tranche B term loan facility. Proceeds received by the Company from loans made under the new credit agreement were used to repay in full all outstanding borrowings under the former credit agreement, dated as of November 10, 2006, as amended from time to time, and for general corporate purposes. As a result of the repayments of debt and refinancing, our total indebtedness was \$575.0 million at February 9, 2012.

## Long-term liquidity

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

## Cash flow

Year ended December 31, 2011 compared to year ended December 31, 2010

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

| (Dollars in thousands)                    | Year ended December 31, |            |            |          |
|---|-------------------------|------------|------------|----------|
|   | 2010                    | 2011       | Change     | % Change |
| Net cash provided by operating activities | \$114,481               | \$169,712  | \$55,231   | 48.2 %   |
| Net cash used in investing activities     | \$(11,204)              | \$(95,953) | \$(84,749) | -756.4 % |
| Net cash used in financing activities     | \$(186,001)             | \$(59,216) | \$126,785  | 68.2 %   |

Net cash provided by operating activities was \$169.7 million for 2011 compared to \$114.5 million in 2010. This increase of \$55.2 million, or 48.2%, is primarily attributable to increased sales volume during 2011 and to a lesser extent favorable net cash inflows from working capital in 2011 compared to net cash flow outflows from working capital in 2010.

Table of Contents

Net cash used for investing activities for the year ended December 31, 2011 was \$96.0 million. This included \$12.1 million used for the purchase of property and equipment and \$83.9 million for the acquisition of the Magnum Products business. Net cash used for investing activities for the year ended December 31, 2010 was \$11.2 million and included \$9.6 million used for the purchase of property and equipment and \$1.6 million for a business acquisition, net of cash acquired.

Net cash used in financing activities was \$59.2 million for the year ended December 31, 2011, a decrease of \$126.8 million in net cash outflows from 2010 due to higher levels of debt payments made in 2010 totaling \$434.3 million which were offset by \$248.3 million of proceeds from the issuance of common stock. In 2011, \$59.4 million of payments on debt were made.

Year ended December 31, 2010 compared to year ended December 31, 2009

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

| (Dollars in thousands)                           | Year ended December 31, |             |             |          |   |
|--|-------------------------|-------------|-------------|----------|---|
|  | 2009                    | 2010        | Change      | % Change |   |
| Net cash provided by operating activities        | \$74,607                | \$114,481   | \$39,874    | 53.4     | % |
| Net cash used in investing activities            | \$(4,351)               | \$(11,204)  | \$(6,853)   | -157.5   | % |
| Net cash provided (used) by financing activities | \$9,822                 | \$(186,001) | \$(195,823) | -1,993.7 | % |

Net cash provided by operating activities was \$114.5 million for 2010 compared to \$74.6 million in 2009. This increase of \$39.9 million represents a 53.4% increase over prior year mainly due to the reduction of cash paid for interest expense of \$38.8 million. A reduction in working capital usage also contributed to the full year 2010 cash flow improvement as well.

Net cash used for investing activities for the year ended December 31, 2010 was \$11.2 million and included \$9.6 million used for the purchase of property and equipment and \$1.6 million for a business acquisition, net of cash acquired. Net cash used for investing activities for the year ended December 31, 2009 was \$4.4 million and included \$4.5 million used for the purchase of property and equipment. The increase in property and equipment purchases in 2010 relates to certain product development and cost reduction projects.

Net cash provided (used) by financing activities was \$(186.0) million for the year ended December 31, 2010, a decrease of \$195.8 million from 2009, due mainly to \$248.3 million of proceeds from the issuance of common stock, offset by payments on debt of \$434.3 million. Net cash provided by financing activities was \$9.8 million for the year ended December 31, 2009 due to a \$20.0 million capital contribution in exchange for shares of our Series A Preferred Stock, offset by principal payments on our first lien term loan of \$9.5 million and \$0.7 million of payments incurred in advance of our IPO.

#### Senior secured credit facilities

In November 2006, as part of the CCMP Transactions, Generac Power Systems entered into (i) a first lien credit facility with Goldman Sachs Credit Partners L.P., as administrative agent, composed of (x) a \$950.0 million term loan, which was scheduled to mature in November 2013 and (y) a \$150 million revolving credit facility, which was scheduled to mature in November 2012, and (ii) a second lien credit facility with JP Morgan Chase Bank, N.A., as administrative agent, composed of a \$430.0 million term loan, which was scheduled to mature in May 2014. The effective interest rate on the first lien credit facility term loan on December 31, 2011 was 3.2%. The effective interest rate, excluding the effect of interest rate swaps in place on the first lien credit facility term loan on December 31, 2011, was 2.8%.

During 2010 and 2011, we used the net proceeds of our initial public offering and a substantial portion of our cash and cash equivalents on hand totaling \$493.8 million to pay down our second lien term loans in full and to repay a portion of our first lien term loans. As a result of these pay downs, the outstanding balance on the first lien credit facility was reduced to \$597.9 million as of December 31, 2011, and our second lien credit facility was repaid in full and terminated. Additional information on this credit facility can be found in the Notes to Consolidated financial Statements – Note 6 Credit Agreements.

## Table of Contents

On February 9, 2012, Generac Power Systems repaid an additional \$22.9 million against its first lien term loan and entered into new senior secured credit facilities. The new credit facilities include a new five-year \$150.0 million revolving credit facility, a five-year \$325.0 million tranche A term loan facility and a seven-year \$250.0 million tranche B term loan facility. Proceeds from loans made under the new credit facilities were used to repay in full all first lien term loans outstanding under our former first lien credit facility, and for general corporate purposes. As a result of the repayments of debt and refinancing, our total indebtedness was \$575.0 million and there were no borrowings on the revolving credit facility at February 9, 2012.

The new revolving credit facility and tranche A term loan facility initially bear interest at rates based upon either a base rate plus an applicable margin of 1.25% or adjusted LIBOR rate plus an applicable margin of 2.25%. The tranche B term loan facility bears interest at rates based upon either a base rate (which, with respect to such tranche B term loan facility, will not be less than 2.00%) plus an applicable margin of 1.75% or adjusted LIBOR rate (which, with respect to such tranche B term loan facility, will not be less than 1.00%) plus an applicable margin of 2.75%. In subsequent periods, the new revolving credit facility and the tranche A term loan facility will bear interest at rates based upon either a base rate plus an applicable margin ranging from 0.75% to 1.50% or adjusted LIBOR rate plus an applicable margin ranging from 1.75% to 2.50%, each determined based on a leverage ratio.

Amounts under the new revolving credit facility can be borrowed and repaid, from time to time, at our option, provided there is no default or event of default under the new credit facilities.

The principal amount of the tranche A term loan amortizes in equal installments of \$4.063 million on the first day of each fiscal quarter commencing on July 1, 2012 through April 1, 2014, then equal installments of \$8.125 million on the first day of each fiscal quarter commencing July 1, 2014 through April 1, 2015, then equal installments of \$10.156 million on the first day of each fiscal quarter commencing July 1, 2015 through January 1, 2017, with a final payment of \$188.906 million on February 9, 2017. The principal amount of the tranche B term loan amortizes in equal installments of \$0.625 million on the first day of each fiscal quarter commencing on July 1, 2012 through January 1, 2019, with a final payment of \$233.125 million on February 9, 2019. Any amounts outstanding under the revolving credit facility are due on February 9, 2017.

The new credit facilities restrict the circumstances in which distributions and dividends can be paid by Generac Power Systems, as the borrower. Payments can be made by Generac Power Systems to us for certain expenses such as operating expenses in the ordinary course and dividends can be used to repurchase equity interests, subject to limitation in certain circumstances. Additionally, the new credit facilities restrict the aggregate amount of dividends and distributions that can be paid and, in certain circumstances, requires the maintenance of certain leverage ratios in order to pay certain dividends or distributions.

The new credit facilities permit Generac Power Systems to prepay its borrowings under the tranche A term loan facility, the tranche B term loan facility and the revolving credit facility, subject to the procedures set forth in the new credit agreement applicable to the new credit facilities. In certain circumstances, Generac Power Systems may be required to make prepayments on its outstanding borrowings under the new credit facilities if it receives proceeds as a result of certain asset sales, debt issuances, casualty or similar events of loss or if Generac Power Systems has excess cash flow (as defined in the new credit facilities).

The new credit agreement contains customary events of default, including, among others, nonpayment of principal, interest or other amounts, failure to perform covenants, inaccuracy of representations or warranties in any material respect, cross-defaults with other material indebtedness, certain undischarged judgments, the occurrence of certain ERISA or bankruptcy or insolvency events or the occurrence of a change in control (as defined in the new credit agreement). Upon an event of default under the new credit agreement, the lenders may declare the loans and all other obligations under the new credit agreement immediately due and payable and require Generac Power Systems to cash

collateralize the outstanding letter of credit obligations. A bankruptcy or insolvency event of default causes such obligations to automatically become immediately due and payable.

The borrowings under the new credit facilities are secured by associated collateral agreements which pledge virtually all assets of Generac Power Systems and the guarantors of the new credit facilities. The new credit agreement requires Generac Power Systems, among other things, to meet certain financial and nonfinancial covenants and maintain a consolidated net leverage ratio not exceeding certain agreed levels and an interest coverage ratio not to decline below certain agreed levels.

Table of Contents

Covenant compliance

The first lien credit facility in place at December 31, 2011 required Generac Power Systems to maintain a leverage ratio of consolidated total debt, net of unrestricted cash and marketable securities, to EBITDA (as defined in such first lien credit facility). We refer to the calculation of EBITDA under and as defined in such first lien credit facility in this annual report as “Covenant EBITDA.” Covenant EBITDA and the leverage ratio were calculated based on the four most recently completed fiscal quarters of Generac Power Systems. Based on the formulations set forth in the first lien credit facility, Generac Power Systems was required to maintain a maximum leverage ratio of 4.75 to 1.00 as of December 31, 2011 and for the remainder of the term of such first lien credit agreement. As of December 31, 2011, Generac Power Systems’ leverage ratio was 2.83 to 1.00. Failure to comply with this covenant would have resulted in an event of default under the first lien credit facility unless waived by the lender thereunder. Generac Power Systems was in compliance with the financial covenants under the first lien credit facility as of December 31, 2009, December 31, 2010 and December 31, 2011. Additional information on the first lien credit facility can be found in the Notes to Consolidated financial Statements – Note 6 Credit Agreements.

The new credit facilities, effective February 9, 2012, requires Generac Power Systems to maintain a leverage ratio of consolidated total debt, net of unrestricted cash and marketable securities, to EBITDA (as defined in the new credit agreement) and an interest coverage ratio of EBITDA to cash interest expense (as defined in the new credit agreement). The calculation of EBITDA under and as defined in the new credit agreement is referred to in this annual report as “Covenant EBITDA.” Covenant EBITDA, the leverage ratio and interest coverage ratio are calculated based on the four most recently completed fiscal quarters of Generac Power Systems. Based on the formulations set forth in the new credit agreement, Generac Power Systems is required to maintain a maximum leverage ratio of 4.00 to 1.00 from the periods June 30, 2012 to September 30, 2012, and 3.75 to 1.00 thereafter. Additionally, Generac Power Systems is required to maintain a minimum interest coverage ratio of 2.50 to 1.00 from June 30, 2012 to September 30, 2012, 2.75 to 1.00 from December 31, 2012 to June 30, 2013, 3.00 to 1.00 from September 30, 2013 to June 30, 2014 and 3.25 to 1.00 thereafter.

Our compliance with the financial covenants and satisfaction of certain leverage based ratios are used in determining, among other things, the interest rate applicable to the outstanding loans under the new credit facilities, the ability to undertake business acquisitions, the ability to incur certain types of indebtedness and the amount of dividends and distributions that are permitted to be paid to our stockholders, subject to certain exceptions.

An event of default under the new credit facilities could result in the acceleration of our indebtedness under such facilities, and we may be unable to repay or finance the amounts due. If there were an event of default as a result of a failure to maintain our required leverage ratio or otherwise, it would have an adverse effect on our financial condition and liquidity, including preventing us from utilizing our revolving credit facility. In addition, the new credit facilities restrict our ability to take certain actions, such as incur additional debt or make certain acquisitions, if we are unable to meet our leverage ratio.

In addition to the financial covenant described above, the new credit facilities contain certain other affirmative and negative covenants that, among other things, provide limitations on the incurrence of additional indebtedness, liens on property, sale and leaseback transactions, investments, loans and advances, merger or consolidation, asset sales, acquisitions, transactions with affiliates, prepayments of any other indebtedness and modifications of Generac Power Systems’ organizational documents.

As of December 31, 2011, \$597.9 million of borrowings were outstanding under the first lien credit facility. As of December 31, 2010, \$657.2 million of borrowings were outstanding under the first lien credit facility. As previously disclosed, on February 9, 2012, Generac Power Systems repaid an additional \$22.9 million against its first lien credit facility and entered into new credit facilities. As of February 9, 2012, a total of \$575.0 million were outstanding under the new credit facilities.

## Contractual obligations

The following table summarizes our expected payments for significant contractual obligations as of December 31, 2011:

| (Dollars in thousands)                        | Payment due by period |                     |           |           |                  |
|---|-----------------------|---------------------|-----------|-----------|------------------|
|   | Total                 | Less than<br>1 year | 2-3 years | 4-5 years | After 5<br>years |
| Contractual obligations                       |                       |                     |           |           |                  |
| Long-term debt, including current portion (1) | \$597,874             | \$--                | \$597,874 | \$--      | --               |
| Interest on long-term debt(2)                 | 31,665                | 17,043              | 14,622    | --        | --               |
| Operating leases                              | 1,325                 | 479                 | 818       | 28        | --               |
| Total contractual cash obligations(3)         | \$630,864             | \$17,522            | \$613,314 | \$28      | \$--             |

(1) On February 9, 2012, a subsidiary of the Company entered into a new credit agreement with certain commercial banks and other lenders. The new credit agreement provides for borrowings under a new \$150.0 million revolving credit facility, a \$325.0 million tranche A term loan facility and a \$250.0 million tranche B term loan facility. The new revolving credit facility and tranche A term loan facility mature February 9, 2017, and the tranche B term loan facility matures February 9, 2019.

(2) Assumes all debt will remain outstanding until maturity and using the interest rates in effect for our senior secured credit facilities as of December 31, 2011.

(3) Pension obligations are excluded from this table as we are unable to estimate the timing of payment due to the inherent assumptions underlying the obligation. However, the Company estimates we will contribute \$2.9 million to our pension plans in 2012.



## Table of Contents

### Capital expenditures

Our operations require capital expenditures for technology, tooling, equipment, capacity expansion and upgrades. Capital expenditures were \$12.1 million for the year ended December 31, 2011, and were funded through cash from operations. Capital expenditures were \$9.6 million for the year ended December 31, 2010, and were also funded through cash from operations.

### Off-balance sheet arrangements

We have an arrangement with a finance company to provide floor plan financing for selected dealers. This arrangement provides liquidity for our dealers by financing dealer purchases of products with credit availability from the finance company. We receive payment from the finance company after shipment of product to the dealer and our dealers are given a longer period of time to pay the finance provider. If our dealers do not pay the finance company, we may be required to repurchase the applicable inventory held by the dealer.

Total inventory financed accounted for approximately 7% of net sales for the year ended December 31, 2010 and approximately 6% of net sales for the year ended December 31, 2011. The amount financed by dealers which remained outstanding was \$9.8 million and \$10.0 million as of December 31, 2010 and 2011, respectively.

### Critical accounting policies

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

### Goodwill and other intangible assets

We perform an annual impairment test for goodwill and trade names and more frequently if an event or circumstances indicate that an impairment loss has been incurred. Conditions that would trigger an impairment assessment include, but are not limited to, a significant adverse change in legal factors or business climate that could affect the value of an asset. The analysis of potential impairment of goodwill requires a two-step process. The first step is the estimation of fair value of the applicable reporting unit. Estimated fair value is based on management judgments and assumptions with the assistance of a third-party valuation firm, and those fair values are compared with our aggregate carrying value of the respective reporting unit. If our fair value is greater than the carrying amount, there is no impairment. If our carrying amount is greater than the fair value, then the second step must be completed to measure the amount of impairment, if any.

The second step calculates the implied fair value of the goodwill, which is compared to its carrying value. The implied fair value of goodwill is calculated by valuing all of the tangible and intangible assets of the reporting unit at the

hypothetical fair value, assuming the reporting unit had been acquired in a business combination. The excess of the fair value of the entire reporting unit over the fair value of its identifiable assets and liabilities is the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized equal to the difference.

The Company performed the required annual impairment tests for goodwill as of October 31, 2011, 2010 and 2009, and found no impairment of goodwill.

During the fourth quarter of 2011, the Company decided to strategically transition certain products to their more widely known Generac brand. Based on this decision, the Company recorded a \$9.4 million non-cash charge which primarily related to the write down of the impacted trade name to net realizable value. In addition, the Company performed its annual fair value-based impairment test as of October 31, 2011. Except as noted, no impairment was indicated.

## Table of Contents

The Company performed its annual fair value-based impairment test on indefinite lived trade names as of October 31, 2010 and 2009. No impairment was indicated.

We can make no assurances that remaining goodwill or trade names will not be impaired in the future. When preparing a discounted cash flow analysis, we make a number of key estimates and assumptions. We estimate the future cash flows of the business based on historical and forecasted revenues and operating costs. This, in turn, involves further estimates, such as estimates of future growth rates and inflation rates. In addition, we apply a discount rate to the estimated future cash flows for the purpose of the valuation. This discount rate is based on the estimated weighted average cost of capital for the business and may change from year to year. Weighted average cost of capital includes certain assumptions such as market capital structures, market betas, risk-free rate of return and estimated costs of borrowing. Changes in these key estimates and assumptions, or in other assumptions used in this process, could materially affect our impairment analysis for a given year. Additionally, since our measurement also considers a market approach, changes in comparable public company multiples can also materially impact our impairment analysis.

