BIO KEY INTERNATIONAL INC
Form 10-Q
November 13, 2009
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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

or

o TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT

For the Transition Period from to

Commission file number 1-13463

BIO-KEY INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**41-1741861**

(State or Other Jurisdiction of Incorporation of Organization)	(IRS Employer Identification Number)

3349 HIGHWAY 138, BUILDING D, SUITE B, WALL, NJ 07719

(Address of Principal Executive Offices)

(732) 359-1100

(Issuer s Telephone Number)

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 x No o

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

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 o	Accelerated filer o
Non-accelerated filer o	Smaller Reporting Company x

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

Number of shares of Common Stock, $.0001 par value per share, outstanding as of November 13, 2009 were 77,244,711.

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PART I FINANCIAL INFORMATION

FINANCIAL STATEMENTS BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS

		September 30, 2009 (Unaudited)		December 31, 2008
ASSETS				
Cash and cash equivalents	$	904,598	$	1,712,912
Accounts receivable, net of allowance for doubtful accounts of $39,546 at September 30, 2009 and $5,845 at December 31, 2008		174,917		96,131
Inventory		22,277		13,159
Prepaid expenses		56,127		54,843
Continuing operations total current assets		1,157,919		1,877,045
Discontinued operations total current assets		963,916		810,708
Equipment and leasehold improvements, net		52,614		25,677
Deposits and other assets		8,711		7,812
Restricted cash		40,500		40,500
Intangible assets less accumulated amortization		233,272		251,812
Continuing operations total non-current assets		335,097		325,801
Discontinued operations non-current assets		7,874,357		8,234,436
TOTAL ASSETS	$	10,331,289	$	11,247,990
LIABILITIES				
Accounts payable	$	416,212	$	252,213
Accrued liabilities		892,882		663,567
Note payable		2,082,460		
Deferred revenue		199,786		677,966
Continuing operations total current liabilities		3,591,340		1,593,746
Discontinued operations total current liabilities		3,949,002		5,196,805
Warrants		152,451		12,317
Redeemable preferred stock derivatives		17,475		439
Deferred revenue		11,524		
Continuing operations total non-current liabilities		181,450		12,756
Discontinued operations total non-current liabilities		62,213		19,892
TOTAL LIABILITIES		7,784,005		6,823,199
Commitments and contingencies				
Series B redeemable convertible preferred stock: authorized, 1,000,000 shares (liquidation preference of $1 per share); issued and outstanding 970,612 shares of $.0001 par value at September 30, 2009 and 970,612 at December 31, 2008		469,550		1,008,224
Series C redeemable convertible preferred stock: authorized, 600,000 shares (liquidation preference of $10 per share); issued and outstanding 592,032 shares of $.0001 par value at September 30, 2009 and 592,032 at December 31, 2008		4,063,666		6,498,516
		4,533,216		7,506,740
STOCKHOLDERS DEFICIT:				
Series A convertible preferred stock: authorized, 100,000 shares (liquidation preference of $100 per share); issued and outstanding 30,557 shares of $.0001 par value, at September 30, 2009 and December 31, 2008		3		3

Common stock authorized, 170,000,000 shares; issued and outstanding; 75,098,235 and 67,876,880 of $.0001 par value at September 30, 2009 and December 31, 2008, respectively		7,510		6,788
Additional paid-in capital		52,494,989		51,692,103
Accumulated deficit		(54,488,434)		(54,780,843)
TOTAL STOCKHOLDERS DEFICIT		(1,985,932)		(3,081,949)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	$	10,331,289	$	11,247,990

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

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BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Revenues				
License fees and other	$ 435,872	$ 394,807	$ 1,039,247	$ 1,889,156
Service	88,479	58,121	303,983	137,667
	524,351	452,928	1,343,230	2,026,823
Costs and other expenses				
Cost of license fees and other	179,286	80,751	352,088	148,472
Cost of Service	15,499	17,540	48,208	36,911
	194,785	98,291	400,296	185,383
Gross Profit	329,566	354,637	942,934	1,841.440
Operating Expenses				
Selling, general and administrative	749,771	863,240	2,474,986	2,639,630
Research, development and engineering	245,318	238,915	719,095	769,147
	995,089	1,102,155	3,194,081	3,408,777
Operating loss	(665,523)	(747,518)	(2,251,147)	(1,567,337)
Other income (expenses)				
Derivative and warrant fair value adjustments	(102,193)	73,600	(157,170)	62,426
Interest income	405	42	405	1,339
Interest expense		(746)		(3,419)
Investment Income		118,631		118,631
Other	(3,774)	(740)	(7,148)	(16,882)
	(105,562)	190,787	(163,913)	162,095
Loss from continuing operations	(771,085)	(556,731)	(2,415,060)	(1,405,242)
Income from discontinued operations	701,674	511,763	2,707,468	612,861
Net income (loss)	$ (69,411)	$ (44,968)	$ 292,408	$ (792,381)
Basic and Diluted Earnings per Common Share:				
Income (loss) from continuing operations	$ (0.01)	$ (0.02)	$ (0.05)	$ (0.04)
Income (loss) from discontinued operations	0.01	0.01	0.04	0.01
Net income (loss)	$ 0.00	$ (0.01)	$ (0.01)	$ (0.03)
Weighted Average Shares Outstanding:				
Basic	73,521,550	64,913,843	71,115,231	63,299,532
Diluted	74,892,822	64,913,843	72,432,503	63,299,532

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

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BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2009	2008
CASH FLOW FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 292,408	$ (792,381)
Less:		
Income (loss) from discontinued operations	2,707,468	(612,861)
Loss from continuing operations	(2,415,060)	(1,405,242)
Adjustments to reconcile net loss to cash used in operating activities:		
Derivative and warrant fair value adjustments	157,170	(62,426)
Depreciation	17,875	15,547
Amortization		
Intangible assets	18,540	9,444
Allowance for doubtful receivables	33,701	13,813
Share-based compensation	69,419	265,753
Change in assets and liabilities:		
Accounts receivable trade	(112,487)	79,287
Inventory	(9,118)	(12,008)
Prepaid expenses and other	(1,284)	8,401
Accounts payable	163,999	(287,331)
Accrued liabilities	185,355	(44,272)
Deferred revenue	(466,656)	(306,426)
Net cash used for continuing operations	(2,358,546)	(1,112,599)
Net cash provided by discontinued operations	1,720,306	730,034
Net cash used for operating activities	(638,240)	(382,565)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(25,085)	(1,361)
Deposits	(899)	(922)
Transfer of funds from restricted cash		112,594
Proceeds from sale of assets		10,530
Net cash provided by (used for) continuing operations	(25,984)	120,841
Net cash provided by (used for) discontinued operations	(24,423)	414,247
Net cash provided by (used for) investing activities	(50,407)	535,088
CASH FLOW FROM FINANCING ACTIVITIES:		
Issuance of short-term obligations	1,000,000	
Repayment of long term obligations	(1,082,460)	
Dividend Payment	(37,207)	
Net cash used for financing activities	(119,667)	
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(808,314)	152,523
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,712,912	964,774
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 904,598	$ 1,117,297

