

GENERAC HOLDINGS INC.
Form 10-Q
August 12, 2011

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 June 30, 2011

OR

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

For the transition period from to

Commission file number 001-34627

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

Delaware
(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

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any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

As of August 8, 2011, there were 67,579,525 shares of the Registrant's common stock outstanding.

GENERAC HOLDINGS INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 78,746	\$ 78,583
Accounts and notes receivable, less allowance for doubtful accounts	79,810	63,154
Inventories	139,728	127,137
Prepaid expenses and other assets	3,043	3,645
Total current assets	301,327	272,519
Property and equipment, net	74,729	75,287
Customer lists, net	77,913	96,944
Patents, net	81,055	84,933
Other intangible assets, net	5,809	6,483
Deferred financing costs, net	4,640	5,822
Trade names	140,050	140,050
Goodwill	527,136	527,148
Other assets	116	697
Total assets	\$ 1,212,775	\$ 1,209,883
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 44,736	\$ 41,809
Accrued wages and employee benefits	6,814	6,833
Other accrued liabilities	39,386	38,043
Current portion of long-term debt	-	-
Total current liabilities	90,936	86,685
Long-term debt	632,498	657,229
Other long-term liabilities	26,261	24,902
Total liabilities	749,695	768,816
Stockholders' equity:		
Common stock (formerly Class A non-voting common stock), par value \$0.01, 500,000,000 shares authorized, 67,579,525 and 67,524,596 shares issued at June 30, 2011 and December 31, 2010, respectively	675	675

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Additional paid-in capital	1,137,945	1,133,918
Excess purchase price over predecessor basis	(202,116)	(202,116)
Accumulated deficit	(461,525)	(481,658)
Accumulated other comprehensive loss	(11,899)	(9,752)
Total stockholders' equity	463,080	441,067
Total liabilities and stockholders' equity	\$ 1,212,775	\$ 1,209,883

See notes to condensed consolidated financial statements.

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

	Three Months Ended June		Six Months Ended June 30,	
	2011	30, 2010	2011	2010
Net sales	\$ 161,363	\$ 140,455	\$ 285,344	\$ 271,173
Costs of goods sold	101,010	85,710	177,814	165,010
Gross profit	60,353	54,745	107,530	106,163
Operating expenses:				
Selling and service	17,317	13,809	31,622	28,121
Research and development	3,608	3,482	7,493	7,204
General and administrative	5,772	5,679	11,889	10,838
Amortization of intangibles	11,856	12,921	23,583	25,682
Total operating expenses	38,553	35,891	74,587	71,845
Income from operations	21,800	18,854	32,943	34,318
Other (expense) income:				
Interest expense	(5,934)	(5,720)	(11,935)	(14,212)
Investment income	23	36	59	110
Write-off of deferred financing costs related to debt extinguishment	(186)	-	(186)	(4,180)
Other, net	(327)	(259)	(568)	(575)
Total other expense, net	(6,424)	(5,943)	(12,630)	(18,857)
Income before provision for income taxes	15,376	12,911	20,313	15,461
Provision for income taxes	87	77	180	159
Net income	15,289	12,834	20,133	15,302
Preferential distribution to:				
Series A preferred stockholders	-	-	-	(2,042)
Class B common stockholders	-	-	-	(12,133)
Beneficial conversion	-	-	-	(140,690)
Net income (loss) attributable to common stockholders (formerly Class A common stockholders)	\$ 15,289	\$ 12,834	\$ 20,133	\$ (139,563)
Net income (loss) per common share - basic:				
Common stock (formerly Class A common stock)	\$0.23	\$0.19	\$0.30	\$(2.71)
Class B common stock	n/a	n/a	n/a	\$505
Net income (loss) per common share - diluted:				
Common stock (formerly Class A common stock)	\$0.23	\$0.19	\$0.30	\$(2.71)
Class B common stock	n/a	n/a	n/a	\$505

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Weighted average common shares outstanding - basic:

Common stock (formerly Class A common stock)	67,134,999	67,093,250	67,121,356	51,507,358
Class B common stock	n/a	n/a	n/a	24,018

Weighted average common shares outstanding - diluted:

Common stock (formerly Class A common stock)	67,718,654	67,200,565	67,463,440	51,507,358
Class B common stock	n/a	n/a	n/a	24,018

See notes to condensed consolidated financial statements.