In the long term, our remaining goodwill and trade name balances could be further impaired in future periods. A number of factors, many of which we have no ability to control, could affect our financial condition, operating results and business prospects and could cause actual results to differ from the estimates and assumptions we employed. These factors include:

- a prolonged global economic crisis;
- a significant decrease in the demand for our products;
- the inability to develop new and enhanced products and services in a timely manner;
  - a significant adverse change in legal factors or in the business climate;
  - an adverse action or assessment by a regulator; and
- successful efforts by our competitors to gain market share in our markets.

Our cash flow assumptions are based on historical and forecasted revenue, operating costs and other relevant factors. If management's estimates of future operating results change or if there are changes to other assumptions, the estimate of the fair value of our business may change significantly. Such change could result in impairment charges in future periods, which could have a significant impact on our operating results and financial condition.

### Defined benefit pension obligations

The funded status of our pension plans is more fully described in Note 9 to our audited consolidated financial statements included in Item 8 of this annual report. As discussed in Note 9, the pension benefit obligation and related pension expense or income are calculated in accordance with ASC 715-30, Defined Benefit Plans—Pension, and are impacted by certain actuarial assumptions, including the discount rate and the expected rate of return on plan assets.

Rates are evaluated on an annual basis considering such factors as market interest rates and historical asset performance. Actuarial valuations for fiscal year 2011 used a discount rate of 5.22% and an expected rate of return on plan assets of 7.62%. Our discount rate was selected using a methodology that matches plan cash flows with a selection of Moody's Aa or higher rated bonds, resulting in a discount rate that better matches a bond yield curve with comparable cash flows. In estimating the expected return on plan assets, we study historical markets and preserve the long-term historical relationships between equities and fixed-income securities. We evaluate current market factors such as inflation and interest rates before we determine long-term capital market assumptions and review peer data and historical returns to check for reasonableness and appropriateness. Changes in the discount rate and return on assets can have a significant effect on the funded status of our pension plans, stockholders' equity and related expense. We cannot predict these changes in discount rates or investment returns and, therefore, cannot reasonably estimate

whether the impact in subsequent years will be significant.

The funded status of our pension plans is the difference between the projected benefit obligation and the fair value of its plan assets. The projected benefit obligation is the actuarial present value of all benefits expected to be earned by the employees' service adjusted for future potential wage increases.

## Table of Contents

Our funding policy for our pension plans is to contribute amounts at least equal to the minimum annual amount required by applicable regulations. Given this policy, we expect to make \$2.9 million in contributions to our pension plans in 2012.

Allowance for doubtful accounts, excess and obsolete inventory reserves, product warranty reserves and other contingencies

The reserves, if any, for customer rebates, product warranty, product liability, litigation, excess and obsolete inventory and doubtful accounts are fact-specific and take into account such factors as specific customer situations, historical experience, and current and expected economic conditions. These reserves are reflected under Notes 2, 4, 5 and 15 to our audited consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Derivative accounting

We have interest rate swap contracts, or the Swaps, in place to fix a portion of our variable rate indebtedness. For 2007 and 2008, the Swaps were deemed highly effective per ASC 815 and therefore, any changes in fair value of these Swaps is recorded in accumulated other comprehensive income (loss). As of January 3, 2009, in accordance with the terms of our senior secured credit facilities, we changed the interest rate election from three-month LIBOR to one-month LIBOR. As a result, we concluded that as of January 3, 2009, the Swaps no longer met hedge effectiveness criteria under ASC 815. Future changes in the fair value of the Swaps was immediately recognized in our statement of operations as interest expense, while the effective portion of the Swaps prior to the change remained in accumulated other comprehensive income (loss) and was amortized as interest expense over the period of the originally designated hedged transactions which ended on January 4, 2010. New interest rate swap contracts entered into in fiscal 2010 are deemed highly effective per ASC 815.

As required by ASC 815 Derivatives and Hedging, we record the Swaps at fair value pursuant to ASC 820 Fair Value Measurements and Disclosures, which 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. When determining the fair value of the Swaps, we considered our credit risk in accordance with ASC 820. The fair value of the Swaps, including the impact of credit risk, at December 31, 2011 and 2010 was a liability of \$5.3 million and \$4.1 million, respectively.

Income taxes

We account for income taxes in accordance with ASC 740 Income Taxes. Our estimate of income taxes payable, deferred income taxes and the effective tax rate is based on an analysis of many factors including interpretations of federal and state income tax laws, the difference between tax and financial reporting bases of assets and liabilities, estimates of amounts currently due or owed in various jurisdictions, and current accounting standards. We review and update our estimates on a quarterly basis as facts and circumstances change and actual results are known.

We have generated significant deferred tax assets as a result of goodwill and intangible asset book versus tax differences as well as significant net operating loss carryforwards. In assessing the realizability of these deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the years in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. As of September 30, 2011, we were in a three year cumulative loss position and had a full valuation allowance recorded against our net deferred tax assets. In the fourth quarter of 2011, we came out of a three-year cumulative loss position and, as part of the normal assessment of the future realization of our net deferred tax assets, determined that a valuation allowance was no longer required. As a result, the valuation allowance previously recorded was reversed in

the fourth quarter of 2011 and was recorded as a component of the income tax provision.

#### Share based compensation

Under the fair value recognition provisions of ASC 718 Compensation – Stock Compensation, share based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period. Determining the fair value of share based awards at the grant date requires judgment, including estimating expected dividends and market volatility of our stock. In addition, judgment is also required in estimating the amount of share based awards that are expected to be forfeited. If actual results differ significantly from these estimates, share based compensation expense and our results of operations could be impacted.

Table of Contents

New Accounting Standards

For information with respect to new accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2 to the consolidated financial statements in Item 8 of this annual report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in foreign currency exchange rates, commodity prices and interest rates. To reduce the risk from changes in certain foreign currency exchange rates and commodity prices, we use financial instruments from time to time. We do not hold or issue financial instruments for trading purposes.

Foreign currency

We are exposed to foreign currency exchange risk as a result of purchasing from suppliers in other countries. Periodically, we utilize foreign currency forward purchase and sales contracts to manage the volatility associated with foreign currency purchases in the normal course of business. Contracts typically have maturities of one year or less. Realized and unrealized gains and losses on transactions denominated in foreign currency are recorded in earnings as a component of cost of goods sold. At December 31, 2011 and December 31, 2010, we had no foreign exchange contracts outstanding.

On February 18, 2010, we entered into a ten-month foreign currency average rate option transaction for Euros with a total notional amount of \$2.5 million and a termination date of December 31, 2010. Total losses recognized in the statement of operations for foreign currency contracts were \$100,000. The primary objective of this hedging activity is to mitigate the impact of potential price fluctuations of the Euro on our financial results.

Commodity prices

We are a purchaser of commodities and of components manufactured from commodities, including steel, aluminum, copper and others. As a result, we are exposed to fluctuating market prices for those commodities. While such materials are typically available from numerous suppliers, commodity raw materials are subject to price fluctuations. We generally buy these commodities and components based upon market prices that are established with the supplier as part of the purchase process. Depending on the supplier, these market prices may reset on a periodic basis based on negotiated lags. To the extent that commodity prices increase and we do not have firm pricing from our suppliers, or our suppliers are not able to honor such prices, we may experience a decline in our gross margins to the extent we are not able to increase selling prices of our products or obtain manufacturing efficiencies to offset increases in commodity costs.

Periodically, we engage in certain commodity risk management activities. The primary objectives of these activities are to understand and mitigate the impact of potential price fluctuations on our financial results. Generally, these risk management transactions will involve the use of commodity derivatives to protect against exposure resulting from significant price fluctuations.

Table of Contents

We primarily utilize commodity contracts with maturities of one year or less. These are intended to offset the effect of price fluctuations on actual inventory purchases. The primary objective of the hedge is to mitigate the impact of potential price fluctuations of copper on our financial results. As of December 31, 2011, we had the following commodity forward contracts outstanding with the fair value gains losses shown (in thousands):

| Hedged Item | Number of<br>Contracts<br>Outstanding | Effective Date                   | Aggregate<br>Notional<br>Amount | Losses<br>recognized in<br>consolidated<br>statement of<br>operations for<br>the year ended<br>December 31,<br>2011 |
|-------------|---------------------------------------|----------------------------------|---------------------------------|---|
| Copper      | 2                                     | October 1, 2011 to June 30, 2012 | \$ 6,468                        | \$ 861  |

## Interest rates

As of December 31, 2011, a portion of the outstanding debt under our term loans was subject to floating interest rate risk. As of this date, we had the following interest rate swap contracts outstanding (in thousands):

| Hedged Item   | Contract Date    | Effective Date  | Notional<br>Amount | Fixed LIBOR<br>Rate | Expiration Date |
|---------------|------------------|-----------------|--------------------|---------------------|-----------------|
| Interest rate | April 1, 2011    | October 1, 2012 | \$ 100,000         | 2.22 %              | October 1, 2013 |
| Interest rate | April 1, 2011    | July 1, 2012    | \$ 200,000         | 1.905 %             | July 1, 2013    |
| Interest rate | June 29, 2010    | October 1, 2010 | \$ 100,000         | 1.025 %             | October 1, 2012 |
| Interest rate | January 21, 2010 | July 1, 2010    | \$ 200,000         | 1.73 %              | July 1, 2012    |

At December 31, 2011, the fair value of the swaps reduced for our credit risk and excluding related accrued interest was a liability of \$5.3 million. For further information on these swaps, see Note 6 to our audited consolidated financial statements included in Item 8 of this Annual Report on Form 10-K. Even after giving effect to these swaps, we are exposed to risks due to changes in interest rates with respect to the portion of our term loans that are not covered by the swaps. A hypothetical change in the LIBOR interest rate of 100 basis points would have changed annual cash interest expense by approximately \$3.0 million (or, without the swaps in place, \$6.0 million).

We expect to maintain our existing swaps as highly effective in accordance with ASC 815 and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss).



Table of Contents

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Generac Holdings Inc.

We have audited Generac Holdings Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Generac Holdings Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Magnum Products LLC, which is included in the December 31, 2011 consolidated financial statements of Generac Holdings Inc. and constituted 7% and 12% of total and net assets, respectively, as of December 31, 2011 and 5% and 1% of revenues and net income, respectively, for the year then ended. Our audit of internal control over financial reporting of Generac Holdings Inc. also did not include an evaluation of the internal control over financial reporting of Magnum Products LLC.

In our opinion, Generac Holdings Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2011 and 2010, and the related consolidated statements of operations, redeemable stock and stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 of Generac Holdings Inc. and our report dated March 9, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin

March 9, 2012

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Generac Holdings Inc.

We have audited the accompanying consolidated balance sheets of Generac Holdings Inc. (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, redeemable stock and stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Generac Holdings Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin  
March 9, 2012

Table of Contents

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

|   | December 31, |             |
|---|--------------|-------------|
|   | 2011         | 2010        |
| <b>Assets</b>   |              |             |
| Current assets:   |              |             |
| Cash and cash equivalents   | \$93,126     | \$78,583    |
| Accounts receivable, less allowance for doubtful accounts of \$789 in 2011 and \$723 in 2010  | 109,705      | 63,154      |
| Inventories   | 162,124      | 127,137     |
| Deferred income taxes   | 14,395       | –           |
| Prepaid expenses and other assets   | 3,915        | 3,645       |
| Total current assets  | 383,265      | 272,519     |
| Property and equipment, net   | 84,384       | 75,287      |
| Customer lists, net   | 72,897       | 96,944      |
| Patents, net  | 78,167       | 84,933      |
| Other intangible assets, net  | 7,306        | 6,483       |
| Deferred financing costs, net   | 3,459        | 5,822       |
| Trade names   | 148,401      | 140,050     |
| Goodwill  | 547,473      | 527,148     |
| Deferred income taxes   | 227,363      | –           |
| Other assets  | 78           | 697         |
| Total assets  | \$1,552,793  | \$1,209,883 |
| <b>Liabilities and stockholders' equity</b>   |              |             |
| Current liabilities:  |              |             |
| Accounts payable  | \$81,053     | \$41,809    |
| Accrued wages and employee benefits   | 14,439       | 6,833       |
| Other accrued liabilities   | 47,024       | 38,043      |
| Current portion of long-term debt   | 22,874       | –           |
| Total current liabilities   | 165,390      | 86,685      |
| Long-term debt  | 575,000      | 657,229     |
| Other long-term liabilities   | 43,514       | 24,902      |
| Total liabilities   | 783,904      | 768,816     |
| Stockholders' equity:   |              |             |
| Common stock (formerly Class A non-voting common stock), par value \$0.01, 500,000,000 shares authorized, 67,652,812 and 67,524,596 shares issued at December 31, 2011 and 2010, respectively | 676          | 675         |
| Additional paid-in capital  | 1,142,701    | 1,133,918   |
| Excess purchase price over predecessor basis  | (202,116 )   | (202,116 )  |
| Accumulated deficit   | (157,015 )   | (481,658 )  |
| Accumulated other comprehensive loss  | (15,357 )    | (9,752 )    |
| Total stockholders' equity  | 768,889      | 441,067     |

|  |             |             |
|--|-------------|-------------|
| Total liabilities and stockholders' equity | \$1,552,793 | \$1,209,883 |
|--|-------------|-------------|

See notes to consolidated financial statements.

Table of Contents

Generac Holdings Inc.  
Consolidated Statements of Operations  
(Dollars in Thousands, Except Share and Per Share Data)

|  | Year Ended December 31, |             |             |
|--|-------------------------|-------------|-------------|
|  | 2011                    | 2010        | 2009        |
| Net sales  | \$791,976               | \$592,880   | \$588,248   |
| Costs of goods sold  | 497,322                 | 355,523     | 352,398     |
| Gross profit   | 294,654                 | 237,357     | 235,850     |
| <b>Operating expenses:</b>   |                         |             |             |
| Selling and service  | 77,776                  | 57,954      | 59,823      |
| Research and development   | 16,476                  | 14,700      | 10,842      |
| General and administrative   | 30,012                  | 22,599      | 14,713      |
| Amortization of intangibles  | 48,020                  | 51,808      | 51,960      |
| Trade name write-down  | 9,389                   | –           | –           |
| Total operating expenses   | 181,673                 | 147,061     | 137,338     |
| Income from operations   | 112,981                 | 90,296      | 98,512      |
| <b>Other (expense) income:</b>   |                         |             |             |
| Interest expense   | (23,718 )               | (27,397 )   | (70,862 )   |
| Gain on extinguishment of debt   | –                       | –           | 14,745      |
| Write-off of deferred financing costs related to debt extinguishment                         | (377 )                  | (4,809 )    | –           |
| Investment income  | 110                     | 235         | 2,205       |
| Costs related to acquisition   | (875 )                  | –           | –           |
| Other, net   | (1,155 )                | (1,105 )    | (1,206 )    |
| Total other expense, net   | (26,015 )               | (33,076 )   | (55,118 )   |
| Income before provision for income taxes   | 86,966                  | 57,220      | 43,394      |
| (Benefit) provision for income taxes   | (237,677 )              | 307         | 339         |
| Net income   | 324,643                 | 56,913      | 43,055      |
| <b>Preferential distribution to:</b>   |                         |             |             |
| Series A preferred stockholders  | –                       | (2,042 )    | (14,151 )   |
| Class B common stockholders  | –                       | (12,133 )   | (100,191 )  |
| Beneficial conversion  | –                       | (140,690 )  | –           |
| Net income (loss) attributable to common stockholders (formerly Class A common stockholders) | \$324,643               | \$(97,952 ) | \$(71,287 ) |
| <b>Net income (loss) per common share - basic:</b>   |                         |             |             |
| Common stock (formerly Class A common stock)   | \$4.84                  | \$(1.65 )   | \$(41,111 ) |
| Class B common stock   | n/a                     | \$505       | \$4,171     |
| <b>Net income (loss) per common share - diluted:</b>   |                         |             |             |
| Common stock (formerly Class A common stock)   | \$4.79                  | \$(1.65 )   | \$(41,111 ) |
| Class B common stock   | n/a                     | \$505       | \$4,171     |

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

Weighted average common shares outstanding - basic:

|  |            |            |        |
|--|------------|------------|--------|
| Common stock (formerly Class A common stock) | 67,130,356 | 59,364,958 | 1,734  |
| Class B common stock                         | n/a        | 24,018     | 24,018 |

Weighted average common shares outstanding - diluted:

|  |            |            |        |
|--|------------|------------|--------|
| Common stock (formerly Class A common stock) | 67,797,371 | 59,364,958 | 1,734  |
| Class B common stock                         | n/a        | 24,018     | 24,018 |

See notes to consolidated financial statements.

