GENERAC HOLDINGS INC.
Form 10-Q
November 06, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from to

Commission File Number 001-34627

GENERAC HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**20-5654756** (IRS Employer Identification No.)
S45 W29290 Hwy 59, Waukesha, WI (Address of principal executive offices)	**53189** (Zip Code)

(262) 544-4811

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

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

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

As of October 30, 2017, there were 62,163,514 shares of registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Generac Holdings Inc.

Condensed Consolidated Balance Sheets

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

	September 30, 2017	December 31, 2016
Assets	(Unaudited)	(Audited)
Current assets:		
Cash and cash equivalents	$ 128,780	$ 67,272
Accounts receivable, less allowance for doubtful accounts	320,626	241,857
Inventories	349,023	349,731
Prepaid expenses and other assets	11,720	24,649
Total current assets	810,149	683,509
Property and equipment, net	218,658	212,793
Customer lists, net	43,404	45,312
Patents, net	41,955	48,061
Other intangible assets, net	2,571	2,925
Tradenames, net	154,643	158,874
Goodwill	720,059	704,640
Deferred income taxes	4,310	3,337
Other assets	5,225	2,233
Total assets	$ 2,000,974	$ 1,861,684
Liabilities and stockholders' equity		
Current liabilities:		
Short-term borrowings	$ 26,226	$ 31,198
Accounts payable	190,207	181,519
Accrued wages and employee benefits	28,266	21,189
Other accrued liabilities	109,362	93,068
Current portion of long-term borrowings and capital lease obligations	104,682	14,965
Total current liabilities	458,743	341,939
Long-term borrowings and capital lease obligations	908,101	1,006,758

Deferred income taxes	49,528	17,278
Other long-term liabilities	69,556	61,459
Total liabilities	1,485,928	1,427,434
Redeemable noncontrolling interest	41,797	33,138
Stockholders’ equity:		
Common stock, par value $0.01, 500,000,000 shares authorized, 70,611,513 and 70,261,481 shares issued at September 30, 2017 and December 31, 2016, respectively	706	702
Additional paid-in capital	456,156	449,049
Treasury stock, at cost	(293,969)	(262,402)
Excess purchase price over predecessor basis	(202,116)	(202,116)
Retained earnings	535,172	456,052
Accumulated other comprehensive loss	(22,802)	(40,163)
Stockholders’ equity attributable to Generac Holdings Inc.	473,147	401,122
Noncontrolling interests	102	(10)
Total stockholders’ equity	473,249	401,112
Total liabilities and stockholders’ equity	$2,000,974	$1,861,684

See notes to consolidated financial statements.

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Generac Holdings Inc.

Condensed Consolidated Statements of Comprehensive Income

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

(Unaudited)

	Three Months Ended September 30, 2017	**Three Months Ended September 30, 2016**	**Nine Months Ended September 30, 2017**	**Nine Months Ended September 30, 2016**
Net sales	$457,253	$373,121	$1,184,443	$1,027,032
Costs of goods sold	299,784	235,349	782,028	667,053
Gross profit	157,469	137,772	402,415	359,979
Operating expenses:				
Selling and service	44,402	44,429	127,702	124,064
Research and development	10,864	9,426	31,732	27,512
General and administrative	22,102	18,066	64,436	55,492
Amortization of intangibles	7,242	9,511	21,554	25,525
Total operating expenses	84,610	81,432	245,424	232,593
Income from operations	72,859	56,340	156,991	127,386
Other (expense) income:				
Interest expense	(10,672)	(11,299)	(32,353)	(33,714)
Investment income	14	–	57	36
Loss on change in contractual interest rate	–	(2,957)	–	(2,957)
Costs related to acquisition	(51)	(577)	(372)	(994)
Other, net	(1,519)	19	(2,733)	564
Total other expense, net	(12,228)	(14,814)	(35,401)	(37,065)
Income before provision for income taxes	60,631	41,526	121,590	90,321
Provision for income taxes	20,581	15,514	42,946	33,154
Net income	40,050	26,012	78,644	57,167
Net income (loss) attributable to noncontrolling interests	341	(171)	433	(112)
Net income attributable to Generac Holdings Inc.	$39,709	$26,183	$78,211	$57,279
Net income attributable to common shareholders per common share - basic:	$0.64	$0.41	$1.27	$0.87
Weighted average common shares outstanding - basic:	61,758,190	64,615,935	62,094,807	65,506,469
Net income attributable to common shareholders per common share - diluted:	$0.64	$0.40	$1.26	$0.87
Weighted average common shares outstanding - diluted:	62,316,788	65,126,117	62,703,269	65,992,127

Comprehensive income attributable to Generac Holdings Inc.	$43,213	$26,647	$92,177	$45,723

See notes to consolidated financial statements.

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Generac Holdings Inc.

Condensed Consolidated Statements of Cash Flows

(U.S. Dollars in Thousands)

(Unaudited)

	Nine Months Ended September 30, 2017	2016
Operating activities		
Net income	$78,644	$57,167
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	17,137	15,818
Amortization of intangible assets	21,554	25,525
Amortization of original issue discount and deferred financing costs	2,400	3,229
Loss on change in contractual interest rate	–	2,957
Deferred income taxes	28,703	22,909
Share-based compensation expense	8,402	7,805
Other	361	(45)
Net changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(70,108)	(11,642)
Inventories	16,738	6,177
Other assets	(3,852)	2,663
Accounts payable	(206)	(2,618)
Accrued wages and employee benefits	6,288	4,981
Other accrued liabilities	17,319	1,341
Excess tax benefits from equity awards	(661)	(6,754)
Net cash provided by operating activities	122,719	129,513
Investing activities		
Proceeds from sale of property and equipment	77	1,349
Expenditures for property and equipment	(16,658)	(20,847)
Acquisitions of businesses, net of cash acquired	1,257	(61,386)
Net cash used in investing activities	(15,324)	(80,884)
Financing activities		
Proceeds from short-term borrowings	74,443	14,117
Proceeds from long-term borrowings	3,069	–
Repayments of short-term borrowings	(80,952)	(8,244)
Repayments of long-term borrowings and capital lease obligations	(13,051)	(10,976)
Stock repurchases	(30,012)	(99,934)
Payment of debt issuance costs	(1,517)	–
Cash dividends paid	–	(76)
Taxes paid related to the net share settlement of equity awards	(2,479)	(12,308)

Proceeds from exercise of stock options	1,717	–
Excess tax benefits from equity awards	–	6,754
Net cash used in financing activities	(48,782)	(110,667)
Effect of exchange rate changes on cash and cash equivalents	2,895	344
Net increase (decrease) in cash and cash equivalents	61,508	(61,694)
Cash and cash equivalents at beginning of period	67,272	115,857
Cash and cash equivalents at end of period	$128,780	$54,163

See notes to consolidated financial statements.

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Generac Holdings Inc.
Notes to Condensed Consolidated Financial Statements

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

(Unaudited)

1. Description of Business and Basis of Presentation

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

Over the years, the Company has executed a number of acquisitions that support its strategic plan (as discussed in Item 1 and Item 8 (Note 1 "Description of Business") of the Annual Report on Form 10-K for the year ended December 31, 2016). A summary of recent acquisitions include the following:

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

In January 2017, the Company acquired Motortech GmbH (Motortech), headquartered in Celle, Germany. Motortech is a leading manufacturer of gaseous-engine control systems and accessories, which are sold globally to gas-engine manufacturers and to aftermarket customers. While the Motortech acquisition was completed in January 2017, it was funded in the fourth quarter of 2016.