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BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

	Nine Months Ended September 30, 2009	2008
Noncash Investing and Financing Activities:		
Issuance of Debt in exchange of discounted Series B redeemable preferred Stock	398,387	
Discount on Series B redeemable preferred Stock	130,153	
Issuance of Debt in exchange of discounted Series C redeemable preferred Stock	1,810,495	
Discount on Series C redeemable preferred Stock	591,487	
Issuance of common stock through conversion of principal and dividends outstanding on preferred stock	767,916	656,096

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

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BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2009 (Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements include the accounts of BIO-key International, Inc. and its wholly-owned subsidiary (collectively, the Company) and are stated in conformity with accounting principles generally accepted in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The operating results for interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year. Pursuant to such rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted. Significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly the Company s financial position and the results of its operations and cash flows for the periods presented. The balance sheet at December 31, 2008 was derived from the audited financial statements, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with the financial statements and the related notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 (the Form 10-K) filed on March 11, 2009.

Recently Issued Accounting Pronouncements

Adoption of New Accounting Standards

In June 2009, the FASB issued SFAS No. 168 *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - A Replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the FASB Accounting Standards CodificationTM (Codification) as the single source of authoritative U.S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. When effective, the Codification will supersede all existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. Following SFAS 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, the FASB will issue Accounting Standards Updates, which will serve only to: (a) update the Codification; (b) provide background information about the guidance; and (c) provide the bases for conclusions on the change(s) in the Codification. The adoption of SFAS 168 did not have an impact on our consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which is now part of ASC 855, *Subsequent Events*. SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 will be effective for interim or annual period ending after June 15, 2009 and will be applied prospectively. The Company has adopted the requirements of this pronouncement for this quarter ended June 30, 2009 and will evaluate subsequent events through the day of filing each financial statement.

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In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2). Under the new guidance, which is now part of the Accounting Standards Codification (ASC) 320, *Investments Debt and Equity Securities*, an other than-temporary impairment is recognized when an entity has the intent to sell a debt security or when it is more likely than not that an entity will be required to sell the debt security before its anticipated recovery in value. Additionally, the new guidance changes the presentation and amount of other-than-temporary impairment losses recognized in the income statement for instances in which the Company does not intend to sell a debt security, or it is more likely than not that the Company will not be required to sell a debt security prior to the anticipated recovery of its remaining cost basis. The Company separates the credit loss component of the impairment form the amount related to all other factors and reports the credit loss component in net realized investment gains (losses). The impairment related to all other factors if reported in accumulated other changes in equity from non-owner sources. In addition to the changes in measurement and presentation, the disclosures are required to be included in both interim and annual periods. The provisions of the new guidance were effective for interim periods ending after June 15, 2009. The adoption of the new guidance did not have a material effect on the Company s results of operations, financial position or liquidity and we will comply with the guidance going forward.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* , which is now part of ASC 825. This FSP essentially expands the disclosure about fair value of financial instruments that were previously required only annually to also be required for interim period reporting. In addition, the FSP requires certain additional disclosures regarding the methods and significant assumptions used to estimate the fair value of financial instruments. These additional disclosures were required beginning with the quarter ended June 30, 2009. The Company has adopted the requirements of this pronouncement effective the quarter ended June 30, 2009.

In February 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(R)-a, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies* (SFAS No. 141(R)-a), now part of ASC 805, which simplifies how entities will be required to account for contingencies arising in business combinations under SFAS 141(R) *Accounting for Business Combinations* . FASB decided to amend the guidance SFAS 141(R) to require assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would be accounted for in accordance with FASB Statement No. 5 *Accounting for Contingencies* (SFAS 5). The provisions of SFAS No. 141(R)-a are applicable to business combinations consummated after January 1, 2009 for calendar year entities. The adoption of SFAS 141(R)-a will have an impact on the Company s accounting for business combinations in connection with any future acquisitions.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* (SFAS No. 160), which establishes accounting and reporting standards for the non-controlling interest in a subsidiary for the deconsolidation of a subsidiary. Under the guidance, which is now part of the (ASC) 810, *Consolidation*, SFAS No. 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. The Company does not currently have any non-controlling interests.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities.* (SFAS No.161) which amends and expands the disclosure requirements related to derivative instruments and hedging activities. Under the guidance, which is now part of the (ASC) 815, *Derivatives and Hedging Activities*, the Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. The provisions of SFAS 161 are effective for the fiscal year beginning January 1, 2009. The Company will comply with the disclosure requirements of this statement since it utilizes derivative instruments.

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In October 2008, the FASB issued Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP 157-3). Under the guidance, which is now part of the (ASC) 350, *Intangibles Goodwill and Other*, FSP 157-3 clarifies the application of SFAS 157, which the Company adopted as of January 1, 2008, in cases where a market is not active. The Company will comply with the clarification to the original application.

In November 2008, the FASB ratified the EITF consensus on Issue No. 08-7, *Accounting for Defensive Intangible Assets* (EITF 08-7). Under the guidance, which is now part of the (ASC) 350, *Intangibles Goodwill and Other*, the consensus addresses the accounting for an intangible asset acquired in a business combination or asset acquisition that an entity does not intend to use or intends to hold to prevent others from obtaining access (a defensive intangible asset). Under EITF 08-7, a defensive intangible asset needs to be accounted as a separate unit of accounting and would be assigned a useful life based on the period over which the asset diminishes in value. EITF 08-7 was effective for transactions occurring after December 31, 2008. The Company will consider this standard in terms of intangible assets in connection with any future acquisitions.

Accounting Standards Not yet Adopted

In June 2009, the FASB issued SFAS No. 166 *Accounting for Transfers of Financial Assets* (SFAS 166). Statement 166 is a revision to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* , and will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures. SFAS 166 enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and an entity s continuing involvement in transferred financial assets. SFAS 166 will be effective at the start of a reporting entity s first fiscal year beginning after November 15, 2009. Early application is not permitted. We are currently evaluating the impact of adoption of SFAS 166 on the accounting for our convertible notes and related warrant liabilities The Company does not expect that the provisions of the new guidance will have a material effect on its results of operations, financial position or liquidity.

In June 2009, the FASB issued SFAS No. 167 *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). Statement 167 is a revision to FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities* , and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity s purpose and design and the reporting entity s ability to direct the activities of the other entity that most significantly impact the other entity s economic performance. SFAS 167 will require a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity s financial statements. SFAS 167 will be effective at the start of a reporting entity s first fiscal year beginning after November 15, 2009. Early application is not permitted. We are currently evaluating the impact, if any, of adoption of SFAS 167 on our financial statements.

2. LIQUIDITY AND CAPITAL RESOURCE MATTERS

We have incurred significant losses to date, and at September 30, 2009, we had an accumulated deficit of approximately $54.5 million. The potential for significant growth of the Company as a whole is largely

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dependent upon market development and market acceptance of our biometric technology.