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

	Six Months Ended June	
	30,	
	2011	2010
Operating activities		
Net income	\$20,133	\$15,302
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,940	3,829
Amortization	23,583	25,682
Write-off of deferred financing costs related to debt extinguishment	186	4,180
Amortization of deferred financing costs	996	1,301
Provision for losses on accounts receivable	(29)	(69)
Loss on disposal of property and equipment	18	-
Share-based compensation	3,717	2,959
Net changes in operating assets and liabilities:		
Accounts receivable	(16,627)	(14,211)
Inventories	(12,591)	12,264
Other assets	1,183	1,999
Accounts payable	2,927	9,346
Accrued wages and employee benefits	(19)	(860)
Other accrued liabilities	567	(15,077)
Net cash provided by operating activities	27,984	46,645
Investing activities		
Proceeds from sale of property and equipment	4	-
Expenditures for property and equipment	(3,404)	(3,035)
Net cash used in investing activities	(3,400)	(3,035)
Financing activities		
Proceeds from issuance of common stock	-	248,309
Payment of long-term debt	(24,731)	(360,117)
Proceeds from exercise of stock options	310	-
Net cash used in financing activities	(24,421)	(111,808)
Net increase (decrease) in cash and cash equivalents	163	(68,198)
Cash and cash equivalents at beginning of period	78,583	161,307
Cash and cash equivalents at end of period	\$78,746	\$93,109

See notes to condensed consolidated financial statements

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Generac Holdings Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

Description of Business

Generac Holdings Inc. (the Company) owns all of the common stock of Generac Acquisition Corp., which in turn, owns all of the common stock of Generac Power Systems, Inc. (the Subsidiary). The Company designs, manufactures, and markets a complete line of backup power generation products for residential, light-commercial, and industrial markets.

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

The condensed consolidated balance sheet as of June 30, 2011, the condensed consolidated statements of cash flows for the six months ended June 30, 2011 and 2010, and the condensed consolidated statements of operations for the three and six months ended June 30, 2011 and 2010 have been prepared by the Company and have not been audited. In the opinion of management, all adjustments, consisting of only normal recurring adjustments necessary for the fair presentation of the financial position, results of operation and cash flows, have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

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

Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (OCI) includes unrealized losses on certain cash flow hedges and the pension liability. The components of OCI at June 30, 2011 and December 31, 2010 were (dollars in thousands):

	June 30, 2011	December 31, 2010
Pension liability	\$(5,607)	\$(5,607)
Unrealized losses on cash flow hedges	(6,292)	(4,145)

Accumulated other comprehensive loss	\$(11,899)	\$(9,752)
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Comprehensive income is comprised of the following:

	For the three months ended June 30,		For the six months ended June 30,	
	2011	2010	2011	2010
Net earnings	\$ 15,289	\$ 12,834	\$ 20,133	\$ 15,302
Net unrealized loss on cash flow hedges	(2,702)	(1,961)	(2,147)	(3,110)
Balance at end of period	\$ 12,587	\$ 10,873	\$ 17,986	\$ 12,192

2. Derivative Instruments and Hedging Activities

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

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Commodities

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

The Company primarily utilizes commodity contracts with maturities of less than 12 months. These are intended to offset the effect of price fluctuations on actual inventory purchases. There were three outstanding commodity contracts in place to hedge the Company's projected commodity purchases at June 30, 2011. There was one outstanding commodity contract in place to hedge the Company's projected commodity purchases at December 31, 2010. In November 2010, the Company entered into a commodity forward contract to purchase \$2,296,000 of copper. The swap was effective from January 1, 2011, and terminated on April 30, 2011. In February 2011, the Company entered into a commodity forward contract to purchase a notional amount of \$2,378,000 of copper. The contract is effective from March 1, 2011, and terminates on December 31, 2011. In March 2011, the Company entered into commodity forward contracts to purchase a notional amount of \$2,100,000 of copper. The contract is effective from April 1, 2011, and terminates on December 31, 2011. In May 2011, the Company entered into commodity forward contracts to purchase a notional amount of \$1,808,000 of copper. The contract is effective from May 5, 2011, and terminates on December 31, 2011. Total gains and losses recognized in the consolidated statements of operations on commodity contracts were gains of \$15,000 and \$14,000 for the three and six months ended June 30, 2011 and losses of \$181,000 and \$196,000 for the three and six months ended June 30, 2010, respectively.

Foreign Currencies

The Company is exposed to foreign currency exchange risk as a result of transactions in other currencies. The Company periodically utilizes foreign currency forward purchase and sales contracts to manage the volatility associated with foreign currency purchases in the normal course of business. Contracts typically have maturities of one year or less.

There were no foreign currency hedge contracts outstanding during the three and six month period ending June 30, 2011. The Company had one foreign currency hedge contract in place at June 30, 2010. The primary objective of that transaction was to mitigate the impact of potential currency fluctuations of the Euro on our financial results. The impact on operations for the three and six months ended June 30, 2010 was a loss of \$209,000.