Table of Contents

Generac Holdings Inc.  
Consolidated Statements of Redeemable Stock and Stockholders' Equity (Deficit)  
(Dollars in Thousands, Except Share Data)

|   | Redeemable         |                | Common Stock |                | Additional | Excess | Retained | Accu        |                 |          |
|---|--------------------|----------------|--------------|----------------|------------|--------|----------|-------------|-----------------|----------|
|   | Series A Preferred | Class B Common | (formerly    | Class A Common |            |        |          |             | Purchase        | Earnings |
|   | Shares             | Amount         | Shares       | Amount         | Shares     | Amount | Paid-In  | Predecessor | (Accumulated In | (L       |
|   |                    |                |              |                |            |        | Capital  | Basis       | Deficit)        | (L       |
| Balance at December 31, 2008                            | 7,835              | \$78,355       | 24,018       | \$765,096      | 1,736      | \$-    | \$2,356  | \$(202,116) | \$(581,626)     | \$(2     |
| Amortization of unrealized loss on interest rate swaps  | -                  | -              | -            | -              | -          | -      | -        | -           | -               | 24       |
| Repayment of stockholder notes receivable               | -                  | -              | -            | -              | -          | -      | -        | -           | -               | -        |
| Cancellation of stock                                   | -                  | -              | -            | -              | (118       | )      | -        | -           | -               | -        |
| Contribution of capital related to debt extinguishment  | 1,476              | 14,754         | -            | -              | -          | -      | -        | -           | -               | -        |
| Proceeds from shares issued to management and directors | 50                 | 497            | -            | -              | -          | -      | -        | -           | -               | -        |
| Proceeds from shares issued to stockholders             | 1,950              | 19,503         | -            | -              | -          | -      | -        | -           | -               | -        |
| Net income  | -                  | -              | -            | -              | -          | -      | -        | -           | 43,055          | -        |
| Amortization of restricted stock expense                | -                  | -              | -            | -              | -          | -      | 38       | -           | -               | -        |
| Pension liability adjustment                            | -                  | -              | -            | -              | -          | -      | -        | -           | -               | (6       |
| Balance at December 31, 2009                            | 11,311             | \$113,109      | 24,018       | \$765,096      | 1,617      | \$-    | \$2,394  | \$(202,116) | \$(538,571)     | \$(4     |
| Unrealized loss on interest rate                        | -                  | -              | -            | -              | -          | -      | -        | -           | -               | (4       |



|   |          |           |          |           |            |       |             |             |             |      |
|---|----------|-----------|----------|-----------|------------|-------|-------------|-------------|-------------|------|
| swaps   |          |           |          |           |            |       |             |             |             |      |
| Repayment of stockholder notes receivable   | –        | –         | –        | –         | –          | –     | –           | –           | –           | –    |
| Corporate reorganization  | (11,311) | (113,109) | (24,018) | (765,096) | 28,368,581 | 284   | 877,921     | –           | –           | –    |
| Beneficial conversion related to Class B Common and Series A Preferred stockholders   | –        | –         | –        | –         | –          | –     | (140,690 )  | –           | –           | –    |
| Accumulated accretion related to Class B Common and Series A Preferred stockholders   | –        | –         | –        | –         | –          | –     | (303,305 )  | –           | –           | –    |
| Issuance of Common stock (formerly Class A Common stock) resulting from the beneficial conversion and accumulated accretion | –        | –         | –        | –         | 18,002,337 | 180   | 443,815     | –           | –           | –    |
| Proceeds from public stock offering   | –        | –         | –        | –         | 20,700,500 | 207   | 247,424     | –           | –           | –    |
| Net income  | –        | –         | –        | –         | –          | –     | –           | –           | 56,913      | –    |
| Share based compensation  | –        | –         | –        | –         | 451,561    | 5     | 6,358       | –           | –           | –    |
| Pension liability adjustment  | –        | –         | –        | –         | –          | –     | –           | –           | –           | (1   |
| Balance at December 31, 2010  | –        | –         | –        | –         | 67,524,596 | \$675 | \$1,133,918 | \$(202,116) | \$(481,658) | \$(9 |
| Unrealized loss on interest rate swaps, net of tax of \$440   | –        | –         | –        | –         | –          | –     | –           | –           | –           | (6   |
| Common stock issued under equity incentive plans, net of  | –        | –         | –        | –         | 128,216    | 1     | (63 )       | –           | –           | –    |

shares withheld  
for employee  
taxes

|   |   |   |   |   |            |       |             |             |             |       |
|---|---|---|---|---|------------|-------|-------------|-------------|-------------|-------|
| Excess tax benefits from equity awards              | – | – | – | – | –          | –     | 200         | –           | –           | –     |
| Share based compensation                            | – | – | – | – | –          | –     | 8,646       | –           | –           | –     |
| Pension liability adjustment, net of tax of \$3,173 | – | – | – | – | –          | –     | –           | –           | –           | (4)   |
| Net income  | – | – | – | – | –          | –     | –           | –           | 324,643     | –     |
| Balance at December 31, 2011                        | – | – | – | – | 67,652,812 | \$676 | \$1,142,701 | \$(202,116) | \$(157,015) | \$(1) |

See notes to consolidated  
financial statements

Table of Contents

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

|  | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2011                    | 2010      | 2009      |
| <b>Operating activities</b>  |                         |           |           |
| Net income   | \$ 324,643              | \$ 56,913 | \$ 43,055 |
| Adjustment to reconcile net income to net cash provided by operating activities:   |                         |           |           |
| Depreciation   | 8,103                   | 7,632     | 7,715     |
| Amortization   | 48,020                  | 51,808    | 51,960    |
| Trade name write-down  | 9,389                   | -         | -         |
| Gain on extinguishment of debt   | -                       | -         | (14,745 ) |
| Amortization of deferred finance costs   | 1,986                   | 2,439     | 3,417     |
| Write-off of deferred financing costs related to debt extinguishment               | 377                     | 4,809     | -         |
| Amortization of unrealized loss on interest rate swaps                             | -                       | -         | 24,222    |
| Provision for losses on accounts receivable  | (7 )                    | (124 )    | 227       |
| Deferred income taxes  | (238,170 )              | -         | -         |
| Loss on disposal of property and equipment   | 10                      | 56        | 41        |
| Share-based compensation expense   | 8,646                   | 6,363     | 38        |
| Net changes in operating assets and liabilities, net of effects from acquisitions: |                         |           |           |
| Accounts receivable  | (22,235 )               | (8,621 )  | 11,779    |
| Inventories  | (11,224 )               | (3,151 )  | 280       |
| Other assets   | (6,834 )                | 1,177     | (1,739 )  |
| Accounts payable   | 18,517                  | 7,896     | (20,886 ) |
| Accrued wages and employee benefits  | 6,516                   | (197 )    | 1,280     |
| Other accrued liabilities  | 21,975                  | (12,519 ) | (32,037 ) |
| Net cash provided by operating activities  | 169,712                 | 114,481   | 74,607    |
| <b>Investing activities</b>  |                         |           |           |
| Proceeds from sale of property and equipment                                       | 14                      | 76        | 69        |
| Expenditures for property and equipment  | (12,060 )               | (9,631 )  | (4,525 )  |
| Collections on receivable notes  | -                       | -         | 105       |
| Acquisition of business, net of cash acquired                                      | (83,907 )               | (1,649 )  | -         |
| Net cash used in investing activities  | (95,953 )               | (11,204 ) | (4,351 )  |
| <b>Financing activities</b>  |                         |           |           |
| Stockholders' contributions of capital – Series A preferred stock                  | -                       | -         | 20,000    |
|  | -                       | -         | (678 )    |

|   |           |            |            |
|---|-----------|------------|------------|
| Payment of expenses incurred in advance of stock issuance             |           |            |            |
| Proceeds from issuance of common stock                                | –         | 248,309    | –          |
| Excess tax benefits from equity awards                                | 200       | –          | –          |
| Taxes paid related to the net share settlement of equity awards       | (371 )    | –          | –          |
| Proceeds from exercise of stock options                               | 310       | –          | –          |
| Payment of long-term debt   | (59,355 ) | (434,310 ) | (9,500 )   |
| Net cash provided by (used in) financing activities                   |           |            |            |
|   | (59,216 ) | (186,001 ) | 9,822      |
| Net increase (decrease) in cash and cash equivalents                  |           |            |            |
|   | 14,543    | (82,724 )  | 80,078     |
| Cash and cash equivalents at beginning of period                      |           |            |            |
|   | 78,583    | 161,307    | 81,229     |
| Cash and cash equivalents at end of period                            |           |            |            |
|   | \$ 93,126 | \$ 78,583  | \$ 161,307 |
| Supplemental disclosure of cash flow information                      |           |            |            |
| Cash paid during the period   |           |            |            |
| Interest  | \$ 24,264 | \$ 36,796  | \$ 75,601  |
| Income taxes  | 437       | 322        | 383        |
| Supplemental disclosure of noncash financing and investing activities |           |            |            |
| Contributions of capital related to debt extinguishment               |           |            |            |
|   | \$ –      | \$ –       | \$ 14,754  |

See notes to consolidated financial statements

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 1. Description of Business

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

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

On February 17, 2010, the Company completed its initial public offering (IPO) of 18,750,000 shares of our common stock at a price of \$13.00 per share. Prior to completion of the IPO, the Company completed a 3.294 for 1 reverse stock split for Class A common and Class B common shares outstanding. In addition, the underwriters exercised their over-allotment option outlined in the underwriters agreement, and purchased an additional 1,950,500 shares of the Company's common stock on March 18, 2010. The Company received approximately \$269,100,000 in gross proceeds from the IPO and over-allotment exercise, or \$247,631,000 in net proceeds after deducting the underwriting discount and total expenses related to the offering. Upon closing of the IPO, all shares of convertible Class B Common stock and Series A preferred stock were automatically converted into 88,476,530 and 19,511,018 Class A Common shares, respectively. The 88,476,530 shares of Class A Common stock was subject to a 3.294 for 1 reverse stock split, resulting in 26,859,906 Class A Common shares relative to the Class B Common stock conversion. Subsequent to the IPO, the Company has one class of common stock.

Capitalization summary upon closing of initial public offering:

|   |            |
|---|------------|
| Class A Common stock issued and outstanding as of December 31, 2009 after the 3.294 for 1 reverse stock split | 1,617      |
| Conversion and 3.294 for 1 reverse stock split of Class B Common stock into Common stock upon closing of IPO  | 26,859,906 |
| Conversion of Series A Preferred stock into Common stock upon closing of IPO                                  | 19,511,018 |
| Sales of Common stock through IPO   | 18,750,000 |
| Issuance of non-vested and fully vested Common stock upon closing of IPO                                      | 456,249    |
| Common stock issued and outstanding after IPO   | 65,578,790 |
| Issuance of Common stock to underwriters due to exercise of over-allotment                                    | 1,950,500  |
| Total Common stock issued and outstanding as of March 18, 2010  | 67,529,290 |

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

## 2. Significant Accounting Policies

Principles of Consolidation

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

53

---

Table of Contents

Generac Holdings Inc.  
 Notes to Consolidated Financial Statements  
 Years Ended December 31, 2011, 2010, and 2009  
 2. Significant Accounting Policies (continued)

## Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

## Concentration of Credit Risk

The Company maintains the majority of its cash in one commercial bank in multiple operating and investment accounts. Balances on deposit are insured by the Federal Deposit Insurance Corporation (FDIC) up to specified limits. Balances in excess of FDIC limits are uninsured.

One customer accounted for approximately 12% and 11% of accounts receivable at December 31, 2011 and December 31, 2010, respectively. No one customer accounted for greater than 10% of net sales during the years ended December 31, 2011, 2010, or 2009.

## Accounts Receivable

Receivables are recorded at their face value amount less an allowance for doubtful accounts. The Company estimates and records an allowance for doubtful accounts based on specific identification and historical experience. The Company writes off uncollectible accounts against the allowance for doubtful accounts after all collection efforts have been exhausted. Sales are generally made on an unsecured basis.

## Inventories

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out method.

## Property and Equipment

Property and equipment are recorded at cost and are being depreciated using the straight-line method over the estimated useful lives of the assets, which are summarized below (in years). Costs of leasehold improvements are amortized over the lesser of the term of the lease (including renewal option periods) or the estimated useful lives of the improvements.

|                            |         |
|----------------------------|---------|
| Land improvements          | 15      |
| Buildings and improvements | 20 – 40 |
| Leasehold improvements     | 10 – 20 |
| Machinery and equipment    | 5 – 10  |
| Dies and tools             | 3 – 5   |
| Vehicles                   | 3 – 5   |
| Office equipment           | 3 – 10  |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

## Customer Lists, Patents, and Other Intangible Assets

The following table summarizes intangible assets by major category as of December 31, 2011 and 2010 (dollars in thousands):

|   | Weighted<br>Average<br>Amortization<br>Years | Cost       | 2011<br>Accumulated<br>Impairment | Amortized<br>Cost | Cost       | 2010<br>Accumulated<br>Impairment | Amortized<br>Cost |
|---|--|------------|-----------------------------------|-------------------|------------|-----------------------------------|-------------------|
| <b>Indefinite lived intangible assets</b> |  |            |                                   |                   |            |                                   |                   |
| Trade names                               |  | \$ 157,790 | \$ (9,389 )                       | \$ 148,401        | \$ 140,050 | \$ -                              | \$ 140,050        |
| <b>Finite lived intangible assets</b>     |  |            |                                   |                   |            |                                   |                   |
| Trade names                               | 0  | 8,715      | (8,715 )                          | -                 | 8,715      | (8,715 )                          | -                 |
| Customer lists                            | 7  | 272,050    | (199,153 )                        | 72,897            | 257,310    | (160,366 )                        | 96,944            |
| Patents                                   | 15   | 118,881    | (40,714 )                         | 78,167            | 117,811    | (32,878 )                         | 84,933            |
| Unpatented technology                     | 11   | 13,165     | (6,325 )                          | 6,840             | 11,015     | (5,065 )                          | 5,950             |
| Software                                  | 8  | 1,014      | (650 )                            | 364               | 1,014      | (524 )                            | 490               |
| Non-compete                               | 5  | 113        | (11 )                             | 102               | 43         | -                                 | 43                |
| Total finite lived intangible assets      |  | 413,938    | (255,568 )                        | 158,370           | 395,908    | (207,548 )                        | 188,360           |

Amortization of intangible assets was \$48,020,000 in 2011, \$51,808,000 in 2010 and \$51,960,000 in 2009. During the fourth quarter of 2011, the Company wrote down its indefinite lived intangible assets related to trade names. See the Goodwill and Other Indefinite-Lived Intangible Assets section for further discussion. Estimated amortization expense each year for the five years subsequent to December 31, 2011 is as follows: 2012, \$45,660,000; 2013, \$23,787,000; 2014, \$16,389,000; 2015, \$15,184,000; 2016, \$13,578,000.

## Deferred Financing Costs

Costs incurred in connection with the issuance of long-term debt have been capitalized and are being amortized using the effective interest rate method over the life of the related debt agreements. Deferred financing costs incurred related to debt financing totaled \$29,571,000. Amortization expense was \$1,986,000, \$2,439,000, and \$3,417,000 for the years ended December 31, 2011, 2010, and 2009, respectively. The Company wrote off \$377,000 and \$4,809,000 of the deferred financing costs in 2011 and 2010, respectively, as a result of debt repayments made throughout the year. As a result of the debt extinguishments in 2009 (see Note 6), \$398,000 of the deferred financing costs were written off and were recorded as a reduction to the gain on the extinguishment of debt. Accumulated amortization was \$26,112,000 and \$23,749,000 at December 31, 2011 and 2010, respectively. Amortization expense is included in interest expense in the consolidated statements of operations. As of December 31, 2011, estimated amortization



expense each year for the two years subsequent to December 31, 2011 is as follows: 2012, \$1,859,000, 2013, \$1,600,000. Based on this timeline, deferred financing costs would be fully amortized in 2013.

The Company refinanced its revolving credit facility and credit agreement, outstanding as of December 31, 2011, on February 9, 2012. Please refer to Note 16 for further details.

Table of Contents

Generac Holdings Inc.  
 Notes to Consolidated Financial Statements  
 Years Ended December 31, 2011, 2010, and 2009  
 2. Significant Accounting Policies (continued)

## Long-Lived Assets

The Company periodically evaluates the carrying value of long-lived assets (excluding goodwill and trade names). Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of an asset, a loss is recognized for the difference between the fair value and carrying value of the asset. Such analyses necessarily involve significant judgments.

## Goodwill and Other Indefinite-Lived Intangible Assets

Goodwill represents the excess of the amount paid to acquire the Company over the estimated fair value of the net tangible and intangible assets acquired as of the acquisition date.

Other indefinite-lived intangible assets consist of trade names. The fair value of trade names was measured using a relief-from-royalty approach, which assumes the fair value of the trade name is the discounted cash flows of the amount that would be paid had the Company not owned the trade name and instead licensed the trade name from another company.

The Company performs an annual impairment test for goodwill and trade names and more frequently if an event or circumstances indicate that an impairment loss has been incurred. Conditions that would trigger an impairment assessment include, but are not limited to, a significant adverse change in legal factors or business climate that could affect the value of an asset. The analysis of potential impairment of goodwill requires a two-step process. The first step is the estimation of fair value of the applicable reporting unit. Estimated fair value is based on management judgments and assumptions and those fair values are compared with the aggregate carrying value of the respective reporting unit. If the fair value of the reporting unit is greater than its carrying amount, there is no impairment. If the carrying value of the reporting unit is greater than the fair value, then the second step must be completed to measure the amount of impairment, if any. The second step calculates the implied fair value of the goodwill, which is compared to its carrying value. If the implied fair value is less than the carrying value, an impairment loss is recognized equal to the difference.