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

The condensed consolidated balance sheet as of September 30, 2017, the condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2017 and 2016, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2017 and 2016 have been prepared by the Company and have not been audited. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary for the fair presentation of the financial position, results of operations and cash flows, have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2016.

New Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. This guidance is the culmination of the FASB’s joint project with the International Accounting Standards Board to clarify the principles for recognizing revenue. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process that entities should follow in order to achieve that core principal. ASU 2014-09, as amended by ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,* ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, and ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, become effective for the Company in 2018. The guidance can be applied either on a full retrospective basis or on a modified retrospective basis in which the cumulative effect of initially applying the standard is recognized at the date of initial application. The Company has substantially completed its assessment of the potential impacts the standard may have on its financial statements, and believes that the adoption will not have a material impact. The Company is currently planning to adopt the standard using the full retrospective method.

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

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

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment*. This guidance is being issued to simplify the subsequent measurement of goodwill by eliminating Step 2 of the goodwill impairment test. Under the new guidance, the recognition of a goodwill impairment charge is calculated based on the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This guidance should be applied on a prospective basis and is effective for the Company in 2020. Early adoption is permitted for goodwill impairment tests performed after January 1, 2017. The Company has early adopted this standard, which did not have a significant impact on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging – Targeted Improvements to Accounting for Hedging Activities*. This guidance is being issued to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements, and to make certain targeted improvements to simplify the application of the hedge accounting guidance. For existing hedges, this guidance should be applied using a cumulative effect adjustment, while the presentation and disclosure guidance should be adopted on a prospective basis. The standard is effective for the Company in 2019, with early adoption permitted. The Company is currently assessing the impact the adoption of this guidance will have on the Company's results of operations and financial position.

In the first quarter of 2017, the Company adopted ASU 2016-09, *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. The primary impact of adoption is the prospective recognition of excess tax benefits or deficiencies within the provision for income taxes on the condensed consolidated statement of comprehensive income rather than within additional paid-in capital on the condensed consolidated balance sheet. Further, the Company has elected to continue to estimate forfeitures expected to occur to determine the amount of stock compensation expense recognized each period. The Company also elected to apply the presentation requirements for cash flows related to excess tax benefits or deficiencies prospectively. The presentation requirements for cash flows related to employee taxes paid in exchange for withheld shares had no impact to any period presented on the condensed consolidated statements of cash flows as such cash flows have historically been presented as a financing activity. There were no cumulative effect adjustments made to equity as of the beginning of the fiscal period, as those provisions of ASU 2016-09 were not applicable or had no impact to the Company.

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

2. Pramac Acquisition

On March 1, 2016, the Company acquired a 65% ownership interest in Pramac for a purchase price, net of cash acquired, of $60,250. Headquartered in Siena, Italy, Pramac is a leading global manufacturer of stationary, mobile and portable generators primarily sold under the Pramac® brand. Pramac products are sold in over 150 countries through a broad distribution network. The acquisition purchase price was funded solely through cash on hand.

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

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The redeemable noncontrolling interest is recorded at the greater of the initial fair value, increased or decreased for the noncontrolling interests' share of comprehensive income (loss), or the estimated redemption value, with any adjustments to the redemption value impacting retained earnings, but not net income. However, the redemption value adjustments are reflected in the earnings per share calculation, as detailed in Note 11, "Earnings Per Share," to the condensed consolidated financial statements. The following table presents the changes in the redeemable noncontrolling interest:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Balance at beginning of period	$37,796	$35,685	$33,138	$-
Noncontrolling interest of Pramac	1,540 (1)	-	1,540 (1)	34,253
Net income	283	(168)	493	(1)
Foreign currency translation	2,178	752	7,535	2,017
Redemption value adjustment	-	-	(909)	-
Balance at end of period	$41,797	$36,269	$41,797	$36,269

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

The Company finalized the Pramac purchase price allocation during the first quarter of 2017, based upon its estimates of the fair value of the acquired assets and assumed liabilities. The final purchase price allocation as of the balance sheet date was as follows:

	March 1, 2016
Accounts receivable, net	$50,716
Inventories	39,889
Property and equipment, net	19,138
Intangible assets	34,471
Goodwill	46,775
Other assets	7,698
Total assets acquired	198,687
Short-term borrowings	21,741
Accounts payable	40,270
Long-term debt and capital lease obligations (including current portion)	18,599
Other liabilities	23,521
Redeemable noncontrolling interest	34,253
Noncontrolling interest	53
Net assets acquired	$60,250

The goodwill ascribed to this acquisition is not deductible for tax purposes. The accompanying condensed consolidated financial statements include the results of Pramac from the date of acquisition through September 30, 2017.

The following unaudited pro forma information of the Company gives effect to this acquisition as though the transaction had occurred on January 1, 2016. Consolidated net sales on a pro forma basis for the three and nine month periods ended September 30, 2016 were $373,121 and $1,056,379, respectively. The pro forma impact of this acquisition on net income and earnings per share for both the three and nine month periods ended September 30, 2016 is not significant due to amortization related to acquired intangible assets and the fair value step-up of inventory in purchase accounting. This unaudited pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated on January 1, 2016.

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3. Derivative Instruments and Hedging Activities

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

Commodities

The Company is exposed to significant price fluctuations in commodities it uses as raw materials, and periodically utilizes commodity derivatives to mitigate the impact of these potential price fluctuations on its financial results and its economic well-being. These derivatives typically have maturities of less than eighteen months. At September 30, 2017, December 31, 2016 and September 30, 2016, the Company had one commodity contract outstanding, covering the purchases of copper.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in cost of goods sold in the Company's condensed consolidated statements of comprehensive income. Net pre-tax gains recognized for the three and nine months ended September 30, 2017 were $140 and $325, respectively. Net pre-tax gains (losses) recognized for the three and nine months ended September 30, 2016 were $(10) and $66, respectively.

Foreign Currencies

The Company is exposed to foreign currency exchange risk as a result of transactions denominated in currencies other than the U.S. Dollar. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with certain foreign currency purchases and sales in the normal course of business. Contracts typically have maturities of twelve months or less. As of September 30, 2017, December 31, 2016 and September 30, 2016, the Company had twenty-two, thirty-eight and fifteen foreign currency contracts outstanding, respectively.

Because these contracts do not qualify for hedge accounting, the related gains and losses are recorded in other, net in the Company's condensed consolidated statements of comprehensive income. Net pre-tax gains recognized for the three and nine months ended September 30, 2017 were $447 and $626, respectively. Net pre-tax gains (losses) recognized for the three and nine months ended September 30, 2016 were $24 and $(154), respectively.

Interest Rate Swaps

In October 2013, the Company entered into two interest rate swap agreements, and in May 2014, the Company entered into an additional interest rate swap agreement. The Company formally documented all relationships between interest rate hedging instruments and the related hedged items, as well as its risk-management objectives and strategies for undertaking various hedge transactions. These interest rate swap agreements qualify as cash flow hedges, and accordingly, the effective portions of the gains or losses are reported as a component of accumulated other comprehensive loss (AOCL). The cash flows of the swaps are recognized as adjustments to interest expense each period. The ineffective portions of the derivatives' changes in fair value, if any, are immediately recognized in earnings. For additional details on these interest rate swaps, refer to Item 7A of the Annual Report on Form 10-K for the year ended December 31, 2016.