Interest Rates

We have four interest rate swap agreements outstanding as of June 30, 2011. In 2010, the Company entered into two new interest rate swap agreements. The first was entered into on January 21, 2010. The effective date of this swap was July 1, 2010 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.73% and an expiration date of July 1, 2012. The second was entered into on June 29, 2010. The effective date of that swap was October 1, 2010 with a notional amount of \$100,000,000, a fixed LIBOR rate of 1.025% and an expiration date of October 1, 2012. The Company entered into two new interest rate swap agreements on April 1, 2011. The effective date of the first swap is July 1, 2012 with a notional amount of \$200,000,000, a fixed LIBOR rate of 1.905% and an expiration date of July 1, 2013. The effective date of the second swap is October 1, 2012 with a notional amount of \$100,000,000, a fixed LIBOR rate of 2.22% and an expiration date of October 1, 2013. We maintain the swaps as highly effective in

accordance with ASC 815 (formerly SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities) and, therefore, any changes in the fair value of the swap would be recorded in accumulated other comprehensive income (loss).

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

	June 30, 2011	December 31, 2010
Derivatives designated as hedging instruments:		
Interest rate swaps	\$(6,292)	\$ (4,145)
	(6,292)	(4,145)
Derivatives not designated as hedging instruments:		
Commodity contracts	42	627
Total derivatives liability	\$(6,250)	\$ (3,518)

As of June 30, 2011 and December 31, 2010, all derivatives that are not designated as hedging instruments are included in other assets in the condensed consolidated balance sheet. As of June 30, 2011 and December 31, 2010, all derivatives designated as hedging instruments are included in other long-term liabilities in the condensed consolidated balance sheet.

The fair value of the derivative contracts considers the Company's credit risk as of June 30, 2011 and December 31, 2010, respectively. Excluding the impact of credit risk, the fair value of the derivatives at June 30, 2011 and December 31, 2010 was a \$6,393,000 and a \$3,642,000 net liability, respectively, which represented the amount the Company would need to pay to exit the agreements on those dates.

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The following presents the impact of interest rate swaps, commodity contracts and foreign currency contracts on the condensed consolidated statement of operations for the six months ended June 30, 2011 and 2010 (dollars in thousands):

	Amount of gain (loss) recognized in AOCI for the six months ended June 30,		Location of gain (loss) reclassified from AOCI into net income (loss)	Amount of loss reclassified from AOCI into net income (loss) for the six months ended June 30,		Amount of gain (loss) recognized in net income (loss) on hedges (ineffective portion) for six months ended June 30,	
	2011	2010		2011	2010	2011	2010
Derivatives designated as hedging instruments							
	I n t e r e s t						
Interest rate swaps	\$ (2,147)	\$ (3,110)	expense	\$ —	\$ —	\$ —	\$ —
Derivatives not designated as hedging instruments							
Commodity and foreign currency contracts	—	—	C o s t o f goods sold	—	—	14	(405)

3. Fair Value Measurements

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

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

The Company believes the carrying amount of its financial instruments (cash and cash equivalents, accounts receivable, notes receivable, accounts payable, and accrued liabilities), excluding long-term debt, approximates the fair value of these instruments based upon their short-term nature. The fair value of long-term debt was approximately \$629,335,000 (level 2) at June 30, 2011, as calculated based on current quotations.

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

		Fair Value Measurement Using	
		Quoted Prices in Active Markets for Identical Contracts (Level 1)	Significant Other Observable Inputs (Level 2)
	Total June 30, 2011		
Interest rate swaps	\$ (6,292)	\$ -	\$ (6,292)
Commodity and foreign currency contracts	\$ 42	\$ -	\$ 42

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

The valuation techniques used to measure the fair value of derivative contracts classified as level 2, all of which have counterparties with high credit ratings, were valued based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data. The fair value of derivative contracts above takes into account the Company's credit risk in accordance with ASC 820-10.

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4. Segment Reporting

The Company operates in and reports as a single operating segment, which is the manufacture and sale of power products. Net sales are predominantly generated through the sale of generators and service parts to distributors and retailers. The Company manages and evaluates its operations as one segment primarily due to similarities in the nature of the products, production processes and methods of distribution. All of the Company's identifiable assets are located in the United States. The Company's sales outside North America represent approximately 1% of net sales.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Residential power products	\$92,206	\$87,867	\$161,392	\$171,866
Industrial/Commercial power products	57,322	43,308	101,632	81,626
Other	11,835	9,280	22,320	17,681
Total	\$161,363	\$140,455	\$285,344	\$271,173

5. Balance Sheet Details

Inventories consist of the following (dollars in thousands):

	June 30, 2011	December 31, 2010
Raw material	\$82,096	\$66,936
Work-in-process	389	315
Finished goods	61,558	63,945
Reserves for excess and obsolescence	(4,315)	(4,059)
	\$139,728	\$127,137

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

	June 30, 2011	December 31, 2010
Land and improvements	\$3,950	\$3,950
Buildings and improvements	49,227	48,986
Leasehold improvements	4	—
Machinery and equipment	34,771	32,672
Dies and tools	12,040	11,301
Vehicles	804	827
Office equipment	7,120	6,836
Gross property and equipment	107,916	104,572
Less accumulated depreciation	(33,187)	(29,285)

Property and equipment, net	\$74,729	\$75,287
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Other accrued liabilities consist of the following (dollars in thousands):