If the Company is unable to generate revenues as planned, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained by the Company in order to meet its needs, or that such financing would not be dilutive to existing shareholders.

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern, and assumes continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business. Recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheets is dependent upon the Company s ability to meet its financing requirements on a continuing basis, and maintain profitability in its future operations. The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

3. DISCONTINUED OPERATIONS

Law Enforcement Division

On August 13, 2009, the Company and InterAct911 Mobile Systems, Inc. (the Buyer), a wholly-owned subsidiary of InterAct911 Corporation (the Parent), entered into an Asset Purchase Agreement (the Purchase Agreement), pursuant to which the Buyer agreed to purchase the Company s Law Enforcement division (the Business). The Buyer will pay the Company an aggregate purchase price of $11 million for the Business, of which $7 million is payable in cash at the closing of the transactions contemplated by the Purchase Agreement (the Asset Sale), subject to customary adjustments provided in the Purchase Agreement, and Buyer will issue a promissory note (the Note) in the original principal amount of $4 million in favor of the Company. The Note is to be paid in three equal annual installments beginning on the first anniversary of the closing and will bear interest, payable on a quarterly basis, at a rate per annum equal to six percent (6%) compounded annually on the principal sum from time to time outstanding. The Note will be guaranteed by the Parent and its owner SilkRoad Equity, LLC (SilkRoad), a private investment firm, and secured by all of the intellectual property assets of the Business being transferred to the Buyer as part of the Asset Sale. In addition, at the closing of the Asset Sale, the Company will issue to SilkRoad a warrant to purchase up to 8 million shares of the Company s common stock at a cash purchase price of $0.30 per share. This warrant will expire on the fifth anniversary of the closing.

The Purchase Agreement provides for Buyer to acquire substantially all of the assets relating to the Business, including the Company s customer contracts, intellectual property, accounts receivables, equipment, inventories, software, technologies, and communication systems relating to the Business, and to assume certain specified liabilities as set forth in the Purchase Agreement. The Company and InterAct Public Safety Systems, an affiliate of Buyer, have collaborated on many projects in the past, including partnership arrangements in which products used in the Business (including elements of the MobileCop®, PocketCop®, MobileRescue , MobileOffice , and InfoServer product lines) have been integrated with those of InterAct Public Safety Systems and sold to law enforcement agencies and other emergency response customers. Outside of those commercial dealings, there are no material relationships among the Company and Buyer or any of their respective affiliates other than in respect of the Purchase Agreement and the related ancillary agreements.

The assets and the liabilities for the Law Enforcement Division for the periods ended September 30, 2009 and December 31, 2008 were as follows:

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		September 30, 2009 (Unaudited)		December 31, 2008 (Unaudited)
ASSETS				
Accounts receivable, net of allowance for doubtful accounts of $8,571 at September 30, 2009 and $76,553 at December 31, 2008	$	929,090	$	624,891
Costs in Excess of Billing				144,551
Prepaid expenses		34,826		41,266
Total current assets		963,916		810,708
Equipment and leasehold improvements, net		36,907		66,561
Intangible assets less accumulated amortization		464		330,889
Goodwill		7,836,986		7,836,986
Non-current assets		7,874,357		8,234,436
TOTAL ASSETS	$	8,838,273	$	9,045,144
LIABILITIES				
Accounts payable	$	81,575	$	28,781
Accrued liabilities		269,185		638,322
Note payable				1,516,651
Deferred rent		20,864		6,541
Deferred revenue		3,577,378		3,006,510
Total current liabilities		3,949,002		5,196,805
Deferred rent		31,652		11,510
Deferred revenue		30,561		8,382
Total non-current liabilities		62,213		19,892
TOTAL LIABILITIES	$	4,011,215	$	5,216,697

The closing of the Asset Sale is conditioned upon the Company s receipt of the approval of its stockholders as well as the satisfaction of certain other customary closing conditions. The Purchase Agreement may be terminated by either the Company or Buyer if the closing has not occurred by January 31, 2010 or upon the occurrence of certain customary events as set forth in the Purchase Agreement. The Company currently expects to hold a special meeting of its stockholders and that, if the stockholders approve the Asset Sale and the other conditions are satisfied, the Asset Sale would close during the fourth quarter of 2009. In addition, if the Purchase Agreement is terminated under certain circumstances, including a determination by the Company s Board of Directors to accept an acquisition proposal it deems superior to the Asset Sale, the Company has agreed to pay Buyer a termination fee equal to $1 million.

Prior to the Purchase Agreement, the Business had been reported as a separate segment. The Business has been reported as a discontinued operation and all periods presented have been recast accordingly to reflect these operations as discontinued.

Revenues and net income for the Law Enforcement Business Segment for the three and nine month periods ended September 30, 2009 and 2008 were as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
		2009		2008		2009		2008
Revenues	$	2,171,869	$	2,429,803	$	7,157,698	$	6,976,279
Net income	$	701,674	$	511,763	$	2,707,468	$	678,314

Fire Division

On May 22, 2007, the Company and ZOLL Data Systems, Inc. (ZOLL), a subsidiary of ZOLL Medical Corporation, entered into an Asset Purchase Agreement (the Purchase Agreement), pursuant to which

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ZOLL acquired substantially all of the assets related to the Company s Fire/EMS Services division (the Fire Segment or Fire).

At the closing of the sale, the Company received approximately $1.8 million in cash, which represented the purchase price of $7 million, less closing adjustments of approximately $4.3 million, which was paid to the Senior Noteholder (see Note 9), approximately $450,000, which was paid to the leaseholder of the Company s premises, $400,000, which was placed in escrow pursuant to the Purchase Agreement, and approximately $40,000 credited to Zoll on the assumption of certain liabilities.

During the quarter ended September 30, 2007, $250,000 of the escrow balance was released to ZOLL. The remaining escrow balance was remitted to the Company on May 6, 2008. From the remaining balance, $50,000 was paid as a settlement of a customer claim associated with the discontinued Fire business, and $15,454 was paid as related professional fees to settle the claim which resulted in the $65,454 loss .

Prior to the sale, Fire had been reported as a separate segment. The Company sold its Fire operating segment to better focus on its core lines of business. The Fire business has been reported as a discontinued operation and all periods presented have been recast accordingly to reflect these operations as discontinued.

Revenues and net income (loss) for the Fire Segment for the three and nine month periods ended September 30, 2009 and 2008 were as follows:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues	$	$	$	$
Net loss	$	$	$	$ (65,454)

4. SHARE BASED COMPENSATION

The Company accounts for share based compensation by measuring compensation cost for all stock awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The majority of our share-based compensation arrangements vest over either three or four years. The Company expenses its share-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. The fair value of stock options is determined using the Black-Scholes valuation model, and requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the expected option term), the estimated volatility of our common stock price over the option s expected term, the risk-free interest rate over the option s expected term, and the Company s expected annual dividend yield. Changes in these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized as an expense in the consolidated statements of operations. As required under the accounting rules, we review our valuation assumptions at each grant date and, as a result, are likely to change our valuation assumptions used to value employee stock-based awards granted in future periods. The values derived from using the Black-Scholes model are recognized as expense over the service period, net of estimated forfeitures (the number of individuals that will ultimately not complete their vesting requirements). The estimation of stock awards that will ultimately vest requires significant judgment. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

The compensation expense increased the Company s loss from continuing operations by $9,651 and $28,291 with no effect per share (basic and diluted) for the three months ended September 30, 2009 and 2008 respectively, and $69,419 and $265,753 with no effect per share (basic and diluted), for the nine months ended September 30, 2009 and 2008 respectively.