The Company performed the required annual impairment tests for fiscal years 2011, 2010 and 2009 and found no impairment of goodwill. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

The changes in the carrying amount of goodwill for the years ended December 31, 2011 and 2010 are as follows (dollars in thousands):

|                              | Year ended December 31, 2011 |                        |              | Year ended December 31, 2010 |                        |              |
|------------------------------|------------------------------|------------------------|--------------|------------------------------|------------------------|--------------|
|                              | Gross                        | Accumulated Impairment | Net Goodwill | Gross                        | Accumulated Impairment | Net Goodwill |
| Balance at beginning of year | \$ 1,030,341                 | \$ 503,193             | \$ 527,148   | \$ 1,029,068                 | \$ 503,193             | \$ 525,875   |
| Acquisition of a business    | 20,325                       | —                      | 20,325       | 1,273                        | —                      | 1,273        |
| Balance at end of year       | \$ 1,050,666                 | \$ 503,193             | \$ 547,473   | \$ 1,030,341                 | \$ 503,193             | \$ 527,148   |

The Company completed an acquisition of a business on October 3, 2011 for \$85,490,000, net of cash acquired and inclusive of estimated earn-out payments, which resulted in additional goodwill of \$20,337,000. The Company also completed an acquisition of a business on December 31, 2010 for \$1,600,000, net of cash acquired, which resulted in net additional goodwill of \$1,261,000. The Company initially recorded goodwill of \$1,273,000 as of December 31, 2010, based upon the results of a preliminary purchase price allocation. Finalization of this purchase price allocation in 2011 resulted in an adjustment to goodwill of \$(12,000). Both goodwill amounts are deductible for tax purposes.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

During the fourth quarter of 2011, the Company decided to strategically transition certain products to their more widely known Generac brand. Based on this decision, the Company recorded a \$9,389,000 non-cash charge which primarily related to the write down of the impacted trade name to net realizable value. In addition, the Company performed its annual fair value-based impairment test as of October 31, 2011. Except as noted, no impairment was indicated.

The Company performed its annual fair value-based impairment test on indefinite lived trade names as of October 31, 2010 and 2009. No impairment was indicated.

Income Taxes

The Company is a C Corporation and, therefore, accounts for income taxes pursuant to the liability method. Accordingly, the current or deferred tax consequences of a transaction are measured by applying the provision of enacted tax laws to determine the amount of taxes payable currently or in future years. Deferred income taxes are provided for temporary differences between the income tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the years in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies, as appropriate, in making this assessment.

Revenue Recognition

Sales, net of estimated returns and allowances, are recognized upon shipment of product to the customer, which is when title passes, the Company has no further obligations, and the customer is required to pay. The Company, at the request of certain customers, will warehouse inventory billed to the customer but not delivered. The Company does not recognize revenue on these transactions until the customers take possession of the product. The funds collected on product warehoused for these customers are recorded as a customer advance until the customer takes possession of the product and the Company's obligation to deliver the goods is completed. Customer advances are included in accrued liabilities in the accompanying consolidated balance sheets.

The Company provides for estimated sales promotion and incentive expenses which are recognized as a reduction of sales.

Historically, product returns, whether in the normal course of business or resulting from repurchases made under a floor plan financing program, have not been material.

Shipping and Handling Costs

Shipping and handling costs billed to customers are included in net sales, and the related costs are included in cost of goods sold in the consolidated statements of operations.

Advertising and Co-Op Advertising

Expenditures for advertising, included in selling and service expenses in the accompanying consolidated statements of operations, are expensed as incurred. Total expenditures for advertising were \$11,742,000, \$11,985,000, and \$11,695,000 for the years ended December 31, 2011, 2010, and 2009, respectively.

Table of Contents

Generac Holdings Inc.  
 Notes to Consolidated Financial Statements  
 Years Ended December 31, 2011, 2010, and 2009  
 2. Significant Accounting Policies (continued)

## Research and Development

The Company expenses research and development costs as incurred. Total expenditures incurred for research and development were \$16,476,000, \$14,700,000, and \$10,842,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

## Foreign Currency Transactions

Realized and unrealized gains and losses on transactions denominated in foreign currency are recorded in earnings as a component of cost of goods sold.

## Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (OCI) includes unrealized losses on certain cash flow hedges and the pension liability. The components of OCI at December 31, 2011 and 2010 were (dollars in thousands):

|                                       | December 31, |            |
|---------------------------------------|--------------|------------|
|                                       | 2011         | 2010       |
| Pension liability                     | \$(10,529 )  | \$(5,607 ) |
| Unrealized losses on cash flow hedges | (4,828 )     | (4,145 )   |
| Accumulated other comprehensive loss  | \$(15,357 )  | \$(9,752 ) |

## Fair Value of Financial Instruments

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities), excluding long-term debt, approximates the fair value of these instruments based upon their short-term nature. The fair value of long-term debt was approximately \$593.4 million (level 2) at December 31, 2011, as calculated based on current quotations.

## Fair Value Measurements

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

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

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

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

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

|                     | Fair Value Measurement Using |   |   |
|---------------------|------------------------------|---|---|
|                     | Total                        | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Contracts<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
|                     | December<br>31, 2010         |   |   |
| Interest rate swaps | \$(4,145 )                   | \$-   | \$(4,145 )  |
| Commodity Contracts | \$627                        | \$-   | \$627   |

The valuation techniques used to measure the fair value of derivative contracts classified as level 2, all of which have counterparties with high credit ratings, were valued based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data. The fair value of derivative contracts above considers the Company's credit risk in accordance with ASC 820-10. Excluding the impact of credit risk, the fair value of derivatives at December 31, 2011 and 2010 was \$5,780,000 (liability) and \$3,642,000 (liability), respectively, and this represents the amount the Company would need to pay to exit the agreements on this date.

#### Use of Estimates

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

#### Derivative Instruments and Hedging Activities

The Company records all derivatives in accordance with ASC 815, Derivatives and Hedging, which requires all derivative instruments be reported on the consolidated balance sheets at fair value and establishes criteria for designation and effectiveness of hedging relationships. The Company is exposed to market risk such as changes in



commodity prices, foreign currencies, and interest rates. The Company does not hold or issue derivative financial instruments for trading purposes.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

Commodities

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

The Company primarily utilizes commodity contracts with maturities of less than 12 months. These are intended to offset the effect of price fluctuations on actual inventory purchases. There were two, one, and one outstanding commodity contracts in place to hedge its projected commodity purchases at December 31, 2011, 2010, and 2009, respectively. In October 2009, the Company entered into commodity swaps to purchase \$1,432,000 of copper. The swaps were effective from October 5, 2009, and terminated on March 31, 2010. In November 2010, the Company entered into a commodity swap to purchase \$2,296,000 of copper. The swap was effective from January 1, 2011, and terminated on April 30, 2011. In February 2011, the Company entered into a commodity forward contract to purchase a notional amount of \$2,378,000 of copper. The contract was effective from March 1, 2011, and terminated on December 31, 2011. In March 2011, the Company entered into a commodity forward contract to purchase a notional amount of \$2,100,000 of copper. The contract was effective from April 1, 2011, and terminated on December 31, 2011. In May 2011, the Company entered into a commodity forward contract to purchase a notional amount of \$1,808,000 of copper. The contract was effective from May 5, 2011, and terminated on December 31, 2011. In September 2011, the Company entered into two new commodity forward contracts to purchase notional amounts of \$4,533,000 and \$1,935,000 of copper. The contracts are effective from October 1, 2011, and terminate on June 30, 2012. Total losses or gains recognized in the consolidated statements of operations on commodity contracts were a loss of \$861,000, a gain of \$1,056,000, and a gain of \$387,000 for the years ended December 31, 2011, 2010, and 2009, respectively.

Foreign Currencies

The Company is exposed to foreign currency exchange risk as a result of transactions in other currencies. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with foreign currency purchases in the normal course of business. Contracts typically have maturities of one year or less. There were no foreign currency hedge contracts outstanding as of December 31, 2011 or 2010. There was one Euro currency contract outstanding during 2010 that expired on December 31, 2010. A loss of \$100,000 was recognized in the consolidated statements of operations for the year ended December 31, 2010 related to this Euro contract.

Interest Rates

The Company has four interest rate swap agreements outstanding as of December 31, 2011 with a notional amount of \$300,000,000. In 2010, the Company entered into two interest rate swap agreements and had formally documented all relationships between interest rate hedging instruments and hedged items, as well as its' risk-management objectives

and strategies for undertaking various hedge transactions. The first was entered into on January 21, 2010. The effective date of this swap was July 1, 2010 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of that swap was October 1, 2010 with a notional amount of \$100,000,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. The Company entered into two interest rate swap agreements on April 1, 2011. The effective date of the first swap is July 1, 2012 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.905% and an expiration date of July 1, 2013. The effective date of the second swap is October 1, 2012 with a notional amount of \$100,000,000, a fixed LIBOR rate of 2.22% and an expiration date of October 1, 2013. The Company maintains the swaps as highly effective in accordance with ASC 815 and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss). These cash flow hedges are recorded at fair value with a corresponding entry recorded in accumulated other comprehensive income (loss) as swaps are highly effective.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

In 2006, the Company entered into various interest rate swap agreements. The Company had formally documented all relationships between interest rate hedging instruments and hedged items, as well as its' risk-management objectives and strategies for undertaking various hedge transactions. Effective January 3, 2009, the Company, within the terms of the Credit Agreements (as defined in note 6), changed the interest rate election from three-month LIBOR to one-month LIBOR. As a result of this change, the Company concluded that as of January 3, 2009, the Swaps no longer met hedge effectiveness tests and were therefore, no longer highly effective as a hedge against the impact on interest payments of changes in the LIBOR interest rate. In 2009, the effective portion of the swaps prior to the change was amortized as interest expense over the period of the originally designated hedged transactions. During 2009, changes in the fair value of the swaps were immediately recognized in the consolidated statements of operations as interest expense. These swaps expired on January 4, 2010.

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

|  | December 31,<br>2011 | December 31,<br>2010 |
|--|----------------------|----------------------|
| Derivatives designated as hedging instruments:     |                      |                      |
| Interest rate swaps                                | \$ (5,268 )          | \$ (4,145 )          |
|  | (5,268 )             | (4,145 )             |
| Derivatives not designated as hedging instruments: |                      |                      |
| Commodity contracts                                | (373 )               | 627                  |
| Total derivatives                                  | \$ (5,641 )          | \$ (3,518 )          |

The fair value of all derivatives not designated as hedging instruments is included in other current liabilities and other assets in the consolidated balance sheets as of December 31, 2011 and 2010, respectively.

The fair value of derivatives designated as hedging instruments included in other current liabilities and other long-term liabilities is \$1,546,000 and \$3,722,000, respectively, as of December 31, 2011. The fair value of all derivatives designated as hedging instruments is included in other long-term liabilities as of December 31, 2010.

The fair value of the derivative contracts considers the Company's credit risk as of December 31, 2011 and 2010. The impact of credit risk on the fair value of derivative contracts at December 31, 2011 and 2010 was \$139,000 and \$124,000, respectively. Excluding the impact of credit risk, the fair value of the derivatives at December 31, 2011 and 2010 was \$5,780,000 (liability) and \$3,642,000 (liability), respectively, and this represents the amount the Company would need to pay to exit the agreements on those dates.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009  
2. Significant Accounting Policies (continued)

The following presents the impact of interest rate swaps and commodity contracts on the consolidated statement of operations for the year ended December 31, 2011 and 2010 (dollars in thousands):

|   | Amount of loss recognized in AOCI for the twelve months ended December 31, |            |      | Location of gain (loss) recognized in net income (loss) on ineffective portion of hedges | Amount of loss reclassified from AOCI into net income (loss) for the twelve months ended December 31, |      |             | Amount of gain (loss) recognized in net income (loss) on hedges (ineffective portion) for twelve months ended December 31, |      |        |
|---|--|------------|------|--|---|------|-------------|--|------|--------|
|   | 2011   | 2010       | 2009 |  | 2011  | 2010 | 2009        | 2011   | 2010 | 2009   |
| Derivatives designated as hedging instruments     |  |            |      |  |   |      |             |  |      |        |
| Interest rate swaps                               | \$ (683 )  | \$ (4,145) | -    | Interest expense   | -   | -    | \$ (24,222) | -  | -    | -      |
| Derivatives not designated as hedging instruments |  |            |      |  |   |      |             |  |      |        |
| Commodity and foreign currency contracts          | -  | -          | -    | Cost of goods sold   | -   | -    | -           | (861 )   | 956  | 387    |
| Interest rate swaps                               | -  | -          | -    | Interest expense   | -   | -    | -           | -  | -    | 24,222 |

There was no impact of derivative instruments on the consolidated statement of operations for the interest rate swaps for the years ended December 31, 2011 and 2010. For the year ended December 31, 2009, the impact of derivative instruments on the consolidated statement of operations for the interest rate swap agreements not designated as hedging instruments was a gain of \$24,222,000. During the years ended December 31, 2011, 2010 and 2009, the impact of derivative instruments on the consolidated statement of operations for the commodity and foreign currency contracts not designated as hedging instruments were net losses of \$861,000, net gains of \$956,000 and net gains of \$387,000, respectively.

#### Stock-Based Compensation

The Company accounts for its restricted stock awards and other stock-based payments in accordance with ASC Topic 718 Compensation – Stock Compensation.

## Segment Reporting

The Company operates in and reports as a single operating segment, which is the design and manufacture of a wide range of power products. Net sales are predominantly generated through the sale of generators and other engine powered products through various distribution channels. The Company manages and evaluates its operations as one segment primarily due to similarities in the nature of the products, production processes and methods of distribution. Substantially all of the Company's identifiable assets are located in the United States. The Company's sales in the United States represent approximately 95%, 95%, and 96% of total sales for the years ended December 31, 2011, 2010 and 2009, respectively.

Table of Contents

Generac Holdings Inc.  
 Notes to Consolidated Financial Statements  
 Years Ended December 31, 2011, 2010, and 2009  
 2. Significant Accounting Policies (continued)

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

|  | Year ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2011                    | 2010      | 2009      |
| Residential power products             | \$491,016               | \$372,782 | \$370,740 |
| Industrial & Commercial power products | 250,270                 | 183,555   | 187,323   |
| Other                                  | 50,690                  | 36,543    | 30,185    |
| Total                                  | \$791,976               | \$592,880 | \$588,248 |

## New Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-08, “Intangibles - Goodwill and Other (Topic 350), Testing Goodwill for Impairment,” which permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying value before applying the two-step goodwill impairment model that is currently in place. If it is determined through the qualitative assessment that a reporting unit's fair value is more likely than not greater than its carrying value, the remaining impairment steps would be unnecessary. The qualitative assessment is optional, allowing companies to go directly to the quantitative assessment. This update is effective for annual and interim goodwill impairment tests performed in fiscal years beginning after December 15, 2011 with early adoption permitted. Management does not expect adoption of this ASU to have a material impact on the Company's results of operations, financial position or cash flow.

In June 2011, the FASB issued ASU No. 2011-05, “Comprehensive Income: Presentation of Comprehensive Income,” which amends current comprehensive income guidance. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, it requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the income statement format used today, and the second statement would include components of OCI. The ASU does not change the items that must be reported in OCI. ASU 2011-05 will be effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2011 with early adoption permitted. Management does not expect adoption of this ASU to have a material impact on the Company's results of operations, financial position or cash flow.

In May 2011, the FASB issued ASU 2011-04 “Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.” The ASU is the result of joint efforts by the FASB and the International Accounting Standards Board (“IASB”) to develop a single, converged fair value framework. While the ASU is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands existing disclosure requirements for fair value measurements and makes other amendments. Key additional disclosures include quantitative disclosures about unobservable inputs in Level 3 measures, qualitative information about sensitivity of Level 3 measures and valuation process, and classification within the fair value hierarchy for instruments where fair value is only disclosed in the footnotes but carrying amount is on some other basis. For public

companies, the ASU is effective for interim and annual periods beginning after December 15, 2011. Management does not expect adoption of this ASU to have a material impact on the Company's results of operations, financial position or cash flow.

In December 2010, the FASB issued ASU 2010-29 "Disclosure of Supplementary Pro Forma Information for Business Combinations." The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The Company adopted this ASU effective at the beginning of fiscal year 2011, and will apply the ASU prospectively to future business combinations for which the acquisition date is after December 31, 2010, as required. This ASU did have an impact the Company's 2011 consolidated financial statement disclosures.



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 3. Acquisitions

On October 3, 2011, a subsidiary of the Company acquired substantially all of the assets and assumed certain liabilities of Magnum Products, LLC and certain of its affiliates (collectively, Magnum) for a purchase price, net of cash acquired and inclusive of estimated earn-out payments, of approximately \$85,490,000. The acquisition was funded solely by cash on the balance sheet.

Magnum is a supplier of powerful, high quality generator powered light towers, mobile generators and combination power units for a variety of industries and specialties including construction, energy, mining, government, military, and special events. Its products are distributed through international, national and regional equipment rental companies, equipment dealers and construction companies. The Magnum business is a strategic fit for the Company as it provides diversification within the existing business, with the introduction of new engine powered products and distribution channels, while also providing opportunities for future revenue and cost synergies. The 2011 consolidated financial statements include the results of Magnum from October 3, 2011 through December 31, 2011.

The purchase price of \$85,490,000 consisted of \$83,907,000 paid in cash at closing and \$1,583,000 recorded as an estimated liability to the sellers for contingent consideration based upon future performance of a particular product line currently in development, as described below. The cash paid at closing included an estimate of acquired working capital. This estimate will be finalized in early 2012 to reflect actual working capital acquired, which could result in a change in the total purchase price at that time.