	June 30, 2011	December 31, 2010
Accrued commissions	\$5,037	\$4,578
Accrued interest	4,795	5,018
Accrued warranties – short term	19,205	17,155
Other accrued liabilities	10,349	11,292
	\$39,386	\$38,043

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6. Product Warranty Obligations

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

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

	For the three months ended June 30,		For the six months ended June 30,	
	2011	2010	2011	2010
Balance at beginning of period	\$22,250	\$20,774	\$22,478	\$20,729
Payments, net of extended warranties	(2,769)	(3,007)	(6,427)	(6,333)
Charged to operations	5,047	3,411	8,477	6,782
Balance at end of period	\$24,528	\$21,178	\$24,528	\$21,178

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

	June 30, 2011	December 31, 2010
Other accrued liabilities	\$19,205	\$17,155
Other long-term liabilities	5,323	5,323
Balance at end of period	\$24,528	\$22,478

7. Credit Agreements

Long-term debt consists of the following (dollars in thousands):

	June 30, 2011	December 31, 2010
First lien term loan	\$639,372	\$664,372
Less: treasury debt – first lien	(6,874)	(7,143)
	\$632,498	\$657,229

At June 30, 2011 and December 31, 2010, the Company had a credit agreement which provided for borrowings under a revolving credit facility (the Revolving Credit Facility) and a first lien term loan (collectively, the Credit Agreement). The Credit Agreement of the Company is secured by the associated collateral agreements which pledge virtually all assets of the Subsidiary. The Credit Agreement requires the Company, among other things, to meet certain financial and nonfinancial covenants and maintain financial ratios in such amounts and for such periods as set forth therein. The Company is required to maintain a leverage ratio (net debt (debt less cash and cash equivalents) divided by EBITDA, as defined in the Credit Agreement) of 5.50 as of June 30, 2011. The leverage ratio decreases quarterly, and for 2011, the Company has been or will be required to maintain a leverage ratio of 5.75, 5.50, 5.25, and 4.75 for the first, second, third, and fourth quarters, respectively. The Company was in compliance with all requirements as of June 30, 2011 and December 31, 2010.

The Credit Agreement restricts the circumstances in which distributions and dividends can be paid by its Subsidiary. Payments can be made to the Company for certain expenses, and dividends can be used to repurchase equity interests, subject to an annual limitation. Additionally, the Credit Agreement restricts the aggregate amount of dividends and distributions that can be paid and requires the maintenance of certain leverage ratios in order to pay certain dividends or distributions.

A voluntary debt repayment of \$24,731,000 was made in April 2011. At that time the Company wrote off \$186,000 of deferred financing costs.

8. Earnings Per Share

The Company's capitalization prior to its' initial public offering (completed on February 17, 2010) consisted of Series A Preferred Stock, Class B Common Stock and Class A Common Stock. The Series A Preferred stock and Class B Common stock were redeemable in a deemed liquidation in the event of a change of control. The redemption features were considered to be outside the control of the Company and therefore, all shares of Series A Preferred stock and Class B Common stock were recorded outside of permanent equity in accordance with guidance originally issued under EITF Topic D-98, Classification and Measurement of Redeemable Securities (codified under Accounting Standards Codification 480, Distinguishing Liabilities from Equity). Upon closing of the IPO, all shares of convertible Class B Common stock and Series A preferred stock were automatically converted into 88,476,530 and 19,511,018 Class A Common shares, respectively. The 88,476,530 shares of Class A Common stock were subject to a 3.294 for 1 reverse stock split, resulting in 26,859,906 Class A Common shares relative to the Class B Common stock conversion, and the Class A Common stock was re-designated as "Common Stock". Subsequent to the IPO, the Company has one class of common stock. The share and per share data used in basic and diluted earnings per share has been retrospectively restated to reflect only the 3.294 for 1 reverse stock split immediately prior to the IPO.

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

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

For the six month period ended June 30, 2010, diluted earnings per share are identical to basic earnings per share because the impact of common stock equivalents on earnings per share is anti-dilutive. Had the impact not been anti-dilutive, the effect of stock compensation awards on weighted average diluted shares outstanding would have been 177,664 shares.

