

Generac Holdings Inc. (NYSE: GNRC)

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Important Company Financial Data (From Ycharts.com, PEG is from NASDAQ.com)

Price: \$33.95	PEG: 0.84	ROE: 57.06%
Market Cap: 2.41 B	EPS: 4.89	ROA: 22.49%
P/E: 6.943	Beta: 0.65	52 Week: 18.35 – 39.18

Thesis

Generac Holdings is a company that is affected directly by the seasons. By owning 70% of the home-generator market, Generac's sales are extremely strong during the winter season as well as the aftermath of storms. Ever since Generac's IPO in February of 2010, Generac's stock is heavy correlated with the seasonal factors and therefore rises during colder times. Given that winter has not even approached, it is the perfect time to buy Generac and there are significant catalysts both in the short and long term, especially with increased estimates for next quarter.

Key Points

- Since being bought by CCMP Capital of New York in 2006, Generac has been experiencing strong growth.
 - Company has **doubled in 5 years**, net sales from \$550 million to \$1 billion; net sales **increased** by 25.6% from Q3 in 2011
 - **MISPERCEPTION:** Even if Generac has double its net sales, Generac still had a debt/equity of 2.035
 - **CORRECTION:** Over the past four years, net income has been increasing YOY while **total debt has been decreasing YOY** (see **Exhibit 2**), which is impressive seeing how Generac is enduring high costs to innovate and expand; it is a relatively small company. By expecting lowering interest rates and by planning to pay down debt, it will ultimately lower interest costs over time
 - Generac has only penetrated 2.5 % of the market, thus **extremely unsaturated** with expansion possibilities
 - A mere increase of **1 % penetration translates into \$2 billion**
 - Q3 has seen great improvement from Q3 of last year: sales **increased** by 17.8%, commercial and industrial product sales **increased** by 48.3%, and gross profit margin **increased** by 4.05%
 - Generac has been experiencing **pure organic growth** with a 15% CAGR from 2000 to 2011, since their first acquisition was Magnum in late 2011 (see **Exhibit 4**)
 - With a **PEG less than 1** and a medium market cap, Generac has a lot of potential to grow
- During **the colder seasons, Generac's stock shoots up** and then plateaus during hotter seasons. Generac's net income, return on asset, and return on equity **follows the same trend** (see **Exhibit 1**)
 - Key is to buy Generac stock before winter rolls into full throttle; history has proven it for the past 2 years
 - **More awareness** due to Sandy's effect in areas not usually affected by hurricanes **will increase sales**
 - **MISPERCEPTION:** Generac's stock has already shot up substantially after Hurricane Sandy and there if will not rise anymore.
 - **CORRECTION:** Although its stock is susceptible to sudden jumps, the winter is just starting to come around. Generac's rise often outlasts the winter season as the subsequent quarterly earnings reflects good earnings and boosts investor's confidence. During the Q3 Conference Call, CFO York Ragen said that the "afterglow can last between six and twelve months after this type of event [Sandy]."
 - Generac has recently **increased their sales growth guidance** for full-year 2012 to low-40% **and EBITDA** for the full-year 2012 to mid-40%, an increase from low-30% and mid-30% respectively due to **stronger expected sales in Q4**
 - By speaking to representatives from both **Home Depot and Lowe's** on November 19th, both of which serve as large intermediaries for portable generators, **the demand has been exceptionally strong** (see **VAR 1 to 3**)
- Generac will be benefitting from increasing exposure of their products as they are a relatively small company
 - Currently **30-50%** of the US power grid is **40 to 50 years old**, in which undergrounding the grid would **cost \$4 trillion**. Generac will certainly benefit from the **inevitability of increasing outages due to technical failures**
 - The number of **power outages have been increasing** over the past 30 years (see **VAR5**)
 - Not only is Generac growing within the United States, Generac is trying to **expand internationally** as well
 - On July 30, Generac started to service Generac home power systems in **Australia and New Zealand**. Similar to the US, Australia has an abundance of natural gas, extreme weather patterns, and high housing prices
 - **Over 100 dealers were added in 35 countries over the last 2 years**
 - Opened Asian Pacific sales office in Hong Kong and a new Spanish website was set up in September