In the second quarter of 2017, the Company entered into ten interest rate swap agreements. In August 2017, the Company entered into ten additional interest rate swap agreements. These interest rate swap agreements also qualify as cash flow hedges. The following table presents the details of the additional interest rate swaps from August 2017:

Hedged Item	**Contract Date**	**Effective Date**	**Notional Amount**	**Fixed LIBOR Rate**	**Expiration Date**
Interest Rate	August 9, 2017	July 1, 2018	$ 125,000	1.6298%	July 1, 2019
Interest Rate	August 9, 2017	July 1, 2019	125,000	1.8598%	July 1, 2020
Interest Rate	August 9, 2017	July 1, 2020	125,000	2.0848%	July 1, 2021
Interest Rate	August 9, 2017	July 1, 2021	125,000	2.3010%	July 1, 2022
Interest Rate	August 9, 2017	July 1, 2022	125,000	2.4848%	May 31, 2023
Interest Rate	August 30, 2017	July 1, 2018	125,000	1.5503%	July 1, 2019
Interest Rate	August 30, 2017	July 1, 2019	125,000	1.7553%	July 1, 2020
Interest Rate	August 30, 2017	July 1, 2020	125,000	1.9803%	July 1, 2021
Interest Rate	August 30, 2017	July 1, 2021	125,000	2.2228%	July 1, 2022
Interest Rate	August 30, 2017	July 1, 2022	125,000	2.4153%	May 31, 2023

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Fair Value

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

	September 30, 2017	December 31, 2016
Commodity contracts	$ 364	$ 623
Foreign currency contracts	1,257	(150)
Interest rate swaps	469	(1,739)

The fair values of the commodity and foreign currency contracts are included in prepaid expenses and other assets, and the fair values of the interest rate swaps are included in other assets in the condensed consolidated balance sheets as of September 30, 2017. The fair value of the commodity contract is included in other assets, the fair value of the foreign currency contracts are included in other accrued liabilities, and the fair value of the interest rate swaps are included in other long-term liabilities in the condensed consolidated balance sheets as of December 31, 2016. Excluding the impact of credit risk, the fair value of the derivative contracts as of September 30, 2017 and December 31, 2016 is an asset of $2,097 and a liability of $1,295, respectively, which represents the amount the Company would either receive or need to pay upon exit of the agreements on those dates.

The amount of gains recognized in AOCL in the condensed consolidated balance sheets on the effective portion of interest rate swaps designated as hedging instruments for the three and nine months ended September 30, 2017 were $581 and $1,345, respectively. The amount of gains (losses) for the three and nine months ended September 30, 2016 were $779 and $(509), respectively.

The amount of pre-tax gains recognized in cost of goods sold in the condensed consolidated statements of comprehensive income for commodity and foreign currency contracts not designated as hedging instruments for the three and nine months ended September 30, 2017 were $587 and $951, respectively. The amount of pre-tax gains (losses) for the three and nine months ended September 30, 2016 were $14 and $(88), respectively.

4. Fair Value Measurements

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

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, short-term borrowings and ABL facility borrowings), excluding Term Loan borrowings, approximates the fair value of these instruments based upon their short-term nature. The fair value of Term Loan borrowings, which have an aggregate carrying value of $904,282, was approximately $907,085 (Level 2) at September 30, 2017, as calculated based on independent valuations whose inputs and significant value drivers are observable.

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

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5. Accumulated Other Comprehensive Loss

The following presents a tabular disclosure of changes in AOCL during the three and nine months ended September 30, 2017 and 2016, net of tax:

	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan	Unrealized Gain (Loss) on Cash Flow Hedges		Total
Beginning Balance – July 1, 2017	$ (15,857)	$ (11,040)	$ (312)		$ (27,209)
Other comprehensive income before reclassifications	3,826	-	581	(1)	4,407
Amounts reclassified from AOCL	-	-	-		-
Net current-period other comprehensive income	3,826	-	581		4,407
Ending Balance – September 30, 2017	$ (12,031)	$ (11,040)	$ 269		$ (22,802)

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

	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan	Unrealized Gain (Loss) on Cash Flow Hedges	Total
Beginning Balance – January 1, 2017	$ (28,047)	$ (11,040)	$ (1,076)	$ (40,163)

Other comprehensive income before reclassifications	16,016	-	1,345 (3)	17,361
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive income	16,016	-	1,345	17,361
Ending Balance – September 30, 2017	$ (12,031)	$(11,040)	$ 269	$(22,802)

	Foreign Currency Translation Adjustments	**Defined Benefit Pension Plan**	**Unrealized Loss on Cash Flow Hedges**	**Total**
Beginning Balance – January 1, 2016	$ (9,502)	$(11,362)	$ (1,611)	$(22,475)
Other comprehensive loss before reclassifications	(11,047)	-	(509) (4)	(11,556)
Amounts reclassified from AOCL	-	-	-	-
Net current-period other comprehensive loss	(11,047)	-	(509)	(11,556)
Ending Balance – September 30, 2016	$ (20,549)	$(11,362)	$ (2,120)	$(34,031)

(1) Represents unrealized gains of $934, net of tax effect of $(373) for the three months ended September 30, 2017.
(2) Represents unrealized gains of $1,279, net of tax effect of $(500) for the three months ended September 30, 2016.
(3) Represents unrealized gains of $2,188, net of tax effect of $(863) for the nine months ended September 30, 2017.
(4) Represents unrealized losses of $(836), net of tax benefit of $327 for the nine months ended September 30, 2016.

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6. Segment Reporting

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

	Net Sales Three Months Ended September 30,		**Nine Months Ended September 30,**	
Reportable Segments	**2017**	**2016**	**2017**	**2016**
Domestic	$364,323	$299,095	$918,727	$833,831
International	92,930	74,026	265,716	193,201
Total net sales	$457,253	$373,121	$1,184,443	$1,027,032

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

	Net Sales Three Months Ended September 30,		**Nine Months Ended September 30,**	
Product Classes	**2017**	**2016**	**2017**	**2016**
Residential products	$251,921	$192,856	$604,894	$533,572
Commercial & industrial products	174,538	149,676	496,736	409,396
Other	30,794	30,589	82,813	84,064
Total net sales	$457,253	$373,121	$1,184,443	$1,027,032

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

Adjusted EBITDA

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2017	**2016**	**2017**	**2016**
Domestic	$83,128	$69,309	$190,131	$173,521
International	5,625	3,527	16,471	13,050
Total adjusted EBITDA	$88,753	$72,836	$206,602	$186,571
Interest expense	(10,672)	(11,299)	(32,353)	(33,714)
Depreciation and amortization	(13,108)	(14,900)	(38,691)	(41,343)
Non-cash write-down and other adjustments (1)	(756)	1,093	(2,632)	(1,689)
Non-cash share-based compensation expense (2)	(2,584)	(2,419)	(8,402)	(7,805)
Loss on change in contractual interest rate (3)	-	(2,957)	-	(2,957)
Transaction costs and credit facility fees (4)	(234)	(739)	(970)	(1,499)
Business optimization expenses (5)	(487)	(58)	(1,933)	(7,164)
Other	(281)	(31)	(31)	(79)
Income before provision for income taxes	$60,631	$41,526	$121,590	$90,321

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

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

(3) For the three and nine month periods ended September 30, 2016, represents a non-cash loss relating to the continued 25 basis point increase in borrowing costs as a result of the credit agreement leverage ratio remaining above 3.0 times based on projections at that time.

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

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

The Company’s sales in the United States represented approximately 76% and 77% of total sales for the three months ended September 30, 2017 and 2016, respectively, and represented approximately 74% and 78% of total sales for the nine months ended September 30, 2017 and 2016, respectively. Approximately 85% and 87% of the Company’s identifiable long-lived assets are located in the United States at September 30, 2017 and December 31, 2016, respectively.