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The following table presents share-based compensation expenses for continuing operations included in the Company s unaudited condensed interim consolidated statements of operations:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008
Selling, general and administrative	$ 2,526	$ 22,699
Research, development and engineering	7,125	5,592
	$ 9,651	$ 28,291

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Selling, general and administrative	$ 51,427	$ 253,019
Research, development and engineering	17,992	12,734
	$ 69,419	$ 265,753

Valuation Assumptions for Stock Options

For the three months ended September 30, 2009 and 2008, 0 and 195,000 stock options were granted, respectively. For the nine months ended September 30, 2009 and 2008, 790,000 and 759,272 stock options were granted, respectively. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,	
	2009	2008
Risk free interest rate		3.09%
Expected life of options (in years)		4.5
Expected dividends		0%
Volatility of stock price		87%

	Nine Months Ended September 30,	
	2009	2008
Risk free interest rate	1.83-1.85%	2.95-3.72%
Expected life of options (in years)	4.5	4.5
Expected dividends	0%	0%
Volatility of stock price	87%	87-88%

The stock volatility for each grant is determined based on the review of the experience of the weighted average of historical daily price changes of the Company s common stock over the expected option term. The expected term was determined using the simplified method for estimating expected option life, which qualify as plain-vanilla options; and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

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EQUITY COMPENSATION PLAN INFORMATION

1996 Stock Option Plan

During 1996, the Board of Directors and stockholders of the Company adopted the 1996 Stock Option Plan (the 1996 Plan). Under the 1996 Plan, 750,000 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 100% of fair market value for incentive stock options and 50% for all others. The term of stock options granted may not exceed ten years. Options issued under the 1996 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 1996 Plan expired in May 2005.

1999 Stock Option Plan

During 1999, the Board of Directors of the Company adopted the 1999 Stock Option Plan (the 1999 Plan). The 1999 Plan was not presented to stockholders for approval and thus incentive stock options are not available under the plan. Under the 1999 Plan, 2,000,000 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of non-statutory stock options granted may not exceed ten years. Options issued under the 1999 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 1999 Plan expired in August 2009.

2004 Stock Option Plan

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan has not yet been presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of the 2004 Plan, 4,000,000 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the 2004 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 2004 Plan expires in October 2014.

Non-Plan Stock Options

Periodically, the Company has granted options outside of the 1996, 1999, and 2004 Plans to various employees and consultants. In the event of change in control, as defined, certain of the non-plan options outstanding vest immediately.

Stock Option Activity

The following table summarizes stock option activity for the nine months ended September 30, 2009:

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	1996 Plan	1999 Plan	Number of Options 2004 Plan	Non Plan	Total	Weighted average exercise price	Weighted average remaining life (in years)	Aggregate intrinsic value
Outstanding, as of December 31, 2008	80,000	335,000	2,837,941	3,755,000	7,007,941	$ 0.78		
Granted		500,000	290,000		790,000	0.087		
Exercised								
Forfeited			(79,008)		(79,008)	0.47		
Expired		(200,000)	(443,492)	(300,000)	(593,492)	0.73		
Outstanding, as of September 30, 2009	**80,000**	**635,000**	**2,605,441**	**3,455,000**	**6,775,441**	**$ 0.71**	**3.10**	**$ 136,013**
Vested or expected to vest at September 30, 2009					**6,646,924**	**$ 0.72**	**3.04**	**$ 125,508**
Exercisable at September 30, 2009					**6,245,938**	**$ 0.76**	**2.86**	**$ 93,834**

The options outstanding and exercisable at September 30, 2009 were in the following exercise price ranges:

Range of exercise prices	Options Outstanding: Number of shares	Weighted average exercise price	Weighted average remaining life (in years)	Options Exercisable: Number exercisable	Weighted average exercise price
$ 0.075-0.21					

	Reportable Segments	2016	2015	2016	2015
Domestic	$	286,720	$ 258,117	$ 534,736	$545,729
International		80,656	30,243	119,175	54,449
Total net sales	$	367,376	$ 288,360	$ 653,911	$600,178

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

	Net Sales Three Months Ended June 30,		Six Months Ended June 30,	
Product Classes	**2016**	**2015**	**2016**	**2015**
Residential products	$181,735	$133,466	$340,716	$290,300
Commercial & industrial products	156,730	134,580	259,720	268,343
Other	28,911	20,314	53,475	41,535
Total net sales	$367,376	$288,360	$653,911	$600,178

Management evaluates the performance of its segments based primarily on Adjusted EBITDA, which is a non-GAAP measure, and therefore 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 June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Domestic	$57,352	$48,457	$104,212	$102,901
International	6,574	3,965	9,523	6,659
Total adjusted EBITDA	$63,926	$52,422	$113,735	$109,560
Interest expense	(11,380)	(10,763)	(22,415)	(22,031)
Depreciation and amortization	(13,650)	(10,129)	(26,443)	(19,163)
Non-cash write-down and other adjustments (1)	(2,909)	(404)	(2,782)	(1,976)
Non-cash share-based compensation expense (2)	(2,901)	(2,582)	(5,386)	(5,090)
Loss on extinguishment of debt (3)	-	(3,427)	-	(4,795)
Transaction costs and credit facility fees (4)	(237)	(481)	(760)	(682)
Business optimization expenses (5)	-	(1,444)	(7,106)	(1,738)
Other	15	280	(48)	90
Income before provision for income taxes	$32,864	$23,472	$48,795	$54,175

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

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

(3)

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

(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 74% and 84% of total sales for the three months ended June 30, 2016 and 2015, respectively, and represented approximately 78% and 85% of total sales for the six months ended June 30, 2016 and 2015, respectively. Approximately 86% and 93% of the Company's identifiable long-lived assets are located in the United States at June 30, 2016 and December 31, 2015, respectively.