(Dollars in Thousands, Except Share and Per Share Data)	Three months ended June		Six months ended June 30,	
	2011	30, 2010	2011	2010
Net income	\$15,289	\$12,834	\$20,133	\$15,302
Less: accretion of Series A Preferred stock	-	-	-	(2,042)
Less: accretion of Class B Common stock	-	-	-	(12,133)
Less: beneficial conversion	-	-	-	(140,690)
Net income (loss) attributable to Common stock (formerly Class A Common stock)	15,289	12,834	20,133	(139,563)
Income attributable to Class B Common stock	-	-	-	12,133
Net income (loss) per common share - basic:				
Common stock (formerly Class A Common stock)	\$0.23	\$0.19	\$0.30	\$(2.71)
Class B Common stock	n/a	n/a	n/a	505
Net income (loss) per common share - diluted:				
Common stock (formerly Class A Common stock)	\$0.23	\$0.19	\$0.30	\$(2.71)
Class B Common stock	n/a	n/a	n/a	505
Weighted average number of shares outstanding –				
Common Stock (formerly Class A Common stock):				
Basic	67,134,999	67,093,250	67,121,356	51,507,358
Dilutive effect of stock compensation awards	583,655	107,315	342,084	-
Diluted	67,718,654	67,200,565	67,463,440	51,507,358
Weighted average number of shares outstanding – Class B				
Common stock – basic and diluted:	n/a	n/a	n/a	24,018

The Series A Preferred and Class B Common stock were only convertible to Class A Common stock immediately prior to an initial public offering. The number of shares of Class A Common stock that were issued upon conversion of the Series A Preferred and Class B Common stock was dependent upon the initial public offering price of the Class A Common stock on the date of conversion of February 10, 2010 as well as the unpaid priority return as of that date.

9. Income Taxes

The Company is currently in a three year cumulative net loss position, due primarily to a goodwill and tradename impairment write-off in 2008, and therefore has not considered expected future taxable income in analyzing the realizability of the Company's deferred tax assets as of June 30, 2011. As a result of this analysis, we have recorded a full valuation allowance against these net deferred tax assets.

10. Benefit Plans

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

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Components of net periodic pension expense:				
Service cost	\$-	\$-	\$-	\$-
Interest cost	592	590	1,184	1,180
Expected return on plan assets	(586)	(501)	(1,171)	(1,002)
Amortization of net loss	68	62	137	122
Net periodic pension expense	\$74	\$151	\$150	\$300

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11. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for selected dealers. The Company receives payment from the finance company after shipment of product to the dealer. The Company participates in the cost of dealer financing up to certain limits. The Company has agreed to repurchase products repossessed by the finance company, but does not indemnify the finance company for any credit losses they incur. The amount financed by dealers which remained outstanding under this arrangement at June 30, 2011 and December 31, 2010 was approximately \$10,390,000 and \$9,735,000, respectively.

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

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

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

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

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

- demand for our products;
- frequency of major power outages;
- availability and cost of quality raw materials and key components used in producing our products;

- competitive factors in the industry in which we operate;
 - our dependence on our distribution network;
- our ability to invest in, develop or adapt to changing technologies and manufacturing techniques;
 - our ability to adjust to operating as a public company;
 - loss of our key management and employees;
 - increase in liability claims; and
- changes in environmental, health and safety laws and regulations.

Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual results may vary in material respects from those projected in these forward-looking statements. A detailed discussion of these and other factors that may affect future results is contained in Generac's filings with the Securities and Exchange Commission, including in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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

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Overview

We are a leading designer and manufacturer of a wide range of backup power generation products for the residential, commercial and industrial markets. We are the only significant market participant focused predominantly on these products, and we have one of the leading market positions in the standby generator market in the United States and Canada. We design, engineer and manufacture generators with an output of between 800W and 9mW of power. We design, manufacture, source and modify engines, alternators, automatic transfer switches and other components necessary for our products. Our generators are fueled by natural gas, liquid propane, gasoline, diesel and Bi-Fuel™. Our products are available through a broad network of independent dealers, retailers and wholesalers.

Business drivers and measures

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

Industry trends

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

Increasing penetration opportunity. Although there have been recent increases in product costs for installed standby generators in the residential and light-commercial markets (driven in the last two years by raw material costs), these costs have declined overall over the last decade, and many potential customers are not aware of the costs and benefits of backup power solutions. We estimate that penetration rates for residential products are approximately 2% of U.S. single-family detached, owner-occupied households with a home value of over \$100,000, as defined by the U.S. Census Bureau's 2009 American Housing Survey for the United States, and penetration rates of many light-commercial outlets such as restaurants, drug stores, and gas stations are significantly lower than penetration of hospitals and industrial locations. We believe that by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby generators.

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

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

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

Operational factors

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

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

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

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Other factors

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

Factors influencing interest expense. Interest expense can be impacted by a variety of factors, including market fluctuations in LIBOR, interest rate election periods, interest rate swap agreements and repayments of indebtedness. Interest expense has decreased in the first six months of 2011 versus 2010, partly due to repayments of indebtedness with net proceeds from our initial public offering during the first quarter of 2010, together with additional repayments of debt in the first quarter of 2010, fourth quarter of 2010 and second quarter of 2011 with available cash on hand. Offsetting this decline in interest expense, we entered into certain interest rate swap agreements effective in the third and fourth quarters of 2010 which will mitigate the risk of interest rate volatility on a portion of our debt, but at rates higher than prior year.