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7. Balance Sheet Details

Inventories consist of the following:

	September 30, 2017	December 31, 2016
Raw material	$ 223,184	$ 218,911
Work-in-process	8,251	2,950
Finished goods	117,588	127,870
Total	$ 349,023	$ 349,731

Property and equipment consists of the following:

	September 30, 2017	December 31, 2016
Land and improvements	$ 12,708	$ 12,079
Buildings and improvements	127,344	122,747
Machinery and equipment	88,555	81,687
Dies and tools	24,799	23,269
Vehicles	1,866	1,474
Office equipment and systems	71,152	66,929
Leasehold improvements	2,465	2,319
Construction in progress	10,380	8,654
Gross property and equipment	339,269	319,158
Accumulated depreciation	(120,611)	(106,365)
Total	$ 218,658	$ 212,793

8. Product Warranty Obligations

The Company records a liability for product warranty obligations at the time of sale to a customer based upon historical warranty experience. The Company also records a liability for specific warranty matters when they become known and are reasonably estimable. Additionally, the Company sells extended warranty coverage for certain products. The sales of extended warranties are recorded as deferred revenue, which is recognized over the lives of the contracts.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2017	**2016**	**2017**	**2016**
Balance at beginning of period	$32,813	$30,735	$31,695	$30,197
Product warranty reserve assumed in acquisition	-	-	43	840
Payments	(5,135)	(5,424)	(13,980)	(13,976)
Provision for warranty issued	6,206	5,762	14,452	13,464
Changes in estimates for pre-existing warranties	(705)	286	969	834
Balance at end of period	$33,179	$31,359	$33,179	$31,359

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2017	**2016**	**2017**	**2016**
Balance at beginning of period	$36,717	$29,082	$31,080	$28,961
Deferred revenue contracts issued	12,355	2,843	21,222	5,606
Amortization of deferred revenue contracts	(1,827)	(1,430)	(5,057)	(4,072)
Balance at end of period	$47,245	$30,495	$47,245	$30,495

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

	September 30, 2017	**December 31, 2016**
Product warranty liability		
Current portion - other accrued liabilities	$ 20,445	$ 20,763
Long-term portion - other long-term liabilities	12,734	10,932
Total	$ 33,179	$ 31,695
Deferred revenue related to extended warranties		
Current portion - other accrued liabilities	$ 10,313	$ 6,728
Long-term portion - other long-term liabilities	36,932	24,352
Total	$ 47,245	$ 31,080

9. Credit Agreements

Short-term borrowings included in the condensed consolidated balance sheets consist of the following:

	September 30, 2017	**December 31, 2016**
ABL facility	$ -	$ -
Other lines of credit	26,226	31,198
Total	$ 26,226	$ 31,198

Long-term borrowings in the condensed consolidated balance sheets include the following:

	September 30, 2017	**December 31, 2016**
Term loan	$929,000	$929,000
Original issue discount and deferred financing costs	(25,708)	(26,677)
ABL facility	100,000	100,000
Capital lease obligation	4,833	4,647

Other	4,658	14,753
Total	1,012,783	1,021,723
Less: current portion of debt	104,011	14,399
Less: current portion of capital lease obligation	671	566
Total	$908,101	$1,006,758

The Company's credit agreements originally provided for a $1,200,000 term loan B credit facility (Term Loan) and currently include a $300,000 uncommitted incremental term loan facility. In November 2016, the Company amended its Term Loan to extend the maturity date from May 31, 2020 to May 31, 2023. The Term Loan is guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and is secured by associated collateral agreements which pledge a first priority lien on virtually all of the Company's assets, including fixed assets and intangibles, other than all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, which are secured by a second priority lien. The Term Loan initially bore interest at rates based upon either a base rate plus an applicable margin of 1.75% or adjusted LIBOR rate plus an applicable margin of 2.75%, subject to a LIBOR floor of 0.75%. Beginning in the second quarter of 2014, and measured each quarterly period thereafter, the applicable margin related to base rate loans is reduced to 1.50% and the applicable margin related to LIBOR rate loans is reduced to 2.50%, in each case, if the Borrower's net debt leverage ratio, as defined in the Term Loan, falls below 3.00 to 1.00 for that measurement period.

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

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In May 2017, the Company amended its Term Loan, modifying the pricing of the facility by reducing the applicable margin rates to base rate plus a fixed applicable margin of 1.25% or adjusted LIBOR rate plus a fixed applicable margin of 2.25%. Further, the amendment removed the pricing grid that would reduce the applicable margin if a net debt leverage ratio of 3.00 to 1.00 was achieved. The amended Term Loan pricing is still subject to the 0.75% LIBOR floor. In connection with this amendment and in accordance with ASC 470-50, *Debt Modifications and Extinguishments*, the Company capitalized $1,432 of fees as deferred financing costs on long-term borrowings and expensed $85 of transaction fees in the second quarter of 2017. As of September 30, 2017, the Company was in compliance with all covenants of the Term Loan. There are no financial maintenance covenants on the Term Loan.

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

In May 2015, the Company borrowed $100,000 under the ABL Facility, the proceeds of which were used as a voluntary prepayment towards the Term Loan. As of September 30, 2017, there was $100,000 outstanding under the ABL Facility, leaving $142,220 of availability, net of outstanding letters of credit. In October 2017, the Company repaid $90,000 of the outstanding ABL Facility balance.

As of September 30, 2017 and December 31, 2016, short-term borrowings consisted of borrowings by our foreign subsidiaries on local lines of credit, which totaled $26,226 and $31,198, respectively.

10. Stock Repurchase Program

In August 2015, the Company's Board of Directors approved a $200,000 stock repurchase program, which the Company completed in the third quarter of 2016. In October 2016, the Company's Board of Directors approved an additional $250,000 stock repurchase program. Under the program, the Company may repurchase up to $250,000 of its common stock over the following 24 months. The Company may repurchase its common stock from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The repurchases may be executed using open market purchases, privately negotiated agreements or other transactions. The actual timing, number and value of shares repurchased under the program will be determined by management at its discretion and will depend on a number of factors, including the market price of the Company's common stock and general market and economic conditions, applicable legal requirements, and compliance with the terms of the Company's outstanding indebtedness. The repurchases may be funded with cash on hand, available borrowings or proceeds from potential debt or other capital markets sources. The stock repurchase program may be suspended or discontinued at any time without prior notice. During the nine months ended September 30, 2017, the Company repurchased 844,500 shares of its common stock for $30,012. Since the inception of both programs, the Company has repurchased 8,116,706 shares of its common stock for $279,891, all funded with cash on hand.

11. Earnings Per Share

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2017	**2016**	**2017**	**2016**
Numerator				
Net income attributable to Generac Holdings Inc.	$39,709	$26,183	$78,211	$57,279
Redeemable noncontrolling interest redemption value adjustment	-	-	909	-
Net income attributable to common shareholders	$39,709	$26,183	$79,120	$57,279
Denominator				
Weighted average shares, basic	61,758,190	64,615,935	62,094,807	65,506,469
Dilutive effect of stock compensation awards (1)	558,598	510,182	608,462	485,658
Diluted shares	62,316,788	65,126,117	62,703,269	65,992,127
Net income attributable to common shareholders per share				
Basic	$0.64	$0.41	$1.27	$0.87
Diluted	$0.64	$0.40	$1.26	$0.87

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(1) Excludes approximately 146,000 stock options for the three-month period ended September 30, 2017, and 188,800 stock options for the nine-month period ended September 30, 2017, as the impact of such awards was anti-dilutive. Excludes approximately 208,400 stock options for the three-month period ended September 30, 2016, and 172,900 stock options for the nine-month period ended September 30, 2016, as the impact of such awards was anti-dilutive.