The Company has recorded a purchase price allocation based on a fair value appraisal by a third party valuation firm. The goodwill ascribed to this acquisition is deductible for tax purposes. A summary of the fair values assigned to the acquired assets is as follows (dollars in thousands):

|  |           |
|--|-----------|
| Accounts receivable                        | \$ 24,309 |
| Inventory                                  | 23,763    |
| Prepaid expenses and other current assets  | 280       |
| Property and equipment                     | 5,164     |
| Goodwill                                   | 20,337    |
| Trade name                                 | 17,740    |
| Customer relationships                     | 14,740    |
| Patents                                    | 1,070     |
| Other intangible assets                    | 2,220     |
| Trade accounts payable                     | (20,727)  |
| Accrued expenses                           | (2,746)   |
| Other long term liabilities                | (2,243)   |
| Total cash paid, net of \$30 cash acquired | \$ 83,907 |

Under the acquisition agreement, the purchase price may be increased based upon the performance of a particular product line for the years 2012 through the second quarter of 2017. Based on performance projections available at the date of the acquisition, the Company has recorded estimated contingent consideration of \$1,583,000 which is the net present value of the earn-out. The contingent consideration is payable periodically during 2012 through 2017, based upon actual future performance. As of December 31, 2011, there have been no changes to our original estimates.

The acquisition has contributed \$38,817,000 and \$3,353,000 of net sales and net income, respectively, for the period from October 3, 2011 to December 31, 2011. Transaction costs of approximately \$876,000 are included in other expense in the consolidated statement of operations for the year ended December 31, 2011.

The following unaudited pro forma information has been prepared as if the Magnum acquisition had been consummated at January 1, 2010. This information is presented for informational purposes only, and is not necessarily indicative of the operating results that would have occurred if the acquisitions had been consummated as of that date. This information should not be used as a predictive measure of our future financial position, results of operations, or liquidity.

|            | Year ended December 31, |           |
|------------|-------------------------|-----------|
|            | 2011                    | 2010      |
| Net sales  | \$897,892               | \$681,278 |
| Net income | 334,076                 | 68,369    |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 4. Balance Sheet Details

Inventories consist of the following (dollars in thousands):

|                                      | December 31, |           |
|--------------------------------------|--------------|-----------|
|                                      | 2011         | 2010      |
| Raw material                         | \$121,098    | \$66,936  |
| Work-in-process                      | 578          | 315       |
| Finished goods                       | 45,165       | 63,945    |
| Reserves for excess and obsolescence | (4,717 )     | (4,059 )  |
|                                      | \$162,124    | \$127,137 |

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

|                               | December 31, |           |
|-------------------------------|--------------|-----------|
|                               | 2011         | 2010      |
| Land and improvements         | \$5,050      | \$3,950   |
| Buildings and improvements    | 52,941       | 48,986    |
| Machinery and equipment       | 38,132       | 32,672    |
| Dies and tools                | 12,982       | 11,301    |
| Vehicles                      | 1,026        | 827       |
| Office equipment              | 8,380        | 6,836     |
| Leasehold improvements        | 44           | -         |
| Construction in progress      | 3,131        | -         |
| Gross property and equipment  | 121,686      | 104,572   |
| Less accumulated depreciation | (37,302 )    | (29,285 ) |
| Property and equipment, net   | \$84,384     | \$75,287  |

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

|                                 | December 31, |          |
|---------------------------------|--------------|----------|
|                                 | 2011         | 2010     |
| Accrued commissions             | \$5,731      | \$4,578  |
| Accrued interest                | 3,119        | 5,018    |
| Accrued warranties – short term | 19,187       | 17,155   |
| Other accrued liabilities       | 18,987       | 11,292   |
|                                 | \$47,024     | \$38,043 |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 4. Balance Sheet Details (continued)

Other long-term liabilities consist of the following (dollars in thousands):

|                              | December 31, |          |
|------------------------------|--------------|----------|
|                              | 2011         | 2010     |
| Accrued pension costs        | \$22,044     | 15,434   |
| Product warranty obligations | 15,193       | 5,323    |
| Other long-term liabilities  | 6,277        | 4,145    |
|                              | \$43,514     | \$24,902 |

## 5. Product Warranty Obligations

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

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

|   | For the year ended December 31, |           |           |
|---|---------------------------------|-----------|-----------|
|   | 2011                            | 2010      | 2009      |
| Balance at beginning of year                | \$22,478                        | \$20,729  | \$17,539  |
| Payments, net of extended warranty receipts | (11,195 )                       | (13,178 ) | (14,208 ) |
| Charged to operations                       | 23,097                          | 14,927    | 17,398    |
| Balance at end of year                      | \$34,380                        | \$22,478  | \$20,729  |

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

|                             | December 31, |          |
|-----------------------------|--------------|----------|
|                             | 2011         | 2010     |
| Other accrued liabilities   | \$19,187     | \$17,155 |
| Other long-term liabilities | 15,193       | 5,323    |
| Balance at end of year      | \$34,380     | \$22,478 |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 6. Credit Agreements

The revolving credit facility and credit agreement discussed below were outstanding for all periods presented. The Company refinanced this debt on February 9, 2012. Please refer to Note 16 for further details.

Long-term debt is included in the balance sheets as follows (dollars in thousands):

|                                 | December 31, |           |
|---------------------------------|--------------|-----------|
|                                 | 2011         | 2010      |
| First lien term loan            | \$604,372    | \$664,372 |
| Less treasury debt – first lien | 6,498        | 7,143     |
| Less current portion            | 22,874       | -         |
|                                 | \$575,000    | \$657,229 |

Maturities of long-term debt outstanding at December 31, 2011, are as follows (dollars in thousands):

| Year  |           |
|-------|-----------|
| 2011  | \$--      |
| 2012  | --        |
| 2013  | 575,000   |
| Total | \$575,000 |

In connection with our debt refinancing on February 9, 2012, the Company paid off \$22,874,000 of debt with available cash on hand. The Company classified this portion of debt as a current liability in the consolidated balance sheet at December 31, 2011.

For all years presented, the Company had credit agreements which provided for borrowings under a revolving credit facility (the Revolving Credit Facility) and two term loans (collectively, the Credit Agreements), which are described further below. The Credit Agreements of the Company were secured by the associated collateral agreements which pledged virtually all assets of the Subsidiary.

Borrowings available under the Revolving Credit Facility were limited to a maximum of \$150,000,000. Availability under the Revolving Credit Facility was reduced by the amount of outstanding undrawn letters of credit. Interest on the Revolving Credit Facility was payable at LIBOR plus 2.5%, or ABR plus 1.5%, as selected by the Company. ABR is the greater of the prime rate or the federal funds rate plus 0.5%. The spreads on these rates would have been reduced as a result of the Company meeting certain financial ratios. As of December 31, 2011, the Company's interest rate on the Revolving Credit Facility was 2.27%. As of December 31, 2011, the Company had \$144,191,000 available under its Revolving Credit Facility and no outstanding borrowings. The Company was required to pay a Revolving Credit Facility commitment fee of 0.375% on the average available unused commitment. The Revolving Credit Facility was scheduled to mature on November 10, 2012, unless terminated earlier under certain conditions contained in the Credit Agreements.

The Credit Agreements provided the Company the ability to issue letters of credit. Outstanding undrawn letters of credit reduced availability under the Company's Revolving Credit Facility. The letters of credit accrued interest at a rate of 2.13%, paid quarterly on the undrawn daily aggregate exposure of the preceding quarter. This rate would have

been reduced as a result of the Company meeting certain financial ratios. At December 31, 2011 and 2010, letters of credit outstanding were \$5,809,000 and \$4,334,000, and interest rates were 2.13% and 2.63% respectively.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 6. Credit Agreements (continued)

The principal amount of and the outstanding balance under the First Lien Term Loan (the First Lien) was \$597,874,000 and \$657,229,000 (net of loans held in treasury by the Company) at December 31, 2011 and 2010, respectively. Prior to the 2010 debt repayments, principal payments were due in quarterly installments of \$2,375,000. Interest on the First Lien was payable at LIBOR plus 2.5%, or ABR plus 1.5%, as selected by the Company. At December 31, 2011 and 2010 the Company's interest rate on the First Lien was 2.80% and 2.76%, respectively. The outstanding principal balance was payable on the earlier of November 10, 2013, or the date of termination of the First Lien, whether by its terms, by prepayment, or by acceleration. In addition to scheduled principal payments, the First Lien required an excess cash flow payment each year. The required excess cash flow payment was the amount by which 50% of the excess cash flow (as defined in the credit agreement) generated by the Company in any given year exceeded the principal payments made during that year. The excess cash flow payment was scheduled to be due 125 days after year-end. For the year ending December 31, 2011, as a result of refinancing the Credit Agreement on February 9, 2012, the Company was not required to make an excess cash flow payment. For the year ending December 31, 2010, based on the calculation, the Company was not required to make an excess cash flow payment. For the year ending December 31, 2009, the required excess cash flow payment was \$29,576,000, which was paid in 2010.

In 2010, the Company used net proceeds from its initial public offering and a substantial portion of its cash and cash equivalents to pay down debt. In February 2010, the Company used \$221.6 million in net proceeds from the initial public offering to pay down the second lien term loan in full and to pay down a portion of the first lien term loan. In addition, in March 2010, December 2010, April 2011 and December 2011, the Company used \$138.5 million, \$74.2 million, \$24.7 million and \$34.6 million respectively, of cash and cash equivalents on hand to further pay down the first lien term loan principal. As a result of these debt repayments, the outstanding balance on the first lien credit facility was reduced to \$597.9 million as of December 31, 2011, and the second lien credit facility had been repaid in full and terminated. Also, quarterly installments for principal payments of \$2,375,000 were paid in full for the remainder of the first lien term loan.

The Credit Agreements required the Company, among other things, to meet certain financial and nonfinancial covenants and maintain financial ratios in such amounts and for such periods as set forth therein. The Company was required to maintain a leverage ratio (net debt divided by EBITDA, as defined within the Credit Agreements) of 4.75 as of December 31, 2011. The Company was in compliance with all requirements as of December 31, 2011 and 2010.

The Credit Agreements restricted the circumstances in which distributions and dividends were permitted be paid by its' Subsidiary. Payments could have been made to the Company for certain expenses, and dividends could have been used to repurchase equity interests, subject to an annual limitation. Additionally, the Credit Agreements restricted the aggregate amount of dividends and distributions that could have been paid and required the maintenance of certain leverage ratios.

During 2009, CCMP acquired \$9,898,000 par value of First Lien term loans and \$20,000,000 par value of Second Lien term loans for approximately \$6,459,000 and \$8,296,000 respectively. CCMP exchanged this debt for additional shares of Series A Preferred stock issued by the Company. The Company subsequently contributed all but \$2,000,000 of the Second Lien term loan debt to its Subsidiary. The fair value of the shares exchanged was \$6,459,000 and \$8,296,000 for the First Lien term loan and Second Lien term loan, respectively. These shares have beneficial conversion features which are contingent upon a future event (see Note 6). The Company recorded this transaction as

Series A Preferred stock of \$14,754,000 based on the fair value of the debt contributed by CCMP which approximated the fair value of shares exchanged. The debt was held in treasury at face value. Consequently, the Company recorded a gain on extinguishment of debt of \$14,745,000, which included the write-off of deferred financing fees and other closing costs, in the consolidated statement of operations for the year ended December 31, 2009.

Effective January 3, 2009, the Company, within the terms of the Credit Agreements, changed the interest rate election from three-month LIBOR to one-month LIBOR. The Company concluded that as of January 3, 2009, the Swaps no longer met hedge effectiveness tests and were therefore no longer highly effective as a hedge against the impact on interest payments of changes in the LIBOR interest rate. The effective portion of the Swaps prior to the change remained in accumulated other comprehensive income (loss) and was amortized as interest expense over the period of the originally designated hedged transactions through January 3, 2010. Changes in the fair value of the Swaps were immediately recognized in the consolidated statements of operations as interest expense. The Company determined its Swaps met hedge effectiveness tests and were deemed highly effective for hedge accounting under ASC 815 as of December 31, 2008. Accordingly, at December 31, 2008 the change in fair value was recorded in accumulated other comprehensive income (loss) net of tax for the effective portion of the hedges.



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

7. Redeemable Stock and Stockholders' Equity (Deficit)

Certain of the current equity investors (affiliates of CCMP Capital Advisors, LLC and related entities, certain other investors, certain members of management of the Subsidiary and board of directors of the Company) had previously acquired a combination of Class A and Class B Common stock and Series A Preferred stock of the Company. General terms of these securities are:

Preferred stock

**Series A Convertible Preferred stock:** Each Series A Preferred share was entitled to a priority return preference equal to the sum of \$10,000 per share base amount plus an amount sufficient to generate a 14% annual return on that base amount compounded quarterly from the date of issuance until the accreted priority return preference was paid in full. Each Series A Preferred share also participated in any equity appreciation beyond the Series A Preferred priority return (the Series A Equity Participation).

**Voting:** Series A Preferred shares did not have voting rights, subject to certain limited approval rights.

**Distributions:** Dividends and other distributions to stockholders in respect of shares, whether as part of an ordinary distribution of earnings, as a leveraged recapitalization or in the event of an ultimate liquidation and distribution of available corporate assets were to be paid to Series A Preferred stockholders as follows: Series A Preferred shares were entitled to receive an amount equal to the Series A Preferred base amount of \$10,000 per share plus an amount sufficient to generate a 14% annual return on that base amount, compounded quarterly from the date in which the Series A Preferred shares were originally issued. Series A Preferred shares then received an equity participation on all remaining proceeds after payment of this priority return to all Series A Preferred stockholders equal to 24.3% of remaining proceeds (Series A Equity Participation). No distribution would be made to any holder of common stock until the Series A Preferred stockholders had received all distributions to which they were entitled as previously described. After such distributions were made to the Series A Preferred stockholders, the holders of common stock were entitled to receive any remaining payments or distributions in accordance with their respective priorities.

**Liquidations:** Distributions in connection with any liquidation or change of control transaction would be made in accordance with the distributions described above. No distribution would be made to any holder of common stock until the Series A Preferred stockholders had received all distributions to which they were entitled as described above. After such distributions were made to the Series A Preferred stockholders, the holders of common stock would be entitled to receive any remaining payments or distributions in accordance with their respective priorities.

**Conversion:** Series A Preferred shares automatically converted into Class A common shares at the time of the initial public offering (IPO). Any unpaid Series A preferred return (base \$10,000 per share plus 14% accretion) was converted into additional Class A common shares valued at the IPO price net of underwriter's discount. That is, each Series A Preferred share was converted into a number of Class A common shares equal to (i) a fraction, the numerator of which is the unpaid priority return on such Series A Preferred share and the denominator of which is the value of a Class A common share at the time of conversion plus (ii) the number of Class A common shares required to be issued to satisfy the Series A Equity Participation. The number of shares of Class A common stock which were issued upon conversion of the Series A Preferred was dependent upon the initial public offering price of the Class A common stock on the date of conversion as well as the unpaid priority return of the Series A Preferred stock.

The Series A Preferred were redeemable in a deemed liquidation in the event of a change of control. The redemption features were considered to be outside the control of the Company and therefore, all shares of Series A Preferred stock were recorded outside of permanent equity in accordance with guidance originally issued under EITF Topic D-98, Classification and Measurement of Redeemable Securities (codified under Accounting Standards Codification 480, Distinguishing Liabilities from Equity). Until the time of the IPO, no adjustment to the carrying value of the Series A Preferred stock securities had been recorded, and the priority returns had not been accreted as a change of control was not probable.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

7. Redeemable Stock and Stockholders' Equity (Deficit) (continued)

Common stock

**Class B Convertible common stock:** Class B shares participated in the equity appreciation after the Series A Preferred priority return was satisfied. Each Class B share was entitled to a priority return preference equal to the sum of \$10,000 per share base amount plus an amount sufficient to generate a 10% annual return on that base amount compounded quarterly from the date of issue until the Class B priority return preference is paid in full. Each Class B share also participated in any equity appreciation beyond the Class B priority return.

**Voting:** Each Class B share was entitled to one vote per share on all matters on which stockholders voted.

**Class A common stock:** Class A shares participated in the equity appreciation after the Class B priority return was satisfied.

Class A shares did not have voting rights, priority preference or any accretion rights.

**Distributions:** After payment of the priority return to Series A Preferred shareholders previously described above under Preferred Stock, dividends and other distributions that remain available to stockholders in respect of shares, whether as part of an ordinary distribution of earnings, as a leveraged recapitalization or in the event of an ultimate liquidation and distribution of available corporate assets, were to be paid to the common stockholders as follows: Class B shares were entitled to receive an amount equal to the Class B base amount of \$10,000 per share plus an amount sufficient to generate a 10% annual return on that base amount, compounded quarterly from the date in which the Class B shares were originally issued. After payment of this priority return to Class B holders, the holders of Class A shares and Class B shares participated together equally and ratably in any and all distributions by the Company.

**Liquidations:** Distributions made in connection with any liquidation or change of control transaction would be made in accordance with the distributions previously described above in the preceding paragraph. In addition, any remaining assets after the Class B preferential distribution would be allocated to the Class A and Class B shares as follows: the Class B shares would receive a percentage of the remaining assets equal to the sum of (i) 88% plus (ii) the product of (A) 12% multiplied by (B) one minus a fraction, the numerator of which is the number of issued and outstanding vested shares of Class A shares and the denominator is 9,350.0098. The remainder would be allocated to the Class A shares.

**Conversion:** Class B shares automatically converted into Class A shares immediately prior to the IPO. Any unpaid Class B Common priority return (base \$10,000 per share plus 10% accretion) was "paid" in additional Class A common shares valued at the IPO price net of underwriter's discount. That is, each Class B share converted into a number of Class A shares required to be issued to satisfy the Class B Common priority return. Each Class B share converted into a number of Class A shares equal to (i) one plus (ii) a fraction, the numerator of which was the unpaid priority return on such Class B share and the denominator of which was the value of a Class A share at the time of conversion, in all cases subject to the priority rights and preferences of the Series A Preferred Shares. The number of shares of Class A common stock which were issued upon conversion of the Class B common stock was dependent upon the initial public offering price of the Class A common stock on the date of conversion as well as the unpaid priority return of the Class B common stock.