Factors influencing provision for income taxes. We have \$1.3 billion of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2010 that we expect to generate cash tax savings of \$510 million through 2021, assuming continued profitability and a 38.5% tax rate. The amortization of these assets for tax purposes is expected to be \$122 million annually through 2020 and \$102 million in 2021, which generates annual cash tax savings of \$47 million through 2020 and \$39 million in 2021, assuming profitability and a 38.5% tax rate. Additionally, we have federal net operating loss, or NOL, carry-forwards of \$166.1 million as of December 31, 2010, which we expect to generate an additional \$58 million of federal cash tax savings at a 35% rate when and if utilized. Based on current business plans, we believe that our cash tax obligations through 2021 will be significantly reduced by these tax attributes. However, any subsequent accumulations of common stock ownership leading to a change of control under Section 382 of the U.S. Internal Revenue Code of 1986, including through sales of stock by large stockholders, all of which are outside of our control, could limit and defer our ability to utilize our net operating loss carry-forwards to offset future federal income tax liabilities.

Seasonality. Although there is demand for our products throughout the year, in each of the past three years approximately 20% to 24% of our net sales occurred in the first quarter, 22% to 25% in the second quarter, 25% to 29% in the third quarter and 26% to 30% in the fourth quarter, with different seasonality depending on the timing of major power outage activity in each year. We maintain a flexible production schedule in order to respond to outage-driven peak demand, but typically increase production levels in the second and third quarters of each year.

Results of operations

Quarter and six months ended June 30, 2011 compared to quarter and six months ended June 30, 2010

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

(dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net Sales	\$161,363	\$140,455	\$285,344	\$271,173
Cost of Goods Sold	101,010	85,710	177,814	165,010
Gross profit	60,353	54,745	107,530	106,163
Operating Expenses:				
Selling and service	17,317	13,809	31,622	28,121
Research and development	3,608	3,482	7,493	7,204
General and administrative	5,772	5,679	11,889	10,838
Amortization of intangibles	11,856	12,921	23,583	25,682

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Total operating expenses	38,553	35,891	74,587	71,845
Income from operations	21,800	18,854	32,943	34,318
Total other expense, net	(6,424)	(5,943)	(12,630)	(18,857)
Income before provision for income taxes	15,376	12,911	20,313	15,461
Provision for income taxes	87	77	180	159
Net income	\$15,289	\$12,834	\$20,133	\$15,302
Residential products	\$92,206	\$87,867	\$161,392	\$171,866
Industrial & Commercial products	57,322	43,308	101,632	81,626
Other	11,835	9,280	22,320	17,681
Net sales	\$161,363	\$140,455	\$285,344	\$271,173

Net sales. Net sales increased \$20.9 million, or 14.9%, to \$161.4 million for the three months ended June 30, 2011 from \$140.5 million for the three months ended June 30, 2010. Residential products increased \$4.3 million, or 4.9%, primarily due to continued expansion of our distribution network, increased awareness of home standby products and new product offerings, partially offset by a slight decline in sales for lower kilowatt portable generators. In addition, industrial and commercial product sales increased \$14.0 million, or 32.4%, driven by strengthened demand from our national account customers and improved quote-to-order conversion rates for our large industrial systems.

Net sales increased \$14.2 million, or 5.2%, to \$285.3 million for the six months ended June 30, 2011 from \$271.2 million for the six months ended June 30, 2010. Residential product sales decreased \$10.5 million, or 6.1%, mainly due to a decline in demand for lower kilowatt portable generators as a result of less severe power outages during the first quarter compared to the prior year and higher inventory levels in the channel coming into the year. Offsetting this decline, industrial and commercial product sales increased \$20.0 million, or 24.5%, for the same reasons described in the second quarter above.

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Costs of goods sold. Costs of goods sold increased \$15.3 million, or 17.9%, to \$101.0 million for the three months ended June 30, 2011 from \$85.7 million for the three months ended June 30, 2010. Raw material costs increased \$14.7 million year-over-year due to an increase in sales volume and higher commodity costs incurred during the current year quarter, primarily steel, copper and aluminum. Direct labor, overhead, and inbound freight costs also increased \$0.6 million, year over year, resulting from the increase in sales volume.

Costs of goods sold increased \$12.8 million, or 7.8%, to \$177.8 million for the six months ended June 30, 2011 from \$165.0 million for the six months ended June 30, 2010. Raw material costs increased \$13.9 million year-over-year for the same reasons described above with respect to the second quarter. Inbound freight costs, direct labor and variable overhead costs decreased \$1.1 million year-over-year.

Gross profit. Gross profit increased \$5.6 million, or 10.2%, to \$60.4 million for the three months ended June 30, 2011 from \$54.7 million for the three months ended June 30, 2010, primarily due to the overall increase in sales volume, offset by a continued increase in commodity costs and a sales mix shift towards more industrial products during the three months ended June 30, 2011 versus the prior year quarter. As a percent of net sales, gross profit margin for the second quarter of 2011 decreased to 37.4% from 39.0% in the same period last year, attributable to the aforementioned commodity cost increases and sales mix shift. The impact of increasing commodity levels was partially offset by selective price increases that were implemented during the first quarter of 2011.