12. Income Taxes

The effective income tax rates for the nine months ended September 30, 2017 and 2016 were 35.3% and 36.7%, respectively. The decrease in the effective income tax rate in 2017 was primarily due to non-recurring discrete tax items that favorably impacted the current year and unfavorably impacted the prior year.

The Company files U.S. federal, U.S. state, and foreign jurisdiction tax returns that are subject to examination up to the expiration of the statute of limitations. We believe the tax positions taken on our returns would be sustained upon an exam, or where a position is uncertain, adequate reserves have been recorded.

The Company is currently under examination in multiple jurisdictions and is working to address all matters. While the Company does not believe any material taxes or penalties are due, there is a possibility that the ultimate tax outcome of an examination may result in differences from what was recorded. Such differences may affect the provision for income taxes in the period in which the determination is made, and could impact the company’s financial results.

13. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for certain dealers. The Company receives payment from the finance company after shipment of product to the dealer. The Company participates in the cost of dealer financing up to certain limits and has agreed to repurchase products repossessed by the finance company, but does not indemnify the finance company for any credit losses it incurs. The amount financed by dealers which remained outstanding under this arrangement at September 30, 2017 and December 31, 2016 was approximately $40,500 and $33,900, 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.

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

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

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

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

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

- frequency and duration of power outages impacting demand for our products;
- availability, cost and quality of raw materials and key components used in producing our products;
- the impact on our results of possible fluctuations in interest rates and foreign currency exchange rates;
- the possibility that the expected synergies, efficiencies and cost savings of our acquisitions will not be realized, or will not be realized within the expected time period;
- the risk that our acquisitions will not be integrated successfully;
- difficulties we may encounter as our business expands globally;
- competitive factors in the industry in which we operate;
- our dependence on our distribution network;
- our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;
- loss of our key management and employees;
- increase in product and other liability claims or recalls; and
- changes in environmental, health and safety laws and regulations.

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in any forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in our filings with the Securities and Exchange Commission, including in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016. Stockholders, potential investors and other readers should consider these factors carefully in evaluating the forward-looking statements.

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

Overview

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

Over the years, we have executed a number of acquisitions that support our strategic plan. A summary of these acquisitions can be found in Note 1, “Description of Business and Basis of Presentation,” to the condensed consolidated financial statements in Item 1 of this quarterly report on Form 10-Q, and in Item 8 (Note 1 “Description of Business”) of the Annual Report on Form 10-K for the year ended December 31, 2016.

Business Drivers and Operational Factors

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

Business Drivers and Trends

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

Increasing penetration opportunity. Many potential customers are not aware of the costs and benefits of automatic backup power solutions. We estimate that penetration rates for home standby generators are only approximately 4.0% of U.S. single-family detached, owner-occupied households with a home value of over $100,000, as defined by the U.S. Census Bureau's 2015 American Housing Survey for the United States. The decision to purchase backup power for many light-commercial buildings such as convenience stores, restaurants and gas stations is more return-on-investment driven and as a result these applications have relatively lower penetration rates as compared to buildings used in code-driven or mission critical applications such as hospitals, wastewater treatment facilities, 911 call centers, data centers and certain industrial locations. The emergence of lower cost, cleaner burning natural gas fueled generators has helped to increase the penetration of standby generators in the light-commercial market. We believe by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby generators for residential, commercial and industrial purposes.

Effect of large scale and baseline power disruptions. Power disruptions are an important driver of customer awareness and have historically influenced demand for generators, both in the United States and internationally. Increased frequency and duration of major power outage events, that have a broader impact beyond a localized level, increases product awareness and may drive consumers to accelerate their purchase of a standby or portable generator during the immediate and subsequent period, which we believe may last for nine to twelve months following a major power outage event for standby generators. Major power disruptions are unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. In addition, there are smaller, more localized power outages that occur frequently across the United States that drive the baseline level of demand for back-up power solutions. The level of baseline power outage activity occurring across the United States can also fluctuate, and may cause our financial results to fluctuate from year to year.

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

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

Factors Affecting Results of Operations

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

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

We have historically attempted to mitigate the impact of rising commodity, currency and component prices through improved product design and sourcing, manufacturing efficiencies, price increases and select hedging transactions. Our results are also influenced by changes in fuel prices in the form of freight rates, which in some cases are accepted by our customers and in other cases are paid by us.

Seasonality. Although there is demand for our products throughout the year, in each of the past five years approximately 23% to 27% of our net sales occurred in the first quarter, 20% to 25% in the second quarter, 24% to 27% in the third quarter and 25% to 29% in the fourth quarter, with different seasonality depending on the occurrence, timing and severity of major power outage activity in each year. Major outage activity is unpredictable by nature and, as a result, our sales levels and profitability may fluctuate from period to period. The seasonality experienced during a major power outage, and for the subsequent quarters following the event, will vary relative to other periods where no major outage events occurred. We maintain a flexible production and supply chain infrastructure in order to respond to outage-driven peak demand.

Factors influencing interest expense and cash interest expense. Interest expense can be impacted by a variety of factors, including market fluctuations in LIBOR, interest rate election periods, interest rate swap agreements, and repayments or borrowings of indebtedness. Cash interest expense decreased during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016, primarily due to the $25 million voluntary prepayment of Term Loan debt in November 2016, the May 2017 Term Loan refinancing and decreased borrowings at other subsidiaries, partially offset by an increase in the LIBOR rate. Refer to Note 9, “Credit Agreements,” to the condensed consolidated financial statements included in Part 1, Item 1 of this Quarterly Report on Form 10-Q for further information.

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Factors influencing provision for income taxes and cash income taxes paid. We had approximately $592 million of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2016 related to our acquisition by CCMP in 2006 that we expect to generate aggregate cash tax savings of approximately $231 million through 2021, assuming continued profitability and a 39% tax rate. The recognition of the tax benefit associated with these assets for tax purposes is expected to be $122 million annually through 2020 and $102 million in 2021, which generates annual cash tax savings of $48 million through 2020 and $40 million in 2021, assuming profitability and a 39% tax rate. As a result of the asset acquisition of the Magnum business in the fourth quarter of 2011, we had approximately $38.0 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2016. We expect these assets to generate aggregate cash tax savings of $14.9 million through 2026 assuming continued profitability and a 39% tax rate. The amortization of these assets for tax purposes is expected to be $3.8 million annually through 2025 and $2.8 million in 2026, which generates an additional annual cash tax savings of $1.5 million through 2025 and $1.1 million in 2026, assuming profitability and a 39% tax rate. Based on current business plans, we believe that our cash tax obligations through 2026 will be significantly reduced by these tax attributes. Other domestic acquisitions have resulted in additional tax deductible goodwill and intangible assets that will generate tax savings, but are not material to our consolidated financial statements.