7. Balance Sheet Details

Inventories consist of the following:

	June 30, 2016	**December 31, 2015**
Raw material	$226,110	$188,354
Work-in-process	4,347	2,856
Finished goods	150,032	144,747
Reserves for excess and obsolete	(13,744)	(10,582)
Total	$366,745	$325,375

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Property and equipment consists of the following:

	June 30, 2016	**December 31, 2015**
Land and improvements	$12,354	$8,553
Buildings and improvements	115,544	104,774
Machinery and equipment	78,434	72,280
Dies and tools	21,779	20,066
Vehicles	1,575	1,244
Office equipment and systems	58,440	29,395
Leasehold improvements	4,322	3,338
Construction in progress	10,507	30,482
Gross property and equipment	302,955	270,132
Accumulated depreciation	(96,255)	(85,919)
Total	$206,700	$184,213

8. Product Warranty Obligations

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

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	**2015**	**2016**	**2015**
Balance at beginning of period	$31,904	$29,277	$30,197	$30,909
Product warranty reserve assumed in acquisition	-	-	840	-

Payments	(4,900)	(5,100)	(8,552)	(10,533)
Provision for warranties issued	4,220	4,480	7,702	9,029
Changes in estimates for pre-existing warranties	(489)	(472)	548	(1,220)
Balance at end of period	$30,735	$28,185	$30,735	$28,185

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

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
	2016	**2015**	**2016**	**2015**
Balance at beginning of period	$28,830	$27,531	$28,961	$27,193
Deferred revenue on extended warranty contracts sold	1,619	810	2,763	2,190
Amortization of deferred revenue on extended warranty contracts	(1,367)	(1,100)	(2,642)	(2,142)
Balance at end of period	$29,082	$27,241	$29,082	$27,241

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

	June 30, 2016	**December 31, 2015**
Product warranty liability		
Current portion - other accrued liabilities	$21,071	$ 21,726
Long-term portion - other long-term liabilities	9,664	8,471
Total	$30,735	$ 30,197
Deferred revenue related to extended warranty		
Current portion - other accrued liabilities	$5,034	$ 6,026
Long-term portion - other long-term liabilities	24,048	22,935
Total	$29,082	$ 28,961

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9. Credit Agreements

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

	June 30, 2016	December 31, 2015
ABL facility	$-	$ -
Other lines of credit	33,649	8,594
Total	$33,649	$ 8,594

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

	June 30, 2016	December 31, 2015
Term loan	$954,000	$954,000
Original issue discount and deferred financing costs	(27,783)	(29,905)
ABL facility	100,000	100,000
Capital lease obligation	4,973	1,694
Other	16,543	12,000
Total	1,047,733	1,037,789
Less: current portion of debt	12,374	500
Less: current portion of capital lease obligation	523	157
Total	$1,034,836	$1,037,132

The Company’s credit agreements provide for a $1,200,000 term loan B credit facility (Term Loan) and include a $300,000 uncommitted incremental term loan facility. The Term Loan matures on May 31, 2020. The Term Loan is guaranteed by all of the Company’s wholly-owned domestic restricted subsidiaries, and is secured by associated collateral agreements which pledge a first priority lien on virtually all of the Company’s assets, including fixed assets and intangibles, other than all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, which are secured by a second priority lien.

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

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

The Company's credit agreements also originally provided for a $150,000 senior secured ABL revolving credit facility (ABL Facility). The maturity date of the ABL Facility originally was May 31, 2018. Borrowings under the ABL Facility are guaranteed by all of the Company's wholly-owned domestic restricted subsidiaries, and are secured by associated collateral agreements which pledge a first priority lien on all cash, trade accounts receivable, inventory, and other current assets and proceeds thereof, and a second priority lien on all other assets, including fixed assets and intangibles of the Company and certain domestic subsidiaries. ABL Facility borrowings initially bore interest at rates based upon either a base rate plus an applicable margin of 1.00% or adjusted LIBOR rate plus an applicable margin of 2.00%, in each case, subject to adjustments based upon average availability under the ABL Facility.

On May 29, 2015, the Company amended its ABL Facility. The amendment (i) increased the ABL Facility from $150,000 to $250,000 (Amended ABL Facility), (ii) extended the maturity date from May 31, 2018 to May 29, 2020, (iii) increased the uncommitted incremental facility from $50,000 to $100,000, (iv) reduced the interest rate spread by 50 basis points and (v) reduced the unused line fee by 12.5 basis points across all tiers. Additionally, the amendment relaxes certain restrictions on the Company's ability to, among other things, (i) make additional investments and acquisitions (including foreign acquisitions), (ii) make restricted payments and (iii) incur additional secured and unsecured debt (including foreign subsidiary debt). In connection with this amendment and in accordance with ASC 470-50, the Company capitalized $483 of new debt issuance costs in 2015.

On May 29, 2015, the Company borrowed $100,000 under the Amended ABL Facility, the proceeds of which were used as a voluntary prepayment towards the Term Loan. As of June 30, 2016, there was $100,000 outstanding under the Amended ABL Facility, leaving $142,123 of availability, net of outstanding letters of credit.

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

As of June 30, 2016 and December 31, 2015, short-term borrowings consisted of borrowings by our foreign subsidiaries on local lines of credit, which totaled $33,649 and $8,594, respectively.

10. Stock Repurchase Program

On August 5, 2015, the Company's Board of Directors approved a $200,000 stock repurchase program. Under the program, the Company may repurchase up to $200,000 of its common stock over 24 months from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The repurchase may be executed using open market purchases, privately negotiated agreements or other transactions. The actual timing, number and value of shares repurchased under the program will be determined by management at its discretion and will depend on a number of factors, including the market price of the Company's shares of common stock and general market and economic conditions, applicable legal requirements, and compliance with the terms of the Company's outstanding indebtedness. The stock repurchase program may be suspended or discontinued at any time without prior notice. For the three months ended June 30, 2016, the Company repurchased 935,000 shares of its common stock for $34,576, funded with cash on hand. Since the inception of the program, the Company has repurchased 4,238,500 shares of its common stock for $134,518, funded with cash on hand.

11. Earnings Per Share

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	**2015**	**2016**	**2015**
Net income attributable to Generac Holdings Inc. (numerator)	$20,888	$14,844	$31,096	$34,529
Weighted average shares (denominator)				
Basic	65,870,714	68,961,877	65,955,455	68,886,672
Dilutive effect of stock compensation awards (1)	517,867	1,101,186	510,315	1,213,268
Diluted	66,388,581	70,063,063	66,465,770	70,099,940
Net income attributable to Generac Holdings Inc. per share				
Basic	$0.32	$0.22	$0.47	$0.50
Diluted	$0.31	$0.21	$0.47	$0.49

(1) Excludes approximately 189,500 stock options and 3,000 shares of restricted stock for the three month period ended June 30, 2016, and 215,800 stock options and 3,400 shares of restricted stock for the six month period ended June 30, 2016, as the impact of such awards was anti-dilutive. Excludes approximately 142,900 stock options and 2,300 shares of restricted stock for the three month period ended June 30, 2015 and 104,400 stock options for the six month period ended June 30, 2015, as the impact of such awards was anti-dilutive.

12. Income Taxes

The effective income tax rates for the six months ended June 30, 2016 and 2015 were 36.2% and 36.3%, respectively.

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13. Commitments and Contingencies

The Company has an arrangement with a finance company to provide floor plan financing for selected dealers. The Company receives payment from the finance company after shipment of product to the dealer. The Company participates in the cost of dealer financing up to certain limits and has agreed to repurchase products repossessed by the finance company, but does not indemnify the finance company for any credit losses they incur. The amount financed by dealers which remained outstanding under this arrangement at June 30, 2016 and December 31, 2015 was approximately $36,200 and $32,400, respectively.