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- Shift from diesel gas generators to natural gas generators (see **VAR4**) in which **Generac is the number one provider** and owns roughly **70% of the home generator market** (see **Exhibit 5**)
 - Use of natural gas can be 35% less expensive, eliminates diesel fuel storage, spillage, spoilage issues
 - **MISPERCEPTION:** If the shift is not significant, Generac's revenue growth will not be significant either
 - **CORRECTION:** Not only does Generac provide products to residential consumers, they also provide a variety of goods to the commercial and industrial market, accounting for 35% of the sales (see **Exhibit 3**). The acquisition of Magnum helped boost commercial and industrial product sales increase by 48.3% as they are the number one provider of light towers.
- In New Jersey, which suffered greatly due to Sandy, lawmakers are pushing for **four varied proposals** that would **require gas stations** to be equipped with back-up generators.
 - These bills aim at the same criteria of **requiring** gas stations to keep **gas-powered** generators to keep fuel pumps during outages
 - One bill would fine a retailer at least \$1,000 for failing to have an alternative power ready in crisis
 - This would act as a huge catalyst in the short-run given that Generac is the **main provider of gas-powered generators** and the number of gas stations in New Jersey

VAR

- **VAR1:** Tavia, representative for Home Depot (general) – It was a “first come, first serve” basis in which “some stores didn’t even try to log” in the generators when they arrived since “**there was no time.**”
- **VAR2:** Dennis, representative for Home Depot (Milton, NJ) – Has worked there for 13 years and never had this degree of demand. People traveled from around the state for the portable generators and 1000 were sold out as soon as they got in.
- **VAR3:** Christine, representative for Lowe’s (general) – There is still a demand even after generators were sold out and they are **still in the process of restocking**
- **VAR4:** Contacted Generac Holdings for more information about change in demand for generators and was led to a report completed by “Frost & Sullivan” regarding shift from diesel to natural gas (see **Exhibit 6**)
- **VAR5:** Contacted Carnegie Mellon University for a research report called "Large Blackouts in North America: Historical Trends and Policy Implications" (see **Exhibit 7**)

How It Plays Out

Generac's main advantage as a company is its **dominant position** in an **unsaturated market** that will experience **strong tailwinds** in the long and short term. Historically, there has been a **heavy positive correlation** with its stock during colder times, which have not really started. In the short run, there are **expected increased earnings in a strong fourth quarter** due to greater awareness caused by Sandy as well as **four potential bills in New Jersey** that would require all gas stations to own gas generators. In the long run, there is a **market shift from diesel to natural gas** and a **continuing weakening power grid** that will increase power outages. Generac is a great stock to buy now given all of these catalysts combined with a **PEG under 1 a low P/E**, especially before winter comes around.

Risks / What Signs Would Indicate We Are Wrong?

- There is the risk of not having any a major storms at all during this winter season, however this would more reflect Q1 earnings of next year rather than Q4 earnings this year
- Stronger expected sales in Q4 could already be built into the stock price right now, so there is the possibility that the Q4 reports will act as a strong catalyst as anticipated

Signposts / Follow-Up

- Follow the four bills in New Jersey and check the likelihood of them getting passed
- Quarter 4 results should be very strong, thus boosting investors' confidence
- The winter season has not started, check for major storms that would cause power outages

Company Description

Founded in 1959, Generac Holdings is a manufacturer of backup power products for residential, light commercial and industrial markets. Bought in 2006 by CCMP Capital of New York, it went public four years later. With 1,500 employees, Generac's headquarters are based in Waukesha, Wisconsin and its CEO is Aaron Jagdfeld.

Idea for MII:

In order to brainstorm companies that I want to potentially long and short, I cut up interesting articles from the WSJ every day and separate them into different categories. After accumulating a wide variety of news articles, I am able to connect ideas and form them into a conclusion on a much grander scale. Therefore, I recommend some way to inform MII members frequently about current events each week. Perhaps, each analyst is required to track some event, whether it is a big macro picture (consumer spending in country X) or something else (prices of commodities). Analysts then have to update a Google doc weekly that is shared with the entire club. Therefore, every member of the club has access to information to build ideas.