Gross profit increased \$1.4 million, or 1.3%, to \$107.5 million for the six months ended June 30, 2011 from \$106.2 million for the six months ended June 30, 2010, primarily due to the factors affecting sales and cost of goods sold described above. As a percent of net sales, gross profit margin for the six months ended June 30, 2011 was 37.7%, decreasing 1.4% from the same period last year.

Operating expenses. Operating expenses increased \$2.7 million, or 7.4%, to \$38.6 million for the three months ended June 30, 2011 from \$35.9 million for the three months ended June 30, 2010. Selling and service expenses increased \$3.5 million due to higher variable expenses on higher sales volumes versus prior year, along with additional sales and marketing infrastructure expenditures to support our long term strategic plan. These increases were partially offset by a \$1.1 million decrease in amortization of intangibles due to certain definite lived intangible assets that became fully amortized at the end of 2010. As a percent of net sales, and excluding amortization of intangibles, operating expenses for the second quarter of 2011 were 16.5%, which was relatively consistent with prior year.

Operating expenses increased \$2.7 million, or 3.8%, to \$74.6 million for the six months ended June 30, 2011 from \$71.8 million for the six months ended June 30, 2010. Selling and service expenses increased \$3.5 million due to the same reasons as described in the second quarter above. General and administrative expenses increased \$1.1 million mainly due to \$0.8 million of higher share-based compensation expense recorded during the first quarter of 2011 compared to the first quarter of 2010 for the time vesting of stock awards. These increases were offset by a \$2.1 million decrease in amortization of intangibles due to certain definite lived intangible assets that became fully amortized at the end of 2010. As a percent of net sales, and excluding amortization of intangibles, operating expenses for the six months ended June 30, 2011 were 17.9% compared to 17.0% for the prior year period. The aforementioned increases in infrastructure and share-based compensation expense compared to prior year helped contribute to this increase as a percent of net sales.

Other expense. Other expense increased \$0.5 million, or 8.1%, to \$6.4 million for the three months ended June 30, 2011 from \$5.9 million for the three months ended June 30, 2010. Interest expense increased \$0.2 million versus prior year due to the impact of interest rate swaps effective during the third and fourth quarters of 2010. The increase in interest expense related to these interest rate swaps was partially offset by nearly \$100 million of debt repayments during the fourth quarter of 2010 and second quarter of 2011. The repayment of debt during the second quarter of

2011 resulted in an acceleration of deferred financing cost amortization of \$0.2 million that did not occur in the second quarter of 2010.

Other expense decreased \$6.2 million, or 33.0%, to \$12.6 million for the six months ended June 30, 2011 from \$18.9 million for the six months ended June 30, 2010. Interest expense decreased \$2.3 million due to the repayment of debt, partially offset by the impact of interest rate swaps effective during the third and fourth quarters of 2010. During the six months ended June 30, 2011, the repayment of debt resulted in an acceleration of deferred financing cost amortization of \$0.2 million. During the six months ended June 30, 2010, the repayment of debt following our IPO resulted in an acceleration of deferred financing cost amortization of \$4.2 million.

Provision for income taxes. Income tax expense was \$0.1 million for both the three months ended June 30, 2011 and 2010. Income tax expense primarily relates to certain state income taxes based on profitability measures other than net income.

Income tax expense was \$0.2 million for both the six months ended June 30, 2011 and 2010. Income tax expense primarily relates to certain state income taxes based on profitability measures other than net income.

Net income. As a result of the factors identified above, we generated net income of \$15.3 million for the three months ended June 30, 2011 compared to \$12.8 million for the three months ended June 30, 2010.

As a result of the factors identified above, we generated net income of \$20.1 million for the six months ended June 30, 2011 compared to \$15.3 million for the six months ended June 30, 2010.

Adjusted EBITDA. Adjusted EBITDA, as defined in the accompanying reconciliation schedules, increased \$1.7 million, or 4.6%, to \$37.6 million for the three months ended June 30, 2011 from \$36.0 million for the three months ended June 30, 2010. Adjusted EBITDA, decreased to \$65.1 million for the six months ended June 30, 2011 from \$67.8 million for the six months ended June 30, 2010.

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Adjusted Net income. Adjusted net income, as defined in the accompanying reconciliation schedules, of \$27.7 million for the three months ended June 30, 2011 increased 5.8% from \$26.1 million for the three months ended June 30, 2010. Adjusted net income of \$44.8 million for the six months ended June 30, 2011 decreased 3.3% from \$46.3 million for the six months ended June 30, 2010.