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

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 and objectives and other similar expressions concerning matters that are not historical facts.

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

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

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

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

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

Business Drivers and Operational Factors

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

Business Drivers and Trends

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

Increasing penetration opportunity. Many potential customers are not aware of the costs and benefits of automatic backup power solutions. We estimate that penetration rates for home standby generators are only approximately 3.5% of U.S. single-family detached, owner-occupied households with a home value of over $100,000, as defined by the U.S. Census Bureau's 2013 American Housing Survey for the United States. The decision to purchase backup power for many light-commercial buildings such as convenience stores, restaurants and gas stations is more return-on-investment (ROI) driven and as a result these applications have relatively lower penetration rates as compared to buildings used in code-driven or mission critical applications such as hospitals, wastewater treatment facilities, 911 call centers, data centers and certain industrial locations. The emergence of lower cost, cleaner burning natural gas fueled generators has helped to increase the penetration of standby generators in the light-commercial market. In addition, the importance of backup power for telecommunications infrastructure is increasing due to the growing importance of uninterrupted voice and data services. Also, in recent years, a more stringent regulatory environment around the flaring of natural gas at oil & gas drilling and production sites has been a catalyst for increased demand for natural gas fueled generators, including mobile solutions. We believe by expanding our distribution network, continuing to develop our product line, and targeting our marketing efforts, we can continue to build awareness and increase penetration for our standby and mobile generators for residential, commercial and industrial purposes.

Effect of large scale and baseline power disruptions. Power disruptions are an important driver of customer awareness and have historically influenced demand for generators. 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 six to twelve months following a major power outage event for standby generators. For example, the multiple major outage events that occurred during the second half of both 2011 and 2012 drove strong demand for portable and home standby generators, and the increased awareness of these products contributed to substantial organic revenue growth in 2012 with strong growth continuing during 2013. 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.

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

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

Factors Affecting Results of Operations

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

Effect of commodity, currency and component price fluctuations. Industry-wide price fluctuations of key commodities, such as steel, copper, aluminum 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 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 three years approximately 23% to 27% of our net sales occurred in the first quarter, 22% to 25% in the second quarter, 24% to 27% in the third quarter and 25% to 28% 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. For example, there were multiple major power outage events that occurred during the second half of both 2011 and 2012, which were significant in terms of severity. As a result, the seasonality experienced during this time period, and for the subsequent quarters following the time period, varied relative to other periods where no major outage events occurred. We maintain a flexible production and supply chain infrastructure in order to respond to outage-driven peak demand.

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

Factors influencing provision for income taxes and cash income taxes paid. We had approximately $715 million of tax-deductible goodwill and intangible asset amortization remaining as of December 31, 2015 related to our acquisition by CCMP in 2006 that we expect to generate aggregate cash tax savings of approximately $279 million through 2021, assuming continued profitability and a 39% tax rate. The recognition of the tax benefit associated with these assets for tax purposes is expected to be $122 million annually through 2020 and $102 million in 2021, which generates annual cash tax savings of $48 million through 2020 and $40 million in 2021, assuming profitability and a 39% tax rate. As a result of the asset acquisition of the Magnum business in the fourth quarter of 2011, we had approximately $42.0 million of incremental tax deductible goodwill and intangible assets remaining as of December 31, 2015. We expect these assets to generate aggregate cash tax savings of $16.4 million through 2026 assuming continued profitability and a 39% tax rate. The amortization of these assets for tax purposes is expected to be $3.8 million annually through 2025 and $2.8 million in 2026, which generates an additional annual cash tax savings of $1.5 million through 2025 and $1.1 million in 2026, assuming profitability and a 39% tax rate. Based on current business plans, we believe that our cash tax obligations through 2026 will be significantly reduced by these tax attributes. Other acquisitions have resulted in additional tax deductible goodwill and intangible assets that will generate tax savings, but are not material to the Company’s consolidated financial statements.

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Results of Operations

Three months ended June 30, 2016 compared to the three months ended June 30, 2015

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

(U.S. Dollars in thousands)	**Three Months Ended June 30, 2016**	**2015**	**$ Change**	**% Change**	
Net sales	$367,376	$288,360	79,016	27.4	%
Cost of goods sold	243,229	192,463	50,766	26.4	%
Gross profit	124,147	95,897	28,250	29.5	%
Operating expenses:					
Selling and service	42,366	28,474	13,892	48.8	%
Research and development	9,889	8,412	1,477	17.6	%
General and administrative	19,593	13,564	6,029	44.4	%
Amortization of intangible assets	8,217	5,980	2,237	37.4	%
Total operating expenses	80,065	56,430	23,635	41.9	%
Income from operations	44,082	39,467	4,615	11.7	%
Total other income (expense), net	(11,218)	(15,995)	4,777	-29.9	%
Income before provision for income taxes	32,864	23,472	9,392	40.0	%
Provision for income taxes	11,921	8,628	3,293	38.2	%
Net income	20,943	14,844	6,099	41.1	%
Net income attributable to noncontrolling interests	55	-	55	N/A	
Net income attributable to Generac Holdings Inc.	$20,888	$14,844	6,044	40.7	%

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

	Net Sales Three Months Ended June 30, 2016	**2015**	**$ Change**	**% Change**	
Domestic	$286,720	$258,117	28,603	11.1	%
International	80,656	30,243	50,413	166.7	%

Total net sales	$367,376	$288,360	79,016	27.4	%

	Adjusted EBITDA Three Months Ended June 30,				
	2016	2015	$ Change	% Change	
Domestic	$57,364	$48,838	8,526	17.5	%
International	6,562	3,584	2,978	83.1	%
Total Adjusted EBITDA	$63,926	$52,422	11,504	21.9	%

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

	Three Months Ended June 30,				
	2016	2015	$ Change	% Change	
Residential products	$181,735	$133,466	48,269	36.2	%
Commercial & industrial products	156,730	134,580	22,150	16.5	%
Other	28,911	20,314	8,597	42.3	%
Total net sales	$367,376	$288,360	79,016	27.4	%

Net sales. The increase in Domestic sales for the three months ended June 30, 2016 was primarily due to the contribution from the CHP acquisition, which closed in August 2015, and an increase in shipments of home standby generators. These increases were partially offset by the ongoing significant declines in shipments of mobile products into oil & gas and general rental markets.

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

The total contribution from non-annualized recent acquisitions to the three months ended June 30, 2016 was $88.1 million.

Gross profit. Gross profit margin for the second quarter of 2016 was 33.8% compared to 33.3% in the prior-year second quarter. The current year quarter includes $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 this adjustment, gross profit margin was 34.7%, an improvement of 140 basis points as compared to the prior year. The increase was primarily driven by the impact of lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar in recent quarters, along with favorable overall product mix, partially offset by the net mix impact from recent acquisitions.

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Operating expenses. The increase in operating expenses was primarily due to the addition of recurring operating expenses associated with recent acquisitions.