Results of Operations

Three months ended September 30, 2017 compared to the three months ended September 30, 2016

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

	Three Months Ended September 30,			
(U.S. Dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Net sales	$457,253	$373,121	$84,132	22.5%
Cost of goods sold	299,784	235,349	64,435	27.4%
Gross profit	157,469	137,772	19,697	14.3%
Operating expenses:				
Selling and service	44,402	44,429	(27)	-0.1%
Research and development	10,864	9,426	1,438	15.3%
General and administrative	22,102	18,066	4,036	22.3%
Amortization of intangible assets	7,242	9,511	(2,269)	-23.9%
Total operating expenses	84,610	81,432	3,178	3.9%
Income from operations	72,859	56,340	16,519	29.3%
Total other expense, net	(12,228)	(14,814)	2,586	-17.5%
Income before provision for income taxes	60,631	41,526	19,105	46.0%

Provision for income taxes	20,581	15,514	5,067	32.7%
Net income	40,050	26,012	14,038	54.0%
Net income attributable to noncontrolling interests	341	(171)	512	-299.4%
Net income attributable to Generac Holdings Inc.	$39,709	$26,183	$13,526	51.7%

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

	Net Sales Three Months Ended September 30,			
(U.S. Dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Domestic	$364,323	$299,095	$65,228	21.8%
International	92,930	74,026	18,904	25.5%
Total net sales	$457,253	$373,121	$84,132	22.5%

	Adjusted EBITDA Three Months Ended September 30,			
	2017	**2016**	**$ Change**	**% Change**
Domestic	$83,128	$69,309	$13,819	19.9%
International	5,625	3,527	2,098	59.5%
Total Adjusted EBITDA	$88,753	$72,836	$15,917	21.9%

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

	Three Months Ended September 30,			
(U.S. Dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Residential products	$251,921	$192,856	$59,065	30.6%
Commercial & industrial products	174,538	149,676	24,862	16.6%
Other	30,794	30,589	205	0.7%
Total net sales	$457,253	$373,121	$84,132	22.5%

Net sales. The increase in Domestic sales for the three months ended September 30, 2017 was primarily due to substantial growth in shipments of portable generators driven by increased outage activity from Hurricanes Harvey, Irma and Maria; along with the continuation of very strong growth for mobile products. Additionally, there were increases in shipments of home standby generators and specialty outdoor power equipment.

The increase in International sales for the three months ended September 30, 2017 was primarily due to the contribution from the recent acquisition of Motortech. The growth was also due to increased organic shipments of both C&I and residential products within the European and Latin America regions, along with the favorable impact of a stronger Euro as compared to the prior year.

The total net sales contribution from non-annualized recent acquisitions to the three months ended September 30, 2017 was $10.1 million.

Gross profit. Gross profit margin for the third quarter of 2017 was 34.4% compared to 36.9% in the prior-year third quarter. The decrease in gross margin as compared to the prior year was primarily due to unfavorable sales mix attributable to significantly higher sales of portable generators and mobile products relative to the prior year, which carry lower gross margins relative to the consolidated average.

Operating expenses. The increase in operating expenses was primarily driven by the addition of recurring operating expenses associated with the Motortech acquisition and additional incentive compensation accrued during the current-year quarter. Partially offsetting these impacts was a decline in amortization of intangibles.

Other expense. The decrease in other expense was primarily due to a prior-year $3.0 million non-cash loss on change in contractual interest rate not repeating; and a decrease in interest expense due to the $25.0 million voluntary prepayment of Term Loan debt in November 2016, the May 2017 Term Loan refinancing and decreased borrowings at other subsidiaries. These impacts were partially offset by an increase in foreign currency transactional losses.

Provision for income taxes. The effective income tax rates for the three months ended September 30, 2017 and 2016 were 33.9% and 37.4%, respectively. The decrease in the effective income tax rate is due to non-recurring discrete tax items that favorably impacted the current year and unfavorably impacted the prior year.

Net income attributable to Generac Holdings Inc. The increase in net income attributable to Generac Holdings Inc. was primarily due to the factors outlined above, partially offset by an increase in net income attributable to noncontrolling interests.

Adjusted EBITDA. Adjusted EBITDA margins for the Domestic segment for the three months ended September 30, 2017 were 22.8% of net sales compared to 23.2% in the prior-year third quarter. Adjusted EBITDA margin in the current year was impacted by unfavorable sales mix due to significantly higher sales of portable generators and mobile products relative to prior year. These impacts were largely offset by improved overall leverage of fixed operating expenses on the organic increase in sales.

Adjusted EBITDA margins for the International segment, before deducting for noncontrolling interests, for the three months ended September 30, 2017 were 6.1% of net sales compared to 4.8% in the prior-year third quarter. The improvement was primarily due to improved leverage of fixed manufacturing and operating expenses on the organic increase in sales. These impacts were partially offset by unfavorable foreign currency effects.

Adjusted Net Income. Adjusted Net Income of $57.8 million for the three months ended September 30, 2017 increased 8.6% from $53.2 million for the three months ended September 30, 2016, due to the factors outlined above, partially offset by an increase in cash income tax expense and an increase in adjusted net income attributable to noncontrolling interests.

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

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Nine months ended September 30, 2017 compared to the nine months ended September 30, 2016

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

(U.S. Dollars in thousands)	Nine Months Ended September 30, 2017	2016	$ Change	% Change
Net sales	$1,184,443	$1,027,032	$157,411	15.3%
Cost of goods sold	782,028	667,053	114,975	17.2%
Gross profit	402,415	359,979	42,436	11.8%
Operating expenses:				
Selling and service	127,702	124,064	3,638	2.9%
Research and development	31,732	27,512	4,220	15.3%
General and administrative	64,436	55,492	8,944	16.1%
Amortization of intangible assets	21,554	25,525	(3,971)	-15.6%
Total operating expenses	245,424	232,593	12,831	5.5%
Income from operations	156,991	127,386	29,605	23.2%
Total other expense, net	(35,401)	(37,065)	1,664	-4.5%
Income before provision for income taxes	121,590	90,321	31,269	34.6%
Provision for income taxes	42,946	33,154	9,792	29.5%
Net income	78,644	57,167	21,477	37.6%
Net income attributable to noncontrolling interests	433	(112)	545	-486.6%
Net income attributable to Generac Holdings Inc.	$78,211	$57,279	$20,932	36.5%

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

(U.S. Dollars in thousands)	Net Sales Nine Months Ended September 30, 2017	2016	$ Change	% Change
Domestic	$918,727	$833,831	$84,896	10.2%
International	265,716	193,201	72,515	37.5%
Total net sales	$1,184,443	$1,027,032	$157,411	15.3%

Adjusted EBITDA
Nine Months
Ended September

	30,			
	2017	2016	$ Change	% Change
Domestic	$190,131	$173,521	$16,610	9.6%
International	16,471	13,050	3,421	26.2%
Total Adjusted EBITDA	$206,602	$186,571	$20,031	10.7%

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

	Nine Months Ended September 30,			
(U.S. Dollars in thousands)	2017	2016	$ Change	% Change
Residential products	$604,894	$533,572	$71,322	13.4%
Commercial & industrial products	496,736	409,396	87,340	21.3%
Other	82,813	84,064	(1,251)	-1.5%
Total net sales	$1,184,443	$1,027,032	$157,411	15.3%

Net sales. The increase in Domestic sales for the nine months ended September 30, 2017 was primarily due to strong growth in shipments of portable generators driven by increased outage activity, along with strong growth for mobile products. Additionally, there were increases in shipments of home standby generators and specialty outdoor power equipment.

The increase in International sales for the nine months ended September 30, 2017 was primarily due to the contribution from the recent acquisitions of Pramac and Motortech. The growth was also due to increased organic shipments of both C&I and residential products within the European and Latin America regions, along with the favorable impact of a stronger Euro as compared to the prior year.

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The total net sales contribution from non-annualized recent acquisitions to the nine months ended September 30, 2017 was $60.1 million.

Gross profit. Gross profit margin for the first nine months of 2017 was 34.0% compared to 35.1% in the first nine months of 2016. The prior year included $2.7 million of business optimization and restructuring costs classified within cost of goods sold to address the significant and extended downturn for capital spending within the oil & gas industry, as well as $3.4 million of expense relating to the purchase accounting adjustment for the step-up in value of inventories relating to the Pramac acquisition. Excluding the impact of these charges, pro-forma gross margin in the prior-year was 35.7%. This pro-forma decline in gross margin as compared to the prior year was due to the mix impact from the Pramac and Motortech acquisitions, unfavorable sales mix attributable to higher sales of portable generators and mobile products relative to prior year, higher commodity prices seen in prior quarters and certain plant consolidation costs. These impacts were partially offset by improved leverage of fixed manufacturing costs on the higher organic sales and net favorable pricing impacts.