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Exhibit 1:

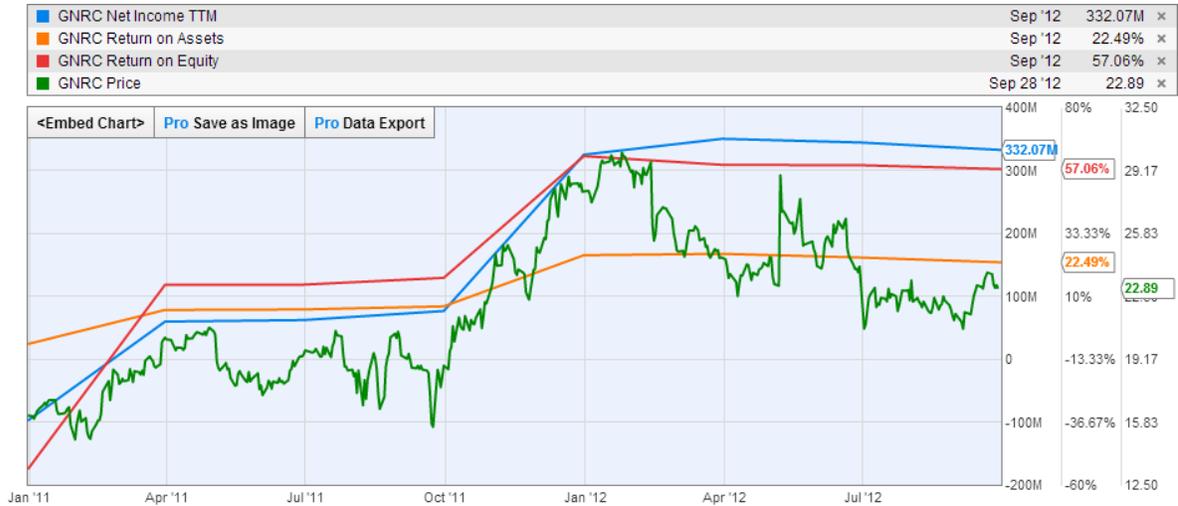


Exhibit 2:

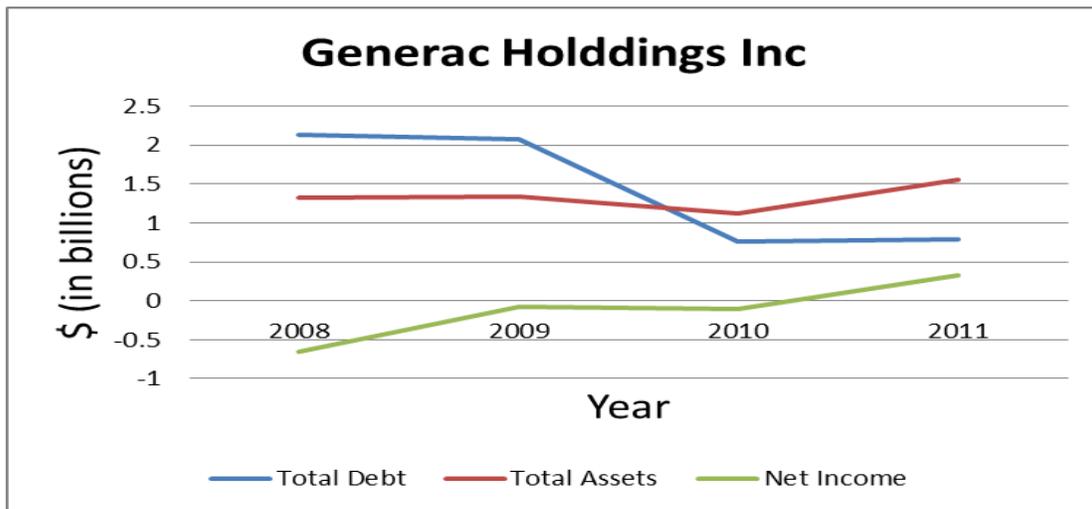


Exhibit 3:

Residential Products		Industrial Products	
	Product	Product	End Markets Served
	Power Washers		Light Towers Temporary lighting for construction
	Inverter Generators		Mobile Generators Temporary power for construction, special events
	Portable Generators & Manual Transfer Switches		Mobile Pumps De-watering for construction sites & flood water removal
	Air-cooled Home Standby Generator		Commercial Stationary Generators Emergency backup – small to mid-sized retail, telecom, municipal
	Liquid-cooled Home Standby Generator		Industrial Stationary Generators Emergency backup – large healthcare, telecom, municipal, manufacturing

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Exhibit 4:

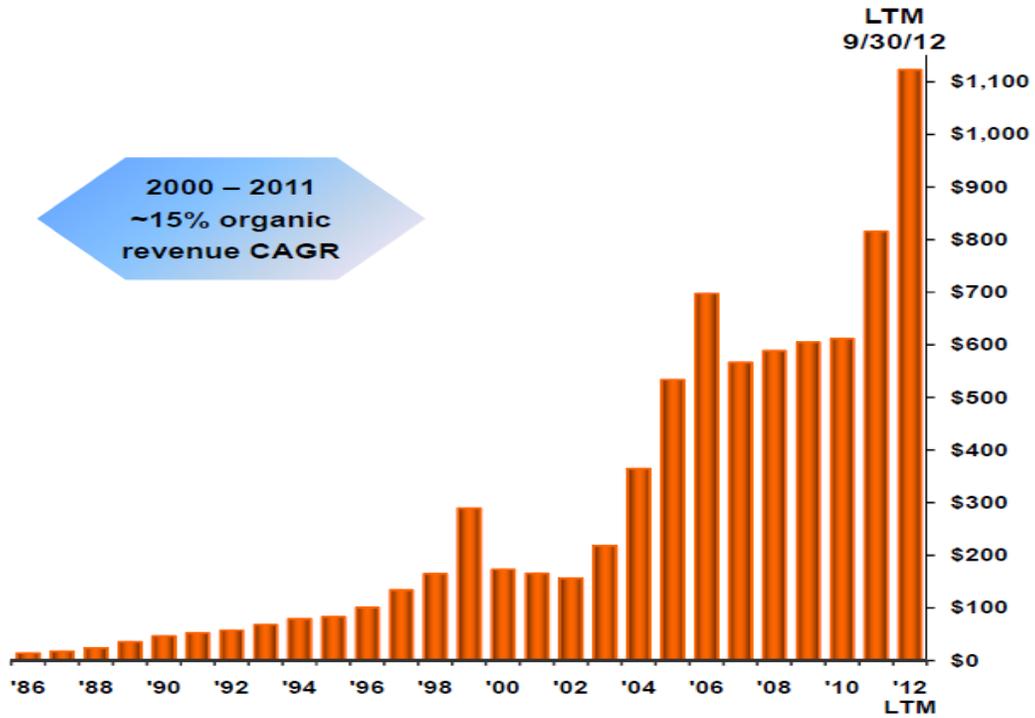


Exhibit 5:

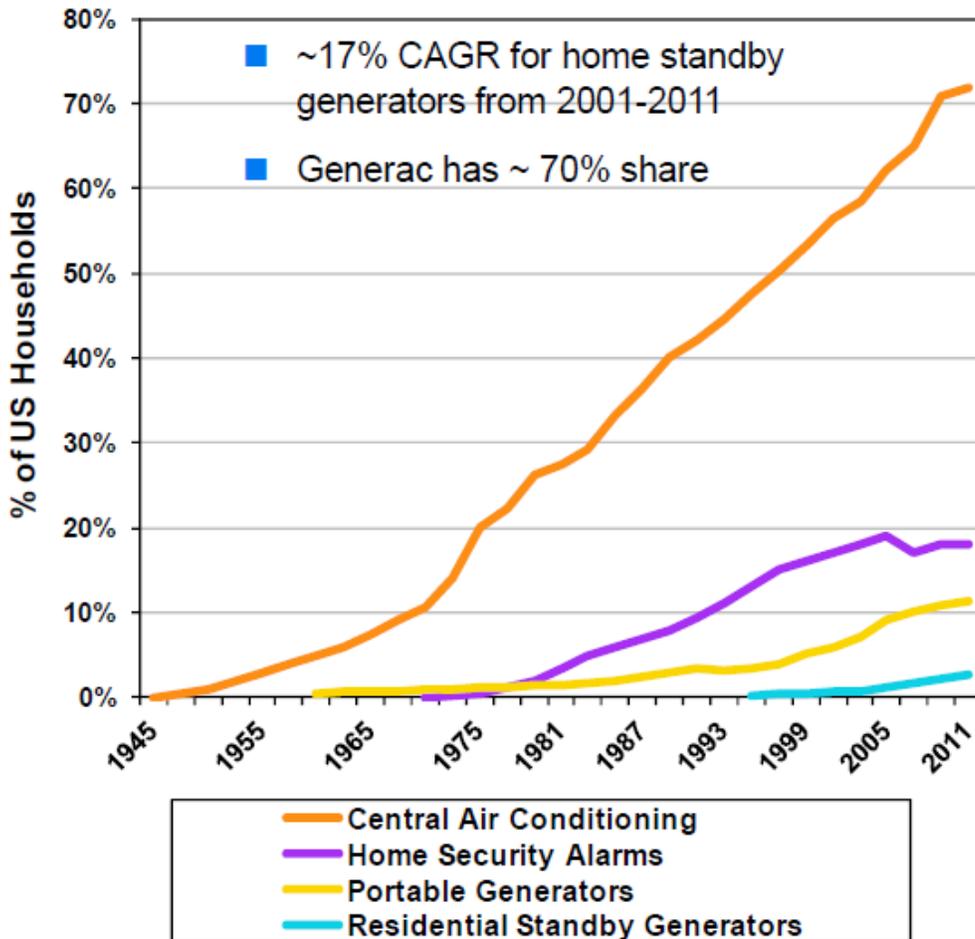
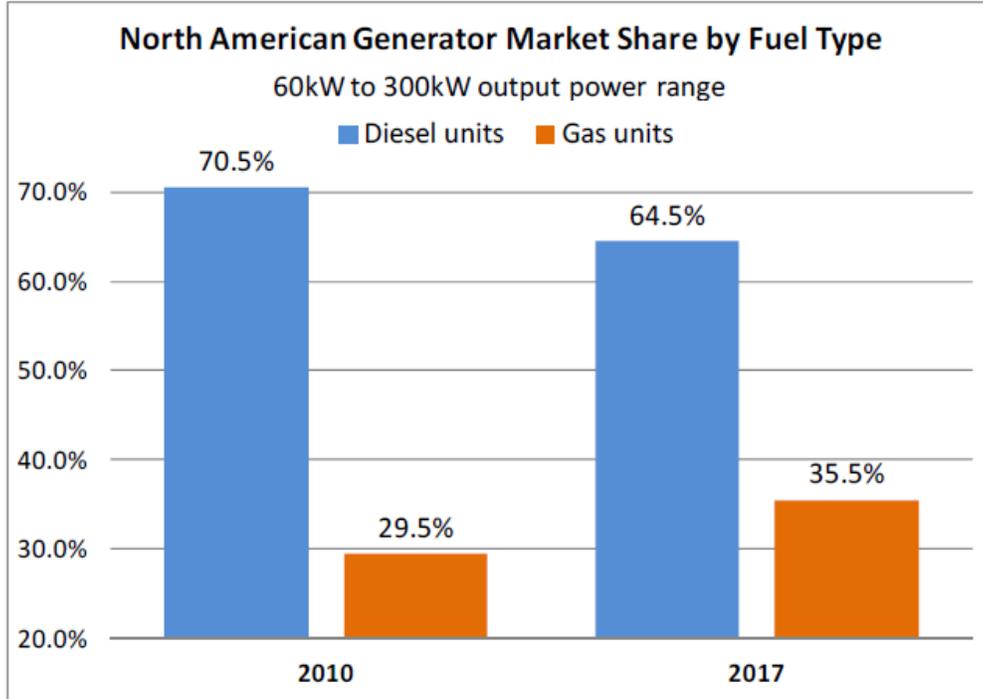


Exhibit 6:

Secular Shift – Natural Gas vs. Diesel Market Growth



Source: Frost & Sullivan, Generac estimates

Exhibit 7:

Carnegie Mellon Electricity Industry Center Working Paper CEIC 09-01

www.cmu.edu/electricity