Other expense. The decrease in other expense was primarily due to a prior year non-cash $3.4 million loss on extinguishment of debt resulting from a voluntary $100.0 million prepayment of term loan debt.

Provision for income taxes. The effective income tax rates for the three months ended June 30, 2016 and 2015 were 36.4% and 36.8%, respectively.

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, as adjusted for net income attributable to noncontrolling interests.

Adjusted EBITDA. Adjusted EBITDA margins for the Domestic segment for the three months ended June 30, 2016 were 20.0% of net sales as compared to 18.8% of net sales for the three months ended June 30, 2015. This increase was primarily due to favorable product mix as well as the favorable impact of lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar in recent quarters, partially offset by higher operating expenses.

Adjusted EBITDA margins for the International segment for the three months ended June 30, 2016 were 8.2% of net sales as compared to 13.1% of net sales for the three months ended June 30, 2015. This decrease was primarily due to unfavorable product and customer mix along with lower absorption of fixed manufacturing overhead costs and reduced leverage of operating expenses on the lower organic sales volumes.

Adjusted Net Income. Adjusted Net Income of $42.7 million for the three months ended June 30, 2016 increased 21.0% from $35.3 million for the three months ended June 30, 2015, due to the factors outlined above, partially offset by the adjusted net income attributable to noncontrolling interests and 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.

Six months ended June 30, 2016 compared to the six months ended June 30, 2015

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

(U.S. Dollars in thousands)	**Six Months Ended June 30, 2016**	**2015**	**$ Change**	**% Change**	
Net sales	$653,911	$600,178	53,733	9.0	%
Cost of goods sold	431,704	401,678	30,026	7.5	%
Gross profit	222,207	198,500	23,707	11.9	%
Operating expenses:					
Selling and service	79,635	58,602	21,033	35.9	%
Research and development	18,086	16,575	1,511	9.1	%
General and administrative	37,426	27,770	9,656	34.8	%
Amortization of intangible assets	16,014	11,175	4,839	43.3	%
Total operating expenses	151,161	114,122	37,039	32.5	%
Income from operations	71,046	84,378	(13,332)	-15.8	%
Total other income (expense), net	(22,251)	(30,203)	7,952	-26.3	%
Income before provision for income taxes	48,795	54,175	(5,380)	-9.9	%
Provision for income taxes	17,640	19,646	(2,006)	-10.2	%
Net income	31,155	34,529	(3,374)	-9.8	%
Net income attributable to noncontrolling interests	59	-	59	N/A	
Net income attributable to Generac Holdings Inc.	$31,096	$34,529	(3,433)	-9.9	%

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

	Net Sales Six Months Ended June 30,			
	2016	**2015**	**$ Change**	**% Change**
Domestic	$534,736	$545,729	(10,993)	-2.0 %
International	119,175	54,449	64,726	118.9 %
Total net sales	$653,911	$600,178	53,733	9.0 %

	Adjusted EBITDA Six Months Ended June 30,			
	2016	**2015**	**$ Change**	**% Change**
Domestic	$104,183	$103,283	900	0.9 %
International	9,552	6,277	3,275	52.2 %
Total Adjusted EBITDA	$113,735	$109,560	4,175	3.8 %

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

	Six Months Ended June 30,			
	2016	**2015**	**$ Change**	**% Change**
Residential products	$340,716	$290,300	50,416	17.4 %
Commercial & industrial products	259,720	268,343	(8,623)	-3.2 %
Other	53,475	41,535	11,940	28.7 %
Total net sales	$653,911	$600,178	53,733	9.0 %

Net sales. The decrease in Domestic sales for the six months ended June 30, 2016 was primarily due to a significant reduction in shipments of mobile products into oil & gas and general rental markets, partially offset by the contribution from the CHP acquisition.

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

The total contribution from non-annualized recent acquisitions to the six months ended June 30, 2016 was $125.3 million.

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

Gross profit. Gross profit margin for the first half of 2016 was 34.0% compared to 33.1% in the prior-year first half, which includes the impact of the aforementioned $2.7 million of business optimization charges classified within cost of goods sold, 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 adjustments, gross profit margin was 34.9%, an improvement of 180 basis points over the prior year. The increase was primarily due to favorable overall product mix as well as the favorable impact of lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar in recent quarters. In addition, gross margin in the prior year was negatively impacted by temporary increases in certain costs associated with the west coast port congestion as well as other overhead-related costs that did not repeat in the current year. These factors were partially offset by the net mix impact from recent acquisitions.

Operating expenses. Excluding the impact of the aforementioned $4.4 million of business optimization charges classified within operating expenses, operating expenses increased $32.6 million, or 28.6%, to $146.7 million for the six months ended June 30, 2016 from $114.1 million for the six months ended June 30, 2015. The increase was primarily due to the addition of recurring operating expenses associated with recent acquisitions.

Other expense. The decrease in other expense was primarily due to a prior year non-cash $4.8 million loss on extinguishment of debt resulting from $150.0 million of voluntary prepayments of term loan debt.

Provision for income taxes. The effective income tax rates for the six months ended June 30, 2016 and 2015 were 36.2% and 36.3%, respectively.

Adjusted EBITDA. Adjusted EBITDA margins for the Domestic segment for the six months ended June 30, 2016 were 19.5% of net sales as compared to 18.9% of net sales for the six months ended June 30, 2015. This increase was primarily due to favorable product mix as well as the favorable impact of lower commodity costs and overseas sourcing benefits from a stronger U.S. Dollar in recent quarters, partially offset by higher operating expenses.

Adjusted EBITDA margins for the International segment for the six months ended June 30, 2016 were 8.0% of net sales as compared to 12.2% of net sales for the six months ended June 30, 2015. This decrease was primarily due to unfavorable product and customer mix along with lower absorption of fixed manufacturing overhead costs and reduced leverage of operating expenses on the lower organic sales volumes.

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Adjusted Net Income. Adjusted Net Income of $73.6 million for the six months ended June 30, 2016 increased 5.6% from $69.7 million for the six months ended June 30, 2015, due to a decrease in cash income tax expense and the factors outlined above, partially offset by the 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.

Liquidity and Financial Condition

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

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

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

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

At June 30, 2016, we had cash and cash equivalents on hand of $75.6 million and $142.1 million of availability under our Amended ABL Facility, net of outstanding letters of credit.

In August 2015, the Company's Board of Directors approved a $200.0 million stock repurchase program. Under the program, the Company may repurchase up to $200.0 million of its common stock over 24 months from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The repurchase may be executed using open market purchases, privately negotiated agreements or other transactions. The actual timing, number and value of shares repurchased under the program will be determined by management at its discretion and will depend on a number of factors, including the market price of the Company's shares of common stock and general market and economic conditions, applicable legal requirements, and compliance with the terms of the Company's outstanding indebtedness. The repurchases will be funded from cash on hand or available borrowings. The stock repurchase program may be suspended or discontinued at any time without prior notice. For the three months ended June 30, 2016, the Company repurchased 935,000 shares of its common stock for $34.6 million, funded with cash on hand. Since the inception of the program, the Company has repurchased 4,238,500 shares of its common stock for $134.5 million, funded with cash on hand.