The Class B common were redeemable in a deemed liquidation in the event of a change of control. The redemption features were considered to be outside the control of the Company and therefore, all shares of Class B common stock were recorded outside of permanent equity in accordance with guidance originally issued under EITF Topic D-98, Classification and Measurement of Redeemable Securities (codified under Accounting Standards Codification 480, Distinguishing Liabilities from Equity). Until the time of the IPO, no adjustment to the carrying value of Class B Common stock securities had been recorded, and the priority returns had not been accreted as a change of control was not probable.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 7. Redeemable Stock and Stockholders' Equity (Deficit) (continued)

Accretion: Cumulative accretion on Series A preferred stock and Class B common stock at the time of the IPO on February 17, 2010, was as follows:

|                      | Series A<br>Preferred | Class B<br>Common |
|----------------------|-----------------------|-------------------|
| Carrying value       | \$ 113,109            | \$ 765,096        |
| Cumulative accretion | 17,006                | 286,299           |
|                      | \$ 130,115            | \$ 1,051,395      |

The amounts above do not include the additional base amount of \$25,790,000 on Class B common stock or the impact of Series A Equity Participation on Series A Preferred stock, both of which were recognized as a beneficial conversion at the time of the initial public offering.

The Company determined that the conversion feature in the Class B Common stock was in-the-money at the date of issuance and therefore represented a beneficial conversion feature. Since the Class B Common stock was convertible upon an initial public offering, it was contingent upon a future event and had not been recorded in the consolidated financial statements prior to the IPO. The beneficial conversion feature, which was valued at \$25,790,000 at its commitment date, was recorded at the completion of the IPO on February 10, 2010 as a return to Class B Common stockholders analogous to a dividend. Since no retained earnings were available to pay this dividend at resolution of the contingency, the dividend was charged against additional paid in capital resulting in no net impact. Upon the completion of the IPO on February 10, 2010, the Company recorded the beneficial conversion of \$25,790,000 as a reduction and offsetting increase to additional paid in capital as no retained earnings were available. There was no net impact on additional paid-in-capital.

**Management Equity Incentive Plan:** On November 10, 2006, the Company adopted the 2006 Management Equity Incentive Plan (2006 Equity Incentive Plan). The 2006 Equity Incentive Plan provided for awards with respect to a maximum of 9,350.0098 Class A Common shares and 5,000 Class B Common shares, subject to certain adjustments. On November 10, 2006, and from time to time thereafter, certain members of management purchased restricted shares of Class A Common stock under the 2006 Equity Incentive Plan for \$341 per share and pursuant to restricted stock agreements. One half of the restricted shares vested over time (Time Vesting Shares), with 25% vesting on November 10, 2007 and on the next three anniversaries thereafter, so long as the participant was still employed by the Company or one of its subsidiaries on the applicable vesting date. Upon the occurrence of a change of control of the Company, any unvested Time Vesting Shares immediately vested in full, so long as the participant was still employed by the Company or one of its subsidiaries. The other half of the restricted shares immediately vested (performance-based vesting) in full, provided the participant was still then employed by the Company or one of its subsidiaries, upon the occurrence of either: (i) a change of control of the Company that provides CCMP with a certain rate of return with respect to net proceeds received by CCMP from their investment in the Company; or (ii) from and after the date of an IPO, the achievement with respect to shares of the Class A Common stock of an average closing trading price exceeding, in any 60 consecutive trading day period starting prior to the later of (a) the fifth year anniversary of the date of grant of the restricted shares, and (b) one year after the IPO, a certain threshold with respect to net proceeds received by CCMP from their investment in the Company. As a condition to the purchase of restricted shares, members of management executed confidentiality, non-competition and intellectual property agreements.

The fair value of the Class A common stock on the date of issuance was estimated to be \$390 per share. The Company recorded \$6,000, and \$38,000, and \$40,000 of stock-based compensation expense related to the Time Vesting Shares in 2010, 2009, and 2008, respectively, related to amortization of the excess of fair value over purchase price of these restricted shares. This excess was being amortized over the vesting provisions of the restricted shares. As a result of the IPO, the remaining unvested performance-based Restricted Shares became fully vested. As a result, the Company has recorded \$159,000 of stock-based compensation expense related to the accelerated vesting in 2010.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 7. Redeemable Stock and Stockholders' Equity (Deficit) (continued)

## Issuance and repurchases of securities

Series A Preferred Stock: In September 2009, the Company issued 2,000 shares of the Series A Preferred stock to CCMP and certain members of management and the board of directors, for an aggregate purchase price of \$20,000,000. In December 2009, the Company issued an aggregate of 1,476 shares of Series A Preferred stock to CCMP in exchange for certain term loans under the first and second lien credit facilities that CCMP had purchased. The exchange ratio in connection with the exchange was one share of Series A Preferred stock per \$10,000 of the amount paid by CCMP for the loans that were so exchanged. Such purchased term loans had a cumulative outstanding principal amount equal to \$154,815,000. The equity consideration was less than the outstanding principal amount, therefore a gain on debt extinguishment was recorded. A summary of the exchanges of purchased term loans for Series A Preferred stock by year is as follows (dollars in thousands):

|                               | Number<br>of Shares | Face Value<br>of Debt | Consideration<br>Paid | Gain on<br>Extinguishment<br>of debt |
|-------------------------------|---------------------|-----------------------|-----------------------|--------------------------------------|
| Year ending December 31, 2009 | 1,476               | \$29,898              | \$ 14,754             | \$ 14,745                            |

The Company determined that the conversion feature in the Series A Preferred stock had a contingent beneficial conversion feature at the date of issuance. The Series A Preferred stock was convertible upon an initial public offering and the number of additional Class A Common shares which may be issued was unknown prior to the IPO. Since it was contingent upon a future event, it had not been recorded in the consolidated financial statements prior to the IPO. The beneficial conversion feature, which is the result of the additional Class A shares issued to satisfy the Series A Equity Participation, was recorded at the completion of the initial public offering on February 10, 2010, as a return to Series A Preferred stockholders analogous to a dividend. Since no retained earnings were available to pay this dividend at resolution of the contingency, the dividend was charged against additional paid in capital resulting in no net impact. Upon the completion of the IPO on February 10, 2010, the Company recorded the beneficial conversion of \$114,900,000 as a reduction and offsetting increase to additional paid in capital as no retained earnings were available. There was no net impact on additional paid-in-capital.

## 8. Earnings Per Share

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

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

Basic earnings per share is calculated by dividing net income by the weighted average number of shares outstanding. 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:

72

---



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 8. Earnings Per Share (continued)

|   | Year ended December 31 , |            |             |
|---|--------------------------|------------|-------------|
|   | 2011                     | 2010       | 2009        |
| Net income  | \$324,643                | \$56,913   | \$43,055    |
| Less: accretion of Series A Preferred stock   | -                        | (2,042 )   | (14,151 )   |
| Less: accretion of Class B Common stock   | -                        | (12,133 )  | (100,191 )  |
| Less: beneficial conversion   | -                        | (140,690 ) | -           |
| Net income (loss) attributable to Common stock (formerly Class A Common stock)                | 324,643                  | (97,952 )  | (71,287 )   |
| Income attributable to Class B Common stock   | -                        | 12,133     | 100,191     |
| Net income (loss) per common share - basic:   |                          |            |             |
| Common stock (formerly Class A Common stock)  | \$4.84                   | \$(1.65 )  | \$(41,111 ) |
| Class B Common stock  | n/a                      | \$505      | \$4,171     |
| Net income (loss) per common share - diluted:   |                          |            |             |
| Common stock (formerly Class A Common stock)  | \$4.79                   | \$(1.65 )  | \$(41,111 ) |
| Class B Common stock  | n/a                      | \$505      | \$4,171     |
| Weighted average number of shares outstanding – Common Stock (formerly Class A Common stock): |                          |            |             |
| Basic   | 67,130,356               | 59,364,958 | 1,734       |
| Dilutive effect of equity awards  | 667,015                  | -          | -           |
| Diluted   | 67,797,371               | 59,364,958 | 1,734       |
| Weighted average number of shares outstanding – Class B Common stock – basic and diluted:     |                          |            |             |
|   | n/a                      | 24,018     | 24,018      |

For the year ended December 31, 2010, diluted earnings per share are identical to basic earnings per share because the impact of common stock equivalents on earnings per share is anti-dilutive. Had the impact not been anti-dilutive, the effect of stock compensation awards on weighted average diluted shares outstanding would have been 257,038.

The Series A Preferred and Class B Common stock were only convertible to Class A Common stock immediately prior to an initial public offering. The impact of the conversion of Series A Preferred and Class B Common stock are excluded from diluted earnings per share calculations for 2009 as this contingent event had not yet occurred by the end of 2009. The number of shares of Class A Common stock that were issued upon conversion of the Series A Preferred and Class B Common stock was dependent upon the initial public offering price of the Class A Common stock on the date of conversion of February 10, 2010 as well as the unpaid priority return. The conversion at the time of the IPO, as well as the reverse stock split, resulted in 19,511,018 and 26,859,906 shares of common stock issued for the Series A Preferred stock and Class B Common stock, respectively.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 9. Income Taxes

The Company's provision for income taxes consists of the following (dollars in thousands):

|                               | Year ended December 31, |           |           |
|-------------------------------|-------------------------|-----------|-----------|
|                               | 2011                    | 2010      | 2009      |
| <b>Current:</b>               |                         |           |           |
| Federal                       | \$ 14,312               | \$-       | \$-       |
| State                         | 1,885                   | 307       | 339       |
|                               | 16,197                  | 307       | 339       |
| <b>Deferred:</b>              |                         |           |           |
| Federal                       | 15,632                  | 19,127    | 15,221    |
| State                         | 1,887                   | 2,831     | (12,378 ) |
|                               | 17,519                  | 21,958    | 2,843     |
| Change in valuation allowance | (271,393 )              | (21,958 ) | (2,843 )  |
| Provision for income taxes    | \$(237,677 )            | \$307     | \$339     |

The Company is the taxpaying entity and files a consolidated federal income tax return. Currently, the Company is not under examination by any major taxing jurisdiction to which the Company is subject. The statute of limitation for tax years 2011, 2010, 2009, and 2008 is open, for federal and state income taxes. Additionally, tax year 2007 remains open for examination by certain state taxing authorities.

Significant components of deferred tax assets and liabilities are as follows (dollars in thousands):

|   | December 31, |            |
|---|--------------|------------|
|   | 2011         | 2010       |
| <b>Deferred tax assets:</b>                 |              |            |
| Goodwill and intangible assets              | \$ 160,311   | \$ 186,014 |
| Accrued expenses                            | 16,572       | 11,967     |
| Deferred revenue                            | 1,370        | 1,093      |
| Inventories                                 | 2,720        | 2,733      |
| Pension obligations                         | 8,641        | 6,059      |
| Stock-based compensation                    | 5,302        | 2,435      |
| Operating loss and R&D credit carryforwards | 50,429       | 64,436     |
| Interest rate swap                          | 2,065        | 1,625      |
| Other                                       | 719          | 381        |
| Valuation allowance                         | -            | (271,393 ) |
| Total deferred tax assets                   | 248,129      | 5,350      |
| <b>Deferred tax liabilities:</b>            |              |            |
| Depreciation                                | 5,994        | 4,780      |
| Prepaid expenses                            | 377          | 570        |
| Total deferred tax liabilities              | 6,371        | 5,350      |
| Net deferred tax asset                      | \$241,758    | \$-        |



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 9. Income Taxes (continued)

The net current and noncurrent components of deferred taxes included in the consolidated balance sheets are as follows (dollars in thousands):

|                                   | December 31, |            |
|-----------------------------------|--------------|------------|
|                                   | 2011         | 2010       |
| Net current deferred tax assets   | \$ 14,395    | \$ 15,269  |
| Net long-term deferred tax assets | 227,363      | 256,124    |
| Valuation allowance               | –            | (271,393 ) |
| Net deferred tax assets           | \$ 241,758   | \$–        |

The Company was in a three year cumulative net loss position, due primarily to the 2008 goodwill and tradename impairment write-off, and therefore had not considered expected future taxable income in analyzing the realizability of the deferred tax assets as of December 31, 2010, resulting in a full valuation allowance against these net deferred tax assets. In the fourth quarter of 2011, the Company was no longer in a three-year cumulative loss position and, as part of the normal assessment of the future realization of the net deferred tax assets, determined that a valuation allowance was no longer required. As a result, the valuation allowance was reversed in the fourth quarter of 2011 and the Company recorded as a tax benefit of \$271,393,000.

At December 31, 2011, the Company has federal net operating loss carryforwards of approximately \$127,100,000, which expire between 2027 and 2030, and various state net operating loss carryforwards, which expire between 2016 and 2030.

As a result of ownership changes, Section 382 of the Internal Revenue Code of 1986 as amended and similar state provisions can limit the annual deductions of net operating loss and tax credit carry forwards. Such annual limitations could result in the expiration of net operating loss and tax credit carry forwards before utilization. The Company has no such limitation as of December 31, 2010 and expects no limitation was triggered in 2011. Future ownership changes may result in such a limitation.

A reconciliation of the statutory tax rates and the effective tax rates for the years ended December 31, 2011, 2010 and 2009 are as follows:

|                     | Year ended December 31, |   |       |   |       |   |
|---------------------|-------------------------|---|-------|---|-------|---|
|                     | 2011                    |   | 2010  |   | 2009  |   |
| U.S. statutory rate | 35                      | % | 35    | % | 35    | % |
| State taxes         | 4                       |   | 4     |   | 4     |   |
| Valuation allowance | (312.3 )                |   | (38 ) |   | (38 ) |   |
| Effective tax rate  | (273.3 )%               |   | 1     | % | 1     | % |

At December 31, 2011 and 2010 the Company has no reserves recorded for uncertain tax positions.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

10. Benefit Plans

Medical and Dental Plan

The Company has a medical and dental benefit plan covering full-time employees of the Company and their dependents. The plan is a partially self-funded plan under which participant claims are obligations of the plan. The plan is funded through employer and employee contributions at a level sufficient to pay for the benefits provided by the plan. The Company's contributions to the plan were \$6,700,000, \$7,300,000, and \$5,900,000 for the years ended December 31, 2011, 2010, and 2009, respectively. The plan maintains individual stop loss insurance policies on the medical portion of \$200,000 to mitigate losses. Balances for the incurred but not yet reported claims, including reported but unpaid claims at December 31, 2011, and 2010, were \$800,000 and \$800,000, respectively. The Company estimates claims incurred but not yet reported each month based on its historical experience, and the Company adjusts its accrual to meet the estimated liability.

Savings Plan

The Company maintains a defined-contribution 401(k) savings plan for virtually all employees who meet certain eligibility requirements. Under the plan, employees may defer receipt of a portion of their eligible compensation.

The Company amended the 401(k) savings plans effective January 1, 2009, to add Company matching and non-elective contributions. The Company may contribute a matching contribution of 50% of the first 6% of eligible compensation of employees. No matching contribution shall be made with respect to employee catch-up contributions. The Company may contribute a non-elective contribution for each plan year after 2008. The contribution will apply to eligible employees employed on December 31, 2008. The rate of the non-elective contribution is determined based upon years of service as of December 31, 2008, and is fixed. Both Company matching contributions and non-elective contributions are subject to vesting. Forfeitures may be applied against plan expenses.

The Company recognized \$2,400,000, \$2,300,000 and \$2,300,000 of expense related to this plan in 2011, 2010 and 2009, respectively.

Pension Plans

The Company has noncontributory salaried and hourly pension plans (combined the Pension Plans) covering substantially all of its employees. The benefits under the salaried plan are based upon years of service and the participants' defined final average monthly compensation. The benefits under the hourly plan are based on a unit amount at the date of termination multiplied by the participant's years of credited service. The Company's funding policy for the Pension Plans is to contribute amounts at least equal to the minimum annual amount required by applicable regulations. The Company elected to freeze the Pension Plans effective December 31, 2008. This resulted in a cessation of all future benefit accruals for both hourly and salary pension plans.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 10. Benefit Plans (continued)

The Company uses a December 31 measurement date for the Pension Plans. Information related to the Pension Plans is as follows (dollars in thousands):

|  | Year Ended December 31, |              |
|--|-------------------------|--------------|
|  | 2011                    | 2010         |
| Accumulated benefit obligation at end of period                                  | \$ 53,467               | \$ 46,049    |
| Change in projected benefit obligation   |                         |              |
| Projected benefit obligation at beginning of period                              | \$ 46,049               | \$ 41,845    |
| Interest cost  | 2,369                   | 2,359        |
| Net actuarial loss   | 6,649                   | 3,138        |
| Benefits paid  | (1,600 )                | (1,293 )     |
| Projected benefit obligation at end of period                                    | \$ 53,467               | \$ 46,049    |
| Change in plan assets  |                         |              |
| Fair value of plan assets at beginning of period                                 | \$ 30,615               | \$ 28,128    |
| Actual return on plan assets   | 623                     | 3,780        |
| Company contributions  | 1,785                   | --           |
| Benefits paid  | (1,600 )                | (1,293 )     |
| Fair value of plan assets at end of period                                       | \$ 31,423               | \$ 30,615    |
| Funded status: accrued pension liability included in other long-term liabilities | \$ (22,044 )            | \$ (15,434 ) |
| Amounts recognized in accumulated other comprehensive income                     |                         |              |
| Net actuarial (loss)/gain  | \$ (13,702 )            | \$ (5,607 )  |

The estimated actuarial loss for the Pension Plans that was amortized from OCI into net periodic benefit cost during 2011 is \$273,000. The amount in OCI as of December 31, 2011 that is expected to be recognized as a component of net periodic pension expense during the next fiscal year is \$909,000.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 10. Benefit Plans (continued)

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

|   | Year ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2011                    | 2010     | 2009     |
| Components of net periodic pension expense: |                         |          |          |
| Interest cost                               | 2,369                   | 2,359    | 2,338    |
| Expected return on plan assets              | (2,342 )                | (2,004 ) | (1,804 ) |
| Amortization of net loss                    | 273                     | 247      | 240      |
| Net periodic pension expense                | \$300                   | \$602    | \$774    |

Weighted-average assumptions used to determine benefit obligation are as follows:

|                                   | December 31, |   |      |   |
|-----------------------------------|--------------|---|------|---|
|                                   | 2011         |   | 2010 |   |
| Discount rate                     | 4.65         | % | 5.23 | % |
| Rate of compensation increase (1) | n/a          |   | n/a  |   |

(1) No compensation increase was assumed, as the plans were frozen effective December 31, 2008.