Operating expenses. Operating expenses increased $12.8 million, or 5.5%, as compared to the first nine months of 2016. The prior-year included $4.4 million of business optimization and restructuring costs classified within operating expenses to address the downturn for capital spending within the oil & gas industry. Excluding the impact of these charges, operating expenses increased $17.2 million, or 7.6%, as compared to the prior year. This increase was primarily driven by the addition of recurring operating expenses associated with the recent acquisitions of Pramac and Motortech, and additional incentive compensation accrued during the current year, partially offset by a decline in amortization of intangibles.

Other expense. The decrease in other expense was primarily due to a prior-year $3.0 million non-cash loss on change in contractual interest rate not repeating, and a decrease in interest expense due to the $25.0 million voluntary prepayment of Term Loan debt in November 2016 and decreased borrowings at other subsidiaries. These impacts were partially offset by an increase in foreign currency transactional losses.

Provision for income taxes. The effective income tax rates for the nine months ended September 30, 2017 and 2016 were 35.3% and 36.7%, respectively. The decrease in the effective income tax rate is due to non-recurring discrete tax items.

Net income attributable to Generac Holdings Inc. The increase in net income attributable to Generac Holdings Inc. was primarily due to the factors outlined above, partially offset by an increase in net income attributable to noncontrolling interests.

Adjusted EBITDA. Adjusted EBITDA margins for the Domestic segment for the nine months ended September 30, 2017 were 20.7% of net sales compared to 20.8% for the nine months ended September 30, 2016. Adjusted EBITDA margins decreased due to unfavorable sales mix and higher commodity prices seen in prior quarters, mostly offset by improved overall leverage of fixed operating expenses on the organic increase in sales, and the net favorable impact of higher pricing.

Adjusted EBITDA margins for the International segment, before deducting for noncontrolling interests, for the nine months ended September 30, 2017 were 6.2% of net sales compared to 6.8% for the nine months ended September 30, 2016. The decline was primarily due to the Pramac acquisition, unfavorable foreign currency impacts, higher commodity prices and increased overall operating expenses including the expansion of branch operations. These impacts were partially offset by improved leverage of fixed manufacturing and operating expenses on the organic increase in sales along with the addition of the Motortech acquisition.

Adjusted Net Income. Adjusted Net Income of $126.9 million for the nine months ended September 30, 2017 increased 0.1% from $126.8 million for the nine months ended September 30, 2016, due to the factors outlined, partially offset by an increase in cash income tax expense.

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

Liquidity and Financial Condition

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

Our credit agreements originally provided for a $1.2 billion Term Loan and currently include a $300.0 million uncommitted incremental term loan facility. The Term Loan matures on May 31, 2023. Following the amendment in May 2017, the Term Loan bears interest at rates based upon either a base rate plus a fixed applicable margin of 1.25% or adjusted LIBOR rate plus a fixed applicable margin of 2.25%, subject to a LIBOR floor of 0.75%. As of September 30, 2017, we were in compliance with all covenants of the Term Loan. There are no financial maintenance covenants on the Term Loan.

Our credit agreements also provide for the $250.0 million ABL Facility. The maturity date of the ABL Facility is May 29, 2020. In May 2015, we borrowed $100.0 million under the ABL Facility, the proceeds of which were used as a voluntary prepayment of Term Loan borrowings. As of September 30, 2017, there was $100.0 million outstanding under the ABL Facility, and we were in compliance with all of its covenants. In October 2017, we repaid $90.0

million of the outstanding ABL Facility balance.

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At September 30, 2017, we had cash and cash equivalents on hand of $128.8 million and $142.2 million of availability under our ABL Facility, net of outstanding letters of credit.

In August 2015, our Board of Directors approved a $200.0 million stock repurchase program, which we completed in the third quarter of 2016. In October 2016, our Board of Directors approved another stock repurchase program, under which we may repurchase an additional $250.0 million of common stock over 24 months from time to time; in amounts and at prices we deem appropriate, subject to market conditions and other considerations. For the nine months ended September 30, 2017, the Company repurchased 844,500 shares of its common stock for $30.0 million. Since the inception of both programs, we have repurchased 8,116,706 shares of our common stock for $279.9 million, all funded with cash on hand.

See Note 9, "Credit Agreements" to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Long-term Liquidity

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

Cash Flow

Nine months ended September 30, 2017 compared to the nine months ended September 30, 2016

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

	Nine Months Ended September 30,

(U.S. Dollars in thousands)	2017	2016	$ Change	% Change
Net cash provided by operating activities	$122,719	$129,513	$(6,794)	-5.2%
Net cash used in investing activities	(15,324)	(80,884)	65,560	-81.1%
Net cash used in financing activities	(48,782)	(110,667)	61,885	-55.9%

The decrease in net cash from operating activities was primarily driven by more of a working capital investment during the current year as compared to the prior year as we replenished inventory levels in the first quarter of 2017 following Hurricane Matthew, and ramped production in the third quarter of 2017 in response to Hurricanes Harvey, Irma and Maria. This decrease is partially offset by an increase in operating income.

Net cash used in investing activities for the nine months ended September 30, 2017 primarily represents cash payments for the purchase of property and equipment. Net cash used in investing activities for the nine months ended September 30, 2016 primarily represents cash payments of $60.9 million related to the acquisition of Pramac and $20.8 million for the purchase of property and equipment. The Motortech acquisition was completed in the first quarter of 2017, but was funded in the fourth quarter of 2016.

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

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

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Contractual Obligations

In May 2017, the Company amended its Term Loan, which reduces future interest payments on the Term Loan. Refer to Note 9, “Credit Agreements,” to the condensed consolidated financial statements for further information. In addition, in October 2017, we repaid $90.0 million of the outstanding ABL Facility balance. Other than the Term Loan amendment and ABL principal payment, there have been no material changes to our contractual obligations since the February 24, 2017 filing of our Annual Report on Form 10-K for the year ended December 31, 2016.

Off-Balance Sheet Arrangements

There have been no material changes to off-balance sheet arrangements since the February 24, 2017 filing of our Annual Report on Form 10-K for the year ended December 31, 2016.

Critical Accounting Policies

There have been no material changes in our critical accounting policies since the February 24, 2017 filing of our Annual Report on Form 10-K for the year ended December 31, 2016.

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2016, in preparing the financial statements in accordance with U.S. GAAP, we are required to make estimates and assumptions that have an impact on the asset, liability, revenue and expense amounts reported. These estimates can also affect our supplemental information disclosures, including information about contingencies, risk and financial condition. We believe, given current facts and circumstances, that our estimates and assumptions are reasonable, adhere to U.S. GAAP and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. We make routine estimates and judgments in determining net realizable value of accounts receivable, inventories, property and equipment, and prepaid expenses. We believe that our most critical accounting estimates and assumptions are in the following areas: goodwill and other intangible asset impairment assessment; business combinations and purchase accounting; defined benefit pension obligations; estimates of product warranty and other contingencies; income taxes and share based compensation.

Non-GAAP Measures

Adjusted EBITDA

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

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

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
- to allocate resources to enhance the financial performance of our business;
- as a benchmark for the determination of the bonus component of compensation for our senior executives under our management incentive plan, as described further in our 2017 Proxy Statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
- in communications with our Board of Directors and investors concerning our financial performance.