Long-term Liquidity

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

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Cash Flow

Six months ended June 30, 2016 compared to the six months ended June 30, 2015

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

(U.S. Dollars in thousands)	Six Months Ended June 30, 2016	2015	$ Change	% Change
Net cash provided by operating activities	$81,235	$41,579	39,656	95.4 %
Net cash used in investing activities	(74,843)	(13,937)	(60,906)	437.0 %
Net cash used in financing activities	(46,723)	(59,752)	13,029	-21.8 %

The 95.4% increase in net cash provided by operating activities was primarily driven by a large reduction in working capital during the current year as compared to a large increase in the prior year.

The increase in net cash used in investing activities for the six months ended June 30, 2016 was primarily due to cash payments of $60.9 million related to the acquisition of Pramac in the first quarter of 2016.

Net cash used in financing activities for the six months ended June 30, 2016 primarily represents $34.6 million of payments for the repurchase of the Company's common stock, $17.0 million of debt repayments ($10.7 million of long-term borrowings and $6.3 million of short-term borrowings) and $12.1 million related to the net share settlement of equity awards. These payments were partially offset by $10.3 million cash proceeds from short-term borrowings and a $6.7 million cash inflow related to excess tax benefits of equity awards.

Net cash used in financing activities for the six months ended June 30, 2015 primarily represents $161.8 million of debt repayments ($150.4 million of long-term borrowings and $11.4 million of short-term borrowings) partially offset by $109.0 million cash proceeds from borrowings ($100.0 million from long-term borrowings under the ABL facility and $9.0 million from short-term borrowings). In addition, the Company paid $12.3 million related to the net share settlement of equity awards, which was partially offset by $8.9 million of cash inflow related to the excess tax benefits of equity awards.

Contractual Obligations

In connection with the Pramac acquisition on March 1, 2016, the Company assumed $21.1 million of short-term borrowings and $18.6 million of long-term debt and capital lease obligations. Refer to Note 2, "Acquisitions," to the condensed consolidated financial statements for further information. Other than the assumption of the Pramac debt, there have been no material changes to our contractual obligations since the February 26, 2016 filing of our Annual Report on Form 10-K for the year ended December 31, 2015.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies

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

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

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Non-GAAP Measures

Adjusted EBITDA

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

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

- for planning purposes, including the preparation of our annual operating budget and developing and refining our internal projections for future periods;
- to allocate resources to enhance the financial performance of our business;
- as a benchmark for the determination of the bonus component of compensation for our senior executives under our management incentive plan, as described further in our 2016 proxy statement;
- to evaluate the effectiveness of our business strategies and as a supplemental tool in evaluating our performance against our budget for each period; and
- in communications with our Board of Directors and investors concerning our financial performance.

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

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

- by comparing our Adjusted EBITDA in different historical periods, our investors can evaluate our operating performance excluding the impact of items described below.

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

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

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

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

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

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

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

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

(U.S. Dollars in thousands)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Net income attributable to Generac Holdings Inc.	$20,888	$14,844	$31,096	$34,529
Net income attributable to noncontrolling interests (a)	55	-	59	-
Net income	20,943	14,844	31,155	34,529
Interest expense	11,380	10,763	22,415	22,031
Depreciation and amortization	13,650	10,129	26,443	19,163
Provision for income taxes	11,921	8,628	17,640	19,646
Non-cash write-down and other adjustments (b)	2,909	404	2,782	1,976
Non-cash share-based compensation expense (c)	2,901	2,582	5,386	5,090
Loss on extinguishment of debt (d)	-	3,427	-	4,795
Transaction costs and credit facility fees (e)	237	481	760	682
Business optimization expenses (f)	-	1,444	7,106	1,738
Other	(15)	(280)	48	(90)
Adjusted EBITDA	63,926	52,422	113,735	109,560
Adjusted EBITDA attributable to noncontrolling interests	1,623	-	2,307	-
Adjusted EBITDA attributable to Generac Holdings Inc.	$62,303	$52,422	$111,428	$109,560

(a) Includes the noncontrolling interests' share of expenses related to Pramac purchase accounting adjustments, including the step-up in value of inventories and intangible amortization, of $4.3 million and $5.5 million for the three and six months ended June 30, 2016, respectively.

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

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

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

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

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

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

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

(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 revolving credit facility commitment fees under our Term Loan and Amended ABL Facility, which we believe to be akin to, or associated with, interest expense and whose inclusion in Adjusted EBITDA is therefore similar to the inclusion of interest expense in that calculation.

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

Adjusted Net Income

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

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

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

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

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

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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 June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net income attributable to Generac Holdings Inc.	$20,888	$14,844	$31,096	$34,529
Net income attributable to noncontrolling interests	55	-	59	-
Net income	20,943	14,844	31,155	34,529
Provision for income taxes	11,921	8,628	17,640	19,646
Income before provision for income taxes	32,864	23,472	48,795	54,175
Amortization of intangible assets	8,217	5,980	16,014	11,175
Amortization of deferred finance costs and original issue discount	1,066	1,639	2,122	3,344
Loss on extinguishment of debt	-	3,427	-	4,795
Transaction costs and other purchase accounting adjustments (a)	3,443	240	4,690	503
Business optimization expenses	-	1,444	7,106	1,738
Adjusted net income before provision for income taxes	45,590	36,202	78,727	75,730
Cash income tax expense (b)	(1,450)	(920)	(3,270)	(6,035)
Adjusted net income	44,140	35,282	75,457	69,695
Adjusted net income attributable to noncontrolling interests	1,451	-	1,881	-
Adjusted net income attributable to Generac Holdings Inc.	$42,689	$35,282	$73,576	$69,695
Adjusted net income per common share attributable to Generac Holdings, Inc. - diluted:	$0.64	$0.50	$1.11	$0.99
Weighted average common shares outstanding - diluted:	66,388,581	70,063,063	66,465,770	70,099,940

(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 six months ended June 30, 2016 is based on an anticipated cash income tax rate of approximately 5% for the full year-ended 2016. Amount for the three and six months ended June 30, 2015 is based on an anticipated cash income tax rate of approximately 6% for the full year-ended 2015. Cash income tax expense for the respective periods is based on the projected taxable income and corresponding cash tax rate for the full year after considering the effects of current and deferred income tax items, and is calculated for each respective period by applying the derived cash tax rate to the period’s pretax income.

New Accounting Standards

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

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

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

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

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

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

	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
04/01/2016–04/30/2016	-	-	-	100,057,756
05/01/2016–05/31/2016	480,825	$ 36.04	480,000	82,757,189
06/01/2016–06/30/2016	455,000	37.97	455,000	65,481,994
Total	935,825	$ 36.98		

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

Item 6. Exhibits

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

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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: August 5, 2016

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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 June 30, 2016 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) related Notes to Condensed Consolidated Financial Statements.

* Filed herewith.
** Furnished herewith.