Weighted-average assumptions used to determine net periodic pension expense are as follows:

|  | Year ended December 31, |   |      |   |      |   |
|--|-------------------------|---|------|---|------|---|
|  | 2011                    |   | 2010 |   | 2009 |   |
| Discount rate                                    | 5.23                    | % | 5.76 | % | 6.28 | % |
| Expected long-term rate of return on plan assets | 7.62                    |   | 7.30 |   | 7.66 |   |
| Rate of compensation increase (1)                | n/a                     |   | n/a  |   | n/a  |   |

(1) No compensation increase was assumed as the plans were frozen effective December 31, 2008.

To determine the long-term rate of return assumption for plan assets, the Company studies historical markets and preserves the long-term historical relationships between equities and fixed-income securities consistent with the widely accepted capital market principle that assets with higher volatility generate a greater return over the long run. The Company evaluates current market factors such as inflation and interest rates before it determines long-term capital market assumptions and reviews peer data and historical returns to check for reasonableness and appropriateness.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 10. Benefit Plans (continued)

The Pension Plan's weighted-average asset allocation at December 31, 2011 and 2010, by asset category, is as follows (dollars in thousands):

| Asset Category       | Target | December 31, 2011 |          | December 31, 2010 |   |          |     |   |
|----------------------|--------|-------------------|----------|-------------------|---|----------|-----|---|
|                      |        | Dollars           | %        | Dollars           | % |          |     |   |
| Fixed Income         | 24     | %                 | 7,349    | 23                | % | 7,385    | 24  | % |
| Domestic equity      | 49     | %                 | 15,879   | 51                | % | 14,967   | 49  | % |
| International equity | 17     | %                 | 4,766    | 15                | % | 5,211    | 17  | % |
| Real estate          | 10     | %                 | 3,429    | 11                | % | 3,052    | 10  | % |
| Total                | 100    | %                 | \$31,423 | 100               | % | \$30,615 | 100 | % |

The fair values of the Pension Plan's assets at December 31, 2011 are as follows:

|                  | Total    | Quoted prices in active markets for identical asset (level 1) |   |   | Significant observable inputs (level 2) | Significant unobservable inputs (level 3) |
|------------------|----------|---|---|---|---|---|
|                  |          | Total   | Quoted prices in active markets for identical asset (level 1) | Significant observable inputs (level 2) |   |   |
| Mutual fund      | \$28,530 | \$28,530  | \$—   | \$—                                     | \$—                                     |   |
| Collective trust | 2,893    | —   | 2,893   | —                                       | —                                       |   |
| Total            | \$31,423 | \$28,530  | \$2,893   | \$—                                     | \$—                                     |   |

The fair values of the Pension Plan's assets at December 31, 2010 are as follows:

|                  | Total    | Quoted prices in active markets for identical asset (level 1) |   |   | Significant observable inputs (level 2) | Significant unobservable inputs (level 3) |
|------------------|----------|---|---|---|---|---|
|                  |          | Total   | Quoted prices in active markets for identical asset (level 1) | Significant observable inputs (level 2) |   |   |
| Mutual fund      | \$28,141 | \$28,141  | \$—   | \$—                                     | \$—                                     |   |
| Collective trust | 2,474    | —   | 2,474   | —                                       | —                                       |   |
| Total            | \$30,615 | \$28,141  | \$2,474   | \$—                                     | \$—                                     |   |



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 10. Benefit Plans (continued)

**Mutual Funds** – This category includes investments in mutual funds that encompass both equity and fixed income securities that are designed to provide a diverse portfolio. The plan’s mutual funds are designed to track exchange indices, and invest in diverse industries. Some mutual funds are classified as regulated investment companies. Investment managers have the ability to shift investments from value to growth strategies, from small to large capitalization funds, and from U.S. to international investments. These investments are valued at the closing price reported on the active market on which the individual securities are traded. These investments are classified within Level 1 of the fair value hierarchy.

**Collective Trusts** – This category includes public investment vehicles valued using the Net Asset Value (NAV) provided by the administrator of the trust. The NAV is based on the value of the underlying assets owned by the trust, minus its liabilities, and then divided by the number of shares outstanding. The NAV of the trust is classified within Level 2 of the fair value hierarchy.

The Company’s target allocation for equity securities and real estate is generally between 65% – 85%, with the remainder allocated primarily to bonds. The Company regularly reviews its actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate.

The Company expects to make estimated contributions of \$2,902,000 to the Pension Plans in 2012.

The following benefit payments are expected to be paid from the Pension Plans (dollars in thousands):

| Year              |         |
|-------------------|---------|
| 2012              | \$1,421 |
| 2013              | 1,525   |
| 2014              | 1,632   |
| 2015              | 1,766   |
| 2016              | 1,865   |
| Years 2017 – 2021 | 11,548  |

## 11. Share Plans

On November 10, 2006, the Company adopted the 2006 Management Equity Incentive Plan (2006 Equity Incentive Plan). The 2006 Equity Incentive Plan provided for awards with respect to a maximum of 9,350.0098 shares of Common stock (formerly Class A Common stock) and 5,000 Class B Common shares, subject to certain adjustments. On November 10, 2006, and from time to time thereafter, certain members of management purchased restricted shares of Class A Common stock under the 2006 Equity Incentive Plan for \$341 per share and pursuant to restricted stock agreements. One half of the restricted shares vested over time (Time Vesting Shares), with 25% vesting on November 10, 2007 and on the next three anniversaries thereafter, so long as the participant was still employed by the Company or one of its subsidiaries on the applicable vesting date. Upon the occurrence of a change of control of the Company, any unvested Time Vesting Shares immediately vested in full, so long as the participant was still employed by the Company or one of its subsidiaries. The remaining restricted shares immediately vested (performance-based vesting) in full, provided the participant was still then employed by the Company or one of its subsidiaries, upon the occurrence of either: (i) a change of control of the Company that provides CCMP with a certain rate of return with

respect to net proceeds received by CCMP from their investment in the Company; or (ii) from and after the date of an IPO, the achievement with respect to shares of the Common stock (formerly Class A Common stock) of an average closing trading price exceeding, in any 60 consecutive trading day period starting prior to the later of (a) the fifth year anniversary of the date of grant of the restricted shares, and (b) one year after the IPO, a certain threshold with respect to net proceeds received by CCMP from their investment in the Company. As a condition to the purchase of restricted shares, members of management executed confidentiality, non-competition and intellectual property agreements.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

11. Share Plans (continued)

The fair value of the Class A common stock on the date of issuance was estimated to be \$390 per share. The Company recorded \$6,000 and \$38,000 of stock-based compensation expense related to the Time Vesting Shares in 2010 and 2009, respectively, related to amortization of the excess of fair value over purchase price of these restricted shares. This excess was being amortized over the vesting provisions of the restricted shares. As a result of the IPO, the remaining unvested performance-based Restricted Shares became fully vested. As a result, the Company recorded \$159,000 of stock-based compensation expense related to the accelerated vesting in 2010.

The Company adopted an equity incentive plan on February 10, 2010 in connection with the IPO. At the time of the IPO, 4,341,504 stock options and 456,249 shares of restricted stock and other stock awards were granted to employees and Board members of the Company pursuant to the equity incentive plan. The Company has subsequently granted an additional 204,877 stock options and 80,983 shares of restricted stock and other stock awards to employees and Board members of the Company. Total share-based compensation cost related to the equity incentive plan recognized in the consolidated statement of operations was \$8,646,000 and \$6,198,000 in 2011 and 2010, respectively, net of actual forfeitures, which is recorded in operating expenses in the consolidated statement of operations.

Stock Options - The stock options granted in 2011 have an exercise price of between \$17.75 per share and \$24.73 per share, and the stock options granted in 2010 have an exercise price equal to the IPO price of \$13.00 per share. All stock options vest in equal installments over five years, subject to the grantee's continued employment or service and expire 10 years after the date of grant.

In 2011, the majority of stock option exercises were net-share settled such that the Company withheld shares with value equivalent to the exercise price of the awards plus the employees' minimum statutory obligation for the applicable income and other employment taxes. Total shares withheld were approximately 55,202, and were based on the value of the stock options on the exercise date as determined based upon an average of the Company's high and low stock sales price. Total payments for the employees' tax obligations to the taxing authorities were \$371,000 and \$0 in 2011 and 2010, respectively, and are reflected as a financing activity within the Consolidated Statement of Cash Flows. The net-share settlements had the effect of share repurchases by the Company as they reduced the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company.

The Company has agreed to pay these taxes on behalf of the employees in return for the employee returning an equivalent value of options to the Company. This transaction resulted in a decrease of approximately \$371,000 in 2011 to equity on the consolidated balance sheet as the cash payment of the taxes effectively was a repurchase of the stock options previously granted.

The grant-date fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model. The fair value is then amortized on a straight-line basis over the requisite service period of the awards, which is generally the vesting period. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Since there is limited history for the Company's stock, expected volatility is calculated based on an analysis of historic and implied volatility measures for a set of peer companies. The average expected life is based on the contractual term of the option using the simplified method. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. The compensation expense recognized is net of estimated forfeitures. Forfeitures are estimated based on voluntary termination behavior,

as there is not sufficient history of actual share option forfeitures at this time. The weighted-average assumptions used in the Black-Scholes-Merton option pricing model for 2011 and 2010 are as follows:

|  | 2011    | 2010   |
|--|---------|--------|
| Weighted average grant date fair value | \$11.10 | \$6.84 |
| Assumptions:                           |         |        |
| Expected stock price volatility        | 50      | % 50   |
| Risk free interest rate                | 2.69    | % 2.94 |
| Expected annual dividend per share     | \$0.00  | \$0.00 |
| Expected life of options (years)       | 6.5     | 6.5    |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 11. Share Plans (continued)

During the year ended December 31, 2011, the Company updated the estimated forfeiture rates it uses in the determination of its stock-based compensation expense. This change was the result of an assessment that included an analysis of the actual number of equity awards that had been forfeited to date compared to prior estimates and an evaluation of future estimated forfeitures. The Company periodically evaluates its forfeiture rates and updates the rates it uses in the determination of its stock-based compensation expense. The impact of the change to the forfeiture rates on non-cash compensation expense was immaterial for the years ended December 31, 2011 and 2010. A summary of the Company's stock option activity and related information for the three years ended December 31, 2011, is as follows:

|                                     | Number of options | Weighted-average exercise price | Average remaining contractual Term (years) | Aggregate intrinsic value (\$ in thousands) |
|-------------------------------------|-------------------|---------------------------------|--|---|
| Outstanding as of December 31, 2009 | -                 | \$ -                            |  |   |
| Granted                             | 4,366,504         | 13.02                           |  |   |
| Exercised                           | -                 | -                               |  |   |
| Expired                             | -                 | -                               |  |   |
| Forfeited                           | (130,245 )        | 13.00                           |  |   |
| Outstanding as of December 31, 2010 | 4,236,259         | 13.02                           | 9.1  | \$13,349                                    |
| Granted                             | 179,877           | 21.26                           |  |   |
| Exercised                           | (107,591 )        | 13.00                           |  |   |
| Expired                             | -                 | -                               |  |   |
| Forfeited                           | -                 | -                               |  |   |
| Outstanding as of December 31, 2011 | 4,308,545         | 13.36                           | 8.2  | 63,193                                      |
| Exercisable as of December 31, 2011 | 739,656           | 13.02                           | 8.1  | 11,101                                      |

Of the 107,591 stock options exercised during the fiscal year 2011, 55,202 shares underlying such exercised options were retained by the Company in a net-share settlement to cover the aggregate exercise price and the required amount of employee withholding taxes.

As of December 31, 2011, there was \$20,028,000 of total unrecognized compensation cost, net of expected forfeitures, related to unvested options. The cost is expected to be recognized over the remaining service period, having a weighted-average period of 3.3 years. Total share-based compensation cost related to the stock options for 2011 and 2010 was \$6,475,000 and \$4,470,000, respectively, which is recorded in operating expenses in the consolidated statement of operations.

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



Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 11. Share Plans (continued)

A summary of the Company's restricted share awards activity for the three years ended December 31, 2011 is as follows:

|                                    | Shares  | Weighted-Average<br>Grant-Date<br>Fair Value |
|------------------------------------|---------|--|
| Non-vested Stock Awards            |         |  |
| Non-vested as of December 31, 2009 | -       | \$ -   |
| Granted                            | 439,999 | 13.02  |
| Vested                             | -       | -  |
| Forfeited                          | (9,844) | (13.00)                                      |
| Non-vested as of December 31, 2010 | 430,155 | 13.02  |
| Granted                            | 59,147  | 20.59  |
| Vested                             | -       | -  |
| Forfeited                          | -       | -  |
| Non-vested as of December 31, 2011 | 489,302 | \$ 13.93                                     |

As of December 31, 2011, there was \$2,900,000 of total unrecognized compensation cost, net of expected forfeitures, related to non-vested stock awards. That cost is expected to be recognized over the remaining service period, having a weighted-average period of 1.7 years. Total share-based compensation cost related to the restricted stock for 2011 and 2010 was \$1,871,000 and 1,447,000, respectively, which is recorded in operating expenses in the consolidated statement of operations.

During 2011 and 2010, 16,680 and 21,406 shares, respectively, of fully vested stock were granted to certain members of the Company's board of directors as a component of their compensation for their service on the board. Total compensation cost for these share grants in 2011 and 2010 was \$300,000 and \$281,000, respectively, which is recorded in operating expenses in the consolidated statement of operations.

## 12. Commitments and Contingencies

The Company leases certain computer equipment, automobiles, and warehouse space under operating leases with initial lease terms ranging up to three years.

The approximate aggregate minimum rental commitments at December 31, 2011, are as follows (dollars in thousands):

| Year  | Amount  |
|-------|---------|
| 2012  | \$479   |
| 2013  | 443     |
| 2014  | 375     |
| 2015  | 28      |
| 2016  | -       |
| Total | \$1,325 |





Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 12. Commitments and Contingencies (continued)

Total rent expense for the years ended December 31, 2011, 2010 and 2009, which includes short-term data processing equipment rentals, was approximately \$1,309,000, \$554,000, and \$347,000, respectively.

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. The Company 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 December 31, 2011 and 2010 was approximately \$10,035,000 and 9,735,000, respectively.

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

## 13. Related-Party Transactions

Prior to the IPO, the Company had an agreement to pay CCMP and certain other investors and related entities an annual advisory fee of \$500,000. The Company expensed \$55,000 in advisory fees for 2010, and \$500,000 in advisory fees for 2009. This agreement was terminated effective with the IPO on February 10, 2010.