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

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

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

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

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

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

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

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

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

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

(U.S. Dollars in thousands)	Three Months Ended September 30, 2017	2016	Nine Months Ended September 30, 2017	2016
Net income attributable to Generac Holdings Inc.	$39,709	$26,183	$78,211	$57,279
Net income attributable to noncontrolling interests (a)	341	(171)	433	(112)
Net income	40,050	26,012	78,644	57,167
Interest expense	10,672	11,299	32,353	33,714
Depreciation and amortization	13,108	14,900	38,691	41,343
Provision for income taxes	20,581	15,514	42,946	33,154
Non-cash write-down and other adjustments (b)	756	(1,093)	2,632	1,689
Non-cash share-based compensation expense (c)	2,584	2,419	8,402	7,805
Loss on change in contractual interest rate (d)	-	2,957	-	2,957
Transaction costs and credit facility fees (e)	234	739	970	1,499
Business optimization expenses (f)	487	58	1,933	7,164
Other	281	31	31	79
Adjusted EBITDA	88,753	72,836	206,602	186,571
Adjusted EBITDA attributable to noncontrolling interests	1,178	708	3,589	3,015
Adjusted EBITDA attributable to Generac Holdings Inc.	$87,575	$72,128	$203,013	$183,556

(a) Includes the noncontrolling interests' share of expenses related to Pramac purchase accounting, including the step-up in value of inventories and intangible amortization, of $1.2 million and $3.4 million for the three and nine months ended September 30, 2017, respectively, and $1.3 million and $6.9 million for the three and nine months ended September 30, 2016, respectively.

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

- The gains/losses on disposals of assets result from the sale of assets that are no longer useful in our business and therefore represent gains or losses that are not from our core operations;
- The adjustments for unrealized mark-to-market gains and losses on commodity contracts represent non-cash items to reflect changes in the fair value of forward contracts that have not been settled or terminated. We believe it is useful to adjust net income for these items because the charges do not represent a cash outlay in the period in which the charge is incurred, although Adjusted EBITDA must always be used together with our U.S. GAAP statements of comprehensive income and cash flows to capture the full effect of these contracts on our operating performance; and

The purchase accounting adjustments represent non-cash items to reflect fair value at the date of acquisition, and therefore do not reflect our ongoing operations.

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

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

(e) Represents transaction costs incurred directly in connection with any investment, as defined in our credit agreement, equity issuance or debt issuance or refinancing, together with certain fees relating to our senior secured credit facilities, such as administrative agent fees and credit facility commitment fees under our Term Loan and ABL Facility, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation.

(f) For the three and nine months ended September 30, 2017, represents severance and other non-recurring plant consolidation costs. For the three and nine months ended September 30, 2016, primarily represents charges relating to business optimization and restructuring costs to address the significant and extended downturn for capital spending within the oil & gas industry. These charges represent expenses that are not from our core operations and do not reflect our ongoing operations.

Adjusted Net Income

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

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

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

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

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

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

(U.S. Dollars in thousands, except share and per share data)	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net income attributable to Generac Holdings Inc.	$39,709	$26,183	$78,211	$57,279
Net income attributable to noncontrolling interests	341	(171)	433	(112)
Net income	40,050	26,012	78,644	57,167
Provision for income taxes	20,581	15,514	42,946	33,154
Income before provision for income taxes	60,631	41,526	121,590	90,321
Amortization of intangible assets	7,242	9,511	21,554	25,525
Amortization of deferred finance costs and original issue discount	1,092	1,107	2,400	3,229
Loss on change in contractual interest rate	-	2,957	-	2,957
Transaction costs and other purchase accounting adjustments (a)	(35)	469	979	5,159
Business optimization expenses	487	58	1,933	7,164
Adjusted net income before provision for income taxes	69,417	55,628	148,456	134,355
Cash income tax expense (b)	(10,878)	(2,325)	(19,607)	(5,595)
Adjusted net income	58,539	53,303	128,849	128,760

Adjusted net income attributable to noncontrolling interests	697	58	1,912	1,939
Adjusted net income attributable to Generac Holdings Inc.	$57,842	$53,245	$126,937	$126,821
Adjusted net income per common share attributable to Generac Holdings, Inc. - diluted:	$0.93	$0.82	$2.02	$1.92
Weighted average common shares outstanding - diluted:	62,316,788	65,126,117	62,703,269	65,992,127

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

(b) Amount for the three and nine months ended September 30, 2017 is based on an anticipated cash income tax rate of approximately 17% for the full year ended 2017. Amount for the three and nine months ended September 30, 2016 is based on an anticipated cash income tax rate of approximately 6% for the full year ended 2016. Cash income tax expense for the respective periods is based on the projected taxable income and corresponding cash tax rate for the full year after considering the effects of current and deferred income tax items, and is calculated for each respective period by applying the derived full year cash tax rate to the period's pretax income.

New Accounting Standards

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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Refer to Note 3, “Derivative Instruments and Hedging Activities,” to the condensed consolidated financial statements for a discussion of changes in commodity, currency and interest rate related risks and hedging activities. Otherwise, there have been no material changes in market risk from the information provided in Item 7A (Quantitative and Qualitative Disclosures About Market Risk) of our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

In March 2016, the Company acquired a 65% ownership interest in Pramac. As a result of the acquisition, we have reviewed the internal control structure of Pramac and are in the process of making appropriate changes as we incorporate our controls and procedures into the acquired business.

In October 2017, a subsidiary of the Company implemented the new global enterprise resource planning (ERP) system. In connection with that ERP system implementation, we are updating our internal controls over financial reporting for that subsidiary, as necessary, to accommodate modifications to their business processes and accounting procedures. Additional implementations are expected to occur at the Company’s remaining locations over a multi-year period.

Other than the continuing assessment of controls for the Pramac acquisition and ERP implementation noted above, there have been no changes during the three months ended September 30, 2017 in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in legal proceedings primarily involving product liability, employment matters and general commercial disputes arising in the ordinary course of our business. As of September 30, 2017, we believe that there is no litigation pending that would have a material effect on our results of operations or financial condition.

Item 1A. Risk Factors

There have been no material changes in our risk factors since the February 24, 2017 filing of our Annual Report on Form 10-K for the year ended December 31, 2016.

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

The following table summarizes our stock repurchase activity for the three months ended September 30, 2017, which also consisted of the withholding of shares upon the vesting of restricted stock awards to pay related withholding taxes on behalf of the recipient:

	Total Number of Shares Purchased	**Average Price Paid per Share**	**Total Number Of Shares Purchased As Part Of Publicly Announced Plans Or Programs**	**Approximate Dollar Value Of Shares That May Yet Be Purchased Under The Plans Or Programs**
07/01/2017 – 07/31/2017	-	-	-	170,108,876
08/01/2017 – 08/31/2017	4,713	$ 37.82	-	170,108,876
09/01/2017 – 09/30/2017	2,463	$ 43.54	-	170,108,876
Total	7,176	$ 39.79		

For equity compensation plan information, please refer to Note 15, "Share Plans," in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 6. Exhibits

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

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SIGNATURES

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

Generac Holdings Inc.

By: /s/ York A. Ragen
York A. Ragen
Chief Financial Officer
(Duly Authorized Officer and Principal Financial and

Accounting Officer)

Dated: November 6, 2017

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Item 6. EXHIBIT INDEX

Exhibits Number	Description
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14 Securities Exchange Act Rules 13a-14(a) and 15d-14(a), pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related Notes to Condensed Consolidated Financial Statements.

* Filed herewith.

** Furnished herewith.