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

Liquidity and financial condition

Our primary cash requirements include payment for our raw material and component supplies, salaries & benefits, operating expenses, interest and principal payments on our debt, and capital expenditures. We finance our operations primarily through cash flow from operations and, if necessary, borrowings under our revolving credit facility. In November 2006, Generac Power Systems entered into a seven-year \$950.0 million first lien term loan, a seven-and-a-half year \$430.0 million second lien term loan, and a six-year \$150.0 million revolving credit facility. On February 17, 2010, we used approximately \$221.6 million of the net proceeds of our initial public offering to pay down our second lien term loan in full and to repay a portion of our first lien term loan. In March 2010, December 2010, and April 2011, we used a substantial portion of our cash and cash equivalents on hand to repay an additional \$138.5 million, \$74.2 million, and 24.7 million, respectively, of our first lien term loan. As a result of these debt pay downs, the outstanding balance on the first lien credit facility has been reduced to \$632.5 million as of June 30, 2011, and our second lien credit facility has been repaid in full and terminated.

At June 30, 2011, we had cash and cash equivalents of \$78.7 million and \$145.8 million of availability under our revolving credit facility, net of outstanding letters of credit.

Long-term liquidity

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

Six months ended June 30, 2011 compared to Six months ended June 30, 2010

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

(Dollars in thousands)	Six months ended		\$ Change	% Change
	2011	2010		
Net cash provided by operating activities	\$27,984	\$46,645	\$(18,661)	(40) %
Net cash used in investing activities	\$(3,400)	\$(3,035)	\$(365)	12 %
Net cash used in financing activities	\$(24,421)	\$(111,808)	\$87,387	(78) %

Net cash provided by operating activities was \$28.0 million for the six months ended June 30, 2011 compared to \$46.6 million for the six months ended June 30, 2010. This year-over-year reduction in net cash provided by operating activities was the result of an increase in working capital needs, primarily related to a temporary increase in inventory levels compared to prior year.

Net cash used in investing activities for the six months ended was \$3.4 million and \$3.0 million for June 30, 2011 and 2010, respectively, mainly related to the purchase of property and equipment.

Net cash provided by financing activities was \$24.4 million for the six months ended June 30, 2011, representing a \$24.7 million repayment of our term loans in the second quarter of 2011, offset by \$0.3 million in proceeds from the exercise of stock options. Net cash used in financing activities was \$111.8 million for the six months ended June 30, 2010. During the six months ended June 30, 2010, we received approximately \$248.3 million of net proceeds from our IPO, which was offset by a \$360.1 million subsequent repayment of our term loans.

Contractual Obligations

Other than with respect to the April 2011 repayment of \$24.7 million on our first lien term loans, there have been no material changes to our contractual obligations since the March 7, 2011 filing of our 2010 Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Off-balance sheet arrangements

There have been no material changes with regards to off-balance sheet arrangements since the March 7, 2011 filing of our 2010 Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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Critical accounting policies

There have been no material changes in our critical accounting policies since the March 7, 2011 filing of our 2010 Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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

Non-GAAP measures

Adjusted EBITDA

Adjusted EBITDA represents net income before interest expense, taxes, depreciation and amortization, as further adjusted for the other items reflected in the reconciliation table set forth below. This presentation is substantially consistent with the presentation used in our senior secured credit facilities (Covenant EBITDA), except that we do not give effect to certain additional adjustments that are permitted under those facilities which, if included, would increase the amount reflected in this table.

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

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
 - to allocate resources to enhance the financial performance of our business;
- 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 2011 Proxy Statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
 - in communications with our board of directors and investors concerning our financial performance.

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

understanding of our results of operations and the factors and trends affecting our business. We believe Adjusted EBITDA is useful to investors for the following reasons:

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

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

- we do not consider indicative of our ongoing operating performance, such as non-cash impairment and other charges, transaction costs relating to the CCMP Transactions and to repurchases of our debt by affiliates of CCMP, non-cash gains and write-offs relating to the retirement of debt, severance costs and other restructuring-related business optimization expenses;

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- we believe to be akin to, or associated with, interest expense, such as administrative agent fees, revolving credit facility commitment fees and letter of credit fees;
- are non-cash in nature, such as share-based compensation; or
- were eliminated following the consummation of our initial public offering, such as sponsor fees.

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

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

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

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

as an additional limitation on the use of Adjusted EBITDA as an analytical tool.

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

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

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net income	\$15,289	\$12,834	\$20,133	\$15,302
Interest expense	5,934	5,720	11,935	14,212
Depreciation and amortization	13,860	14,859	27,523	29,511
Income taxes provision	87	77	180	159
Non-cash impairment and other charges (a)	158	415	604	564
Non-cash share based compensation expense (b)	1,717	1,713	3,717	2,959
Write-off of deferred financing costs related to debt extinguishment (c)	186	-	186	4,180
Transaction costs and credit facility fees (d)	258	305	431	667
Business optimization expenses (e)	77	-	298	108
Sponsor fees (f)	-	-	-	56
Letter of credit fees (g)	(13)	19	(11)	