## 14. Quarterly Financial Information (Unaudited)

Unaudited quarterly financial information for the years ended December 31, 2011 and 2010, (in thousands, except per share data):

|                                       | Quarters Ended 2011 |            |            |            |
|---------------------------------------|---------------------|------------|------------|------------|
|                                       | Q1                  | Q2         | Q3         | Q4         |
| Net sales                             | \$ 123,981          | \$ 161,363 | \$ 239,324 | \$ 267,308 |
| Gross profit                          | 47,177              | 60,353     | 88,659     | 98,465     |
| Operating income                      | 11,143              | 21,800     | 44,178     | 35,860     |
| Net income                            | 4,844               | 15,289     | 37,379     | 267,131    |
| Net income per common share, basic:   | \$ 0.07             | \$ 0.23    | \$ 0.56    | \$ 3.98    |
| Net income per common share, diluted: | \$ 0.07             | \$ 0.23    | \$ 0.55    | \$ 3.91    |

  

|   | Quarters Ended 2010 |            |            |            |
|---|---------------------|------------|------------|------------|
|   | Q1                  | Q2         | Q3         | Q4         |
| Net sales                                   | \$ 130,718          | \$ 140,455 | \$ 160,666 | \$ 161,041 |
| Gross profit                                | 51,418              | 54,745     | 67,362     | 63,832     |
| Operating income                            | 15,464              | 18,854     | 29,770     | 26,208     |
| Net income                                  | 2,468               | 12,834     | 22,998     | 18,613     |
| Less: accretion of Series A preferred stock | (2,042 )            | -          | -          | -          |
| Less: accretion of Class B common stock     | (12,133 )           | -          | -          | -          |

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

|   |            |         |         |         |
|---|------------|---------|---------|---------|
| Less: beneficial conversion   | (140,690 ) | -       | -       | -       |
| Net (loss) income attributable to Common<br>Stock (formerly Class A Common Stock) | (152,397 ) | 12,834  | 22,998  | 18,613  |
| Income attributable to Class B common stock                                       | 12,133     | -       | -       | -       |
| Net (loss) income per common share, basic:  |            |         |         |         |
| Common stock (formerly Class A Common<br>stock)                                   | \$ (4.26 ) | \$ 0.19 | \$ 0.34 | \$ 0.28 |
| Class B common stock  | \$ 505     | -       | -       | -       |
| Net (loss) income per common share, diluted:                                      |            |         |         |         |
| Common stock (formerly Class A Common<br>stock)                                   | \$ (4.26 ) | \$ 0.19 | \$ 0.34 | \$ 0.28 |
| Class B common stock  | \$ 505     | -       | -       | -       |

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

## 15. Valuation and Qualifying Accounts

For the years ended December 31, 2011, 2010 and 2009 (dollars in thousands):

|                                  | Balance at<br>Beginning<br>of Period | Reserves<br>Assumed in<br>Acquisition | Additions<br>Charged to<br>Earnings | Charges to<br>Reserve,<br>Net (1) | Balance at<br>End<br>of Year |
|----------------------------------|--------------------------------------|---------------------------------------|-------------------------------------|-----------------------------------|------------------------------|
| Year ended December 31, 2011     |                                      |                                       |                                     |                                   |                              |
| Allowance for doubtful accounts  | \$723                                | \$171                                 | \$(7 )                              | \$(98 )                           | \$789                        |
| Reserves for inventory           | 4,059                                | 657                                   | 1,092                               | (1,091 )                          | 4,717                        |
| Valuation of deferred tax assets | 271,393                              | –                                     | (271,393 )                          | –                                 | –                            |
| Year ended December 31, 2010     |                                      |                                       |                                     |                                   |                              |
| Allowance for doubtful accounts  | \$1,016                              | –                                     | \$(124 )                            | \$(169 )                          | \$723                        |
| Allowance for doubtful notes     | 965                                  | –                                     | –                                   | (965 )                            | –                            |
| Reserves for inventory           | 3,937                                | –                                     | 1,056                               | (934 )                            | 4,059                        |
| Valuation of deferred tax assets | 289,529                              | –                                     | (18,136 )                           | –                                 | 271,393                      |
| Year ended December 31, 2009     |                                      |                                       |                                     |                                   |                              |
| Allowance for doubtful accounts  | \$1,020                              | –                                     | \$227                               | \$(231 )                          | \$1,016                      |
| Allowance for doubtful notes     | 965                                  | –                                     | –                                   | –                                 | 965                          |
| Reserves for inventory           | 4,908                                | –                                     | 548                                 | (1,519 )                          | 3,937                        |
| Valuation of deferred tax assets | 292,372                              | –                                     | (2,843 )                            | –                                 | 289,529                      |

(1) Deductions from the allowance for doubtful accounts equal accounts receivable written off, less recoveries, against the allowance. Deductions from the reserves for inventory excess and obsolete items equal inventory written off against the reserve as items were disposed of. Deductions to the valuation of deferred tax assets relate to the reversals due to changes in management's judgments regarding the future realization of the underlying deferred tax assets.

## 16. Subsequent Events

The Company evaluated its financial statements for subsequent events through the date the financial statements were available to be issued. The Company is not aware of any subsequent events which require recognition or disclosure in the financial statements, except as disclosed below.

Acquisition of Gen-Tran Corporation - On February 1, 2012, a subsidiary of the Company acquired substantially all of the assets and assumed certain liabilities of Gen-Tran Corporation, a leading transfer switch and portable generator accessory manufacturer located in Alpharetta, GA. The acquisition is not material to the Company's consolidated financial statements.

Table of Contents

Generac Holdings Inc.  
Notes to Consolidated Financial Statements  
Years Ended December 31, 2011, 2010, and 2009

16. Subsequent Events (continued)

Refinancing of Revolving Credit Facility and Credit Agreement - On February 9, 2012, a subsidiary of the Company (the "Borrower") entered into a new credit agreement with certain commercial banks and other lenders. The new credit agreement provides for borrowings under a new \$150.0 million revolving credit facility, a \$325.0 million tranche A term loan facility and a \$250.0 million tranche B term loan facility. The new revolving credit facility and tranche A term loan facility mature February 9, 2017, and the tranche B term loan facility matures February 9, 2019.

Proceeds received by the Company from loans made under the new credit agreement were used to repay in full all outstanding borrowings under the former credit agreement, dated as of November 10, 2006, as amended from time to time, and for general corporate purposes. The Company's former credit facility is comprised of a revolving credit facility and a first-lien term loan, which were scheduled to mature in November 2012 and November 2013, respectively.

The new borrowings are secured by associated collateral agreements which pledge virtually all assets of the Borrower. The new credit agreement requires the Borrower, among other things, to meet certain financial and nonfinancial covenants and maintain a consolidated net leverage ratio not exceeding certain agreed levels and an interest coverage ratio not to decline below certain agreed levels.

The new revolving credit facility and tranche A term loan facility initially bear interest at rates based upon either a base rate plus an applicable margin of 1.25% or adjusted LIBOR rate plus an applicable margin of 2.25%. The tranche B term loan facility bears interest at rates based upon either a base rate (which, with respect to such tranche B term loan facility, will not be less than 2.00%) plus an applicable margin of 1.75% or adjusted LIBOR rate (which, with respect to such tranche B term loan facility, will not be less than 1.00%) plus an applicable margin of 2.75%. In subsequent periods, the new revolving credit facility and the Tranche A term loan facility will bear interest at rates based upon either a base rate plus an applicable margin ranging from 0.75% to 1.50% or adjusted LIBOR rate plus an applicable margin ranging from 1.75% to 2.50%, each determined based on a leverage ratio.

The new credit agreement restricts the circumstances in which distributions and dividends can be paid by the Borrower. Payments can be made by the Borrower to the Company for certain expenses such as operating expenses in the ordinary course and dividends can be used to repurchase equity interests, subject to limitation in certain circumstances. Additionally, the new credit agreement restricts the aggregate amount of dividends and distributions that can be paid and, in certain circumstances, requires the maintenance of certain leverage ratios in order to pay certain dividends or distributions.

The new credit agreement contains customary events of default, including, among others, nonpayment of principal, interest or other amounts, failure to perform covenants, inaccuracy of representations or warranties in any material respect, cross-defaults with other material indebtedness, certain undischarged judgments, the occurrence of certain ERISA or bankruptcy or insolvency events or the occurrence of a change in control (as defined in the new credit agreement). Upon an event of default under the new credit agreement, the lenders may declare the loans and all other obligations under the new credit agreement immediately due and payable and require the Borrower to cash collateralize the outstanding letter of credit obligations. A bankruptcy or insolvency event causes such obligations to automatically become immediately due and payable.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There were no changes in, or disagreements with, accountants reportable herein.

86

---

Table of Contents

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Securities Exchange Act of 1934, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has conducted an evaluation of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act as of the end of the period covered by this report on Form 10-K. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective in providing reasonable assurance that the information required to be disclosed in this report on Form 10-K has been recorded, processed, summarized and reported as of the end of the period covered by this report on Form 10-K.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles.

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Company's financial statements.

There are inherent limitations to the effectiveness of any internal control over financial reporting, including the possibility of human error or the circumvention or overriding of the controls. Accordingly, even an effective internal control over financial reporting can provide only reasonable assurance of achieving its objective. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate, because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management conducted an assessment of the effectiveness of internal control over financial reporting as of December 31, 2011 based on the criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In conducting this assessment, our management excluded the Magnum Products business given its acquisition was only as recent as the fourth quarter 2011 and

constituted 7% and 12% of total and net assets, respectively, as of December 31, 2011 and 5% and 1% of revenues and net income, respectively, for the year then ended. Notwithstanding Magnum, based on this assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2011.

Our independent registered public accounting firm has issued an attestation report on our internal control over financial reporting as of December 31, 2011. Its report appears in the consolidated financial statements included in this Annual Report on Form 10-K on page 47.

Table of Contents

Changes in Internal Control Over Financial Reporting

On October 3, 2011, a subsidiary of the Company acquired substantially all of the assets and certain liabilities of Magnum. As a result of the acquisition, we are in the process of reviewing the internal control structure of Magnum and, if necessary, will make appropriate changes as we incorporate our controls and procedures into the acquired business. Except for the acquisition, there have been no changes in our internal control over financial reporting that occurred during the three months ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None  
PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 not already provided herein under “Item 1 – Business – Executive Officers”, will be included in our 2012 Proxy Statement, and is incorporated by reference herein.

Item 11. Executive Compensation

The information required by this item will be included in our 2012 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item will be included in our 2012 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item will be included in our 2012 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item will be included in our 2012 Proxy Statement and is incorporated herein by reference.



Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

Included in Part II of this report:

|  | Page      |
|--|-----------|
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>47</u> |
| <u>Consolidated balance sheets as of December 31, 2011 and 2010</u>  | <u>49</u> |
| <u>Consolidated statements of operations for years ended December 31, 2011, 2010 and 2009</u>  | <u>50</u> |
| <u>Consolidated statements of redeemable stock and stockholders' equity (deficit) for years ended December 31, 2011, 2010 and 2009</u> | <u>51</u> |
| <u>Consolidated statements of cash flows for the years ended December 31, 2011, 2010 and 2009</u>                                      | <u>52</u> |
| <u>Notes to consolidated financial statements</u>  | <u>53</u> |

(a)(2) Financial Statement Schedules

All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

(a)(3) Exhibits

See the Exhibits Index following the signature pages for a list of the exhibits being filed or furnished with or incorporated by reference into this Annual Report on Form 10-K.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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/ Aaron Jagdfeld  
Aaron Jagdfeld  
Chief Executive Officer

Dated: March 9, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons and on behalf of the Registrant in the capacities and on the dates indicated.

| Signature                                    | Title   | Date          |
|--|---|---------------|
| /s/ Aaron Jagdfeld<br>Aaron Jagdfeld         | Chief Executive Officer and Director                    | March 9, 2012 |
| /s/ York A. Ragen<br>York A. Ragen           | Chief Financial Officer and<br>Chief Accounting Officer | March 9, 2012 |
| /s/ John D. Bowlin<br>John D. Bowlin         | Director  | March 9, 2012 |
| /s/ Barry J. Goldstein<br>Barry J. Goldstein | Director  | March 9, 2012 |
| /s/ Edward A. LeBlanc<br>Edward A. LeBlanc   | Director  | March 9, 2012 |
| /s/ Stephen Murray<br>Stephen Murray         | Director  | March 9, 2012 |
| /s/ david ramon<br>David Ramon               | Director  | March 9, 2012 |
| /s/ Timothy Walsh<br>Timothy Walsh           | Director  | March 9, 2012 |

Table of Contents

## EXHIBIT INDEX

| Exhibits<br>Number | Description   |
|--------------------|---|
| 2.1                | Agreement and Plan of Merger by and among Generac Power Systems, Inc., the representative named therein, GPS CCMP Acquisition Corp., and GPS CCMP Merger Corp., dated as of September 13, 2006 (incorporated by reference to Exhibit 2.1 of the Registration Statement on Form S-1 filed with the SEC on January 11, 2010).   |
| 2.2                | Amendment to Agreement and Plan of Merger by and among Generac Power Systems, Inc., the representative named therein, GPS CCMP Acquisition Corp., and   |
| 2.3*               | GPS CCMP Merger Corp (incorporated by reference to Exhibit 2.1 of the Registration Statement on Form S-1 filed with the SEC on January 11, 2010).<br>Asset Purchase Agreement, dated as of October 3, 2011, by and among Magnum Power Products, LLC, Magnum Products, LLC and the other Sellers named therein, the Equityholders named therein and Thomas Joseph, as Sellers' Representative.   |
| 3.1                | Third Amended and Restated Certificate of Incorporation of Generac Holdings Inc. (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010).  |
| 3.2                | Amended and Restated Bylaws of Generac Holdings Inc. (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010).  |
| 4.1                | Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).   |
| 4.2                | Shareholders Agreement, dated as of November 10, 2006, by and among Generac Holdings Inc., certain stockholders of Generac Holdings Inc., including CCMP Capital Investors II, L.P., various of its affiliated funds, various funds affiliated with Unitas Capital Ltd. and the Management Shareholders (as defined in Shareholders Agreement) (incorporated by reference to Exhibit 4.2 of the Registration Statement on Form S-1 filed with the SEC on October 20, 2009).   |
| 10.1               | Credit Agreement, dated as of February 9, 2012, among Generac Power Systems, Inc., Generac Acquisition Corp., the lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, Goldman Sachs Credit Partners L.P. and Merrill Lynch, Pierce, Fenner & Smith LLP, as syndication agents, and RBS Citizens, N.A., PNC Bank, National Association, Mizuho Corporate Bank, Ltd., Sumitomo Mitsui Banking Corporation and Bank of Montreal, as Documentation Agents (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on February 10, 2012). |
| 10.2               | Guarantee and Collateral Agreement, dated as of February 9, 2012, among Generac Acquisition Corp., Generac Power Systems, Inc., certain subsidiaries of Generac Power Systems, Inc. and JPMorgan Chase Bank, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed with the SEC on February 10, 2012).   |
| 10.3               | Advisory Services and Monitoring Agreement, dated November 10, 2006 (incorporated by reference to Exhibit 10.7 of the Registration Statement on Form S-1 filed with the SEC on November 24, 2009).  |
| 10.4+              | 2009 Executive Management Incentive Compensation Program (incorporated by reference to Exhibit 10.46 of the Registration Statement on Form S-1 filed with the SEC on December 17, 2009).  |
| 10.5+              |   |

- 10.6+ Generac Holdings Inc. 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).  
Generac Holdings Inc. Annual Performance Bonus Plan (incorporated by reference to Exhibit 10.63 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).
- 10.7+ Amended and Restated Employment Agreement, dated January 14, 2010, between Generac and Aaron Jagdfeld (incorporated by reference to Exhibit 10.65 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).

Table of Contents

## EXHIBIT INDEX (continued)

| Exhibits<br>Number | Description   |
|--------------------|---|
| 10.8+              | Employment Agreement, dated as of November 10, 2006, between Generac and Dawn Tabat (incorporated by reference to Exhibit 10.3 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).   |
| 10.9+              | Amendment to Employment Agreement, dated January 14, 2010, between Generac and Dawn Tabat (incorporated by reference to Exhibit 10.66 of the Registration Statement on Form S-1 filed with the SEC on October 20, 2009).  |
| 10.10+             | Employment Letter with Terrence Dolan (incorporated by reference to Exhibit 10.62 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).  |
| 10.11+             | Form of Change in Control Severance Agreement (incorporated by reference to Exhibit 10.64 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).  |
| 10.12              | Form of Confidentiality, Non-Competition and Intellectual Property Agreement (incorporated by reference to Exhibit 10.40 of the Registration Statement on Form S-1 filed with the SEC on November 24, 2009).  |
| 10.13+             | Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.44 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).   |
| 10.14+             | Form of Nonqualified Stock Option Award Agreement (incorporated by reference to Exhibit 10.45 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).  |
| 10.15              | Form of Generac Holdings Inc. Director Indemnification Agreement for Stephen Murray and Timothy Walsh (incorporated by reference to Exhibit 10.50 of the Registration Statement on Form S-1 filed with the SEC on January 11, 2010).  |
| 10.16              | Form of Generac Holdings Inc. Director Indemnification Agreement for Barry Goldstein, John D. Bowlin and Edward A. LeBlanc (incorporated by reference to Exhibit 10.51 of the Registration Statement on Form S-1 filed with the SEC on January 11, 2010).   |
| 10.17              | Form of Generac Holdings Inc. Officer Indemnification Agreement (incorporated by reference to Exhibit 10.52 of the Registration Statement on Form S-1 filed with the SEC on January 11, 2010).  |
| 10.18              | Form of Generac Power Systems, Inc. Director Indemnification Agreement for Stephen Murray and Timothy Walsh (incorporated by reference to Exhibit 10.53 of the Registration Statement on Form S-1 filed with the SEC on January 25, 2010).  |
| 10.19              | Form of Generac Power Systems, Inc. Indemnification Agreement for Barry Goldstein, John D. Bowlin, Edward A. LeBlanc, Aaron Jagdfeld, David Ramon, York A. Ragen, Dawn Tabat, Allen Gillette, Roger Schaus, Jr., Roger Pascavis and Russell S. Minick (incorporated by reference to Exhibit 10.54 of the Registration Statement on Form S-1 |
| 10.20+             | filed with the SEC on January 25, 2010).  |
| 10.21+             | Amendment to Employment Agreement with Dawn Tabat (incorporated by reference to Exhibit 10.1 of the quarterly report filed with the SEC on November 14, 2011).<br>Offer letter to Russ Minick (incorporated by reference to Exhibit 10.2 of the quarterly report filed with the SEC on November 14, 2011).                                  |
| 21.1*              | List of Subsidiaries of Generac Holdings Inc.   |
| 23.1*              | Consent of Ernst & Young, Independent Registered Public Accounting Firm, relating to Generac Holdings Inc.  |
| 31.1*              |   |

- 31.2\* 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.
- 32.1\*\* 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.
- 32.2\*\* 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.
- 101\* 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 financial information from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed with the SEC on March 9, 2012, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets at December 31, 2011 and December 31, 2010; (ii) Consolidated Statements of Operations for the Fiscal Years Ended December 31, 2011, December 31, 2010 and December 31, 2009; (iii) Consolidated Statements of Redeemable Stock and Stockholders' Equity (Deficit) for the Fiscal Years Ended December 31, 2011, December 31, 2010 and December 31, 2009; (iv) Consolidated Statements of Cash Flows for the Fiscal Years Ended December 31, 2011, December 31, 2010 and December 31, 2009; (v) Notes to Consolidated Financial Statements.

- 
- \* Filed herewith.
- \*\* Furnished herewith.
- + Indicates management contract or compensatory plan or arrangement.