

ITRON INC /WA/
Form 10-Q
August 04, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-22418

ITRON, INC.

(Exact name of registrant as specified in its charter)

Washington
(State of Incorporation) 91-1011792
(I.R.S. Employer Identification Number)
2111 N Molter Road, Liberty Lake, Washington 99019

(509) 924-9900

(Address and telephone number of registrant's principal executive offices)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of June 30, 2010 there were outstanding 40,374,888 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

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Itron, Inc.

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Table of Contents**PART I: FINANCIAL INFORMATION****Item 1: Financial Statements (Unaudited)****ITRON, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)**

| | Three Months Ended June 30 | | Six Months Ended June 30, | |
|--|--|-------------|----------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except per share data) | | | |
| Revenues | \$ 569,460 | \$ 413,748 | \$ 1,068,740 | \$ 802,266 |
| Cost of revenues | 393,136 | 280,639 | 733,521 | 539,573 |
| Gross profit | 176,324 | 133,109 | 335,219 | 262,693 |
| Operating expenses | | | | |
| Sales and marketing | 40,974 | 37,925 | 82,511 | 74,900 |
| Product development | 33,022 | 30,809 | 66,062 | 61,967 |
| General and administrative | 33,285 | 28,467 | 66,342 | 57,491 |
| Amortization of intangible assets | 16,766 | 24,189 | 34,577 | 47,667 |
| Total operating expenses | 124,047 | 121,390 | 249,492 | 242,025 |
| Operating income | 52,277 | 11,719 | 85,727 | 20,668 |
| Other income (expense) | | | | |
| Interest income | 111 | 481 | 278 | 1,016 |
| Interest expense | (13,965) | (16,399) | (28,888) | (33,244) |
| Loss on extinguishment of debt, net | - | - | - | (10,340) |
| Other income (expense), net | (425) | (2,877) | (1,017) | (4,911) |
| Total other income (expense) | (14,279) | (18,795) | (29,627) | (47,479) |
| Income (loss) before income taxes | 37,998 | (7,076) | 56,100 | (26,811) |
| Income tax (provision) benefit | (11,098) | 22,365 | (2,413) | 22,371 |
| Net income (loss) | \$ 26,900 | \$ 15,289 | \$ 53,687 | \$ (4,440) |
| Earnings (loss) per common share-Basic | \$ 0.67 | \$ 0.40 | \$ 1.33 | \$ (0.12) |
| Earnings (loss) per common share-Diluted | \$ 0.65 | \$ 0.40 | \$ 1.31 | \$ (0.12) |
| Weighted average common shares outstanding-Basic | 40,329 | 37,776 | 40,261 | 36,968 |
| Weighted average common shares outstanding-Diluted | 41,161 | 38,130 | 41,011 | 36,968 |

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

Table of Contents**ITRON, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands)

| | June 30, 2010 | December 31, 2009 |
|--|----------------------|--------------------------|
| | (unaudited) | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 137,371 | \$ 121,893 |
| Accounts receivable, net | 366,476 | 337,948 |
| Inventories | 201,678 | 170,084 |
| Deferred tax assets current, net | 20,833 | 20,762 |
| Other current assets | 65,336 | 75,229 |
| Total current assets | 791,694 | 725,916 |
| Property, plant, and equipment, net | 289,409 | 318,217 |
| Prepaid debt fees | 7,109 | 8,628 |
| Deferred tax assets noncurrent, net | 67,684 | 89,932 |
| Other noncurrent assets | 15,612 | 18,117 |
| Intangible assets, net | 309,030 | 388,212 |
| Goodwill | 1,146,082 | 1,305,599 |
| Total assets | \$ 2,626,620 | \$ 2,854,621 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 235,441 | \$ 219,255 |
| Other current liabilities | 59,677 | 64,583 |
| Wages and benefits payable | 85,386 | 71,592 |
| Taxes payable | 18,097 | 14,377 |
| Current portion of long-term debt | 10,182 | 10,871 |
| Current portion of warranty | 26,250 | 20,941 |
| Unearned revenue | 37,987 | 40,140 |
| Deferred tax liabilities current, net | 1,625 | 1,625 |
| Total current liabilities | 474,645 | 443,384 |
| Long-term debt | 663,159 | 770,893 |
| Warranty | 22,953 | 12,932 |
| Pension plan benefits | 54,953 | 63,040 |
| Deferred tax liabilities noncurrent, net | 60,017 | 80,695 |
| Other noncurrent obligations | 67,908 | 83,163 |
| Total liabilities | 1,343,635 | 1,454,107 |
| Commitments and contingencies | | |
| Shareholders' equity | | |
| Preferred stock | - | - |
| Common stock | 1,315,067 | 1,299,134 |
| Accumulated other comprehensive income (loss), net | (116,019) | 71,130 |

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| | | | | |
|--|--|--------------|----|-----------|
| Retained earnings | | 83,937 | | 30,250 |
| Total shareholders' equity | | 1,282,985 | | 1,400,514 |
| Total liabilities and shareholders' equity | | \$ 2,626,620 | \$ | 2,854,621 |

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

Table of Contents**ITRON, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

| | Six Months Ended June 30, | |
|--|----------------------------------|-------------------|
| | 2010 | 2009 |
| | (in thousands) | |
| Operating activities | | |
| Net income (loss) | \$ 53,687 | \$ (4,440) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 65,071 | 74,407 |
| Stock-based compensation | 9,121 | 9,279 |
| Amortization of prepaid debt fees | 2,762 | 2,272 |
| Amortization of convertible debt discount | 4,957 | 4,895 |
| Loss on extinguishment of debt, net | - | 9,960 |
| Deferred taxes, net | (7,159) | (35,000) |
| Other adjustments, net | 3,306 | (465) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (52,332) | 9,940 |
| Inventories | (40,930) | (1,575) |
| Accounts payables, other current liabilities, and taxes payable | 42,463 | (4,054) |
| Wages and benefits payable | 19,648 | (9,004) |
| Unearned revenue | (1,205) | 12,719 |
| Warranty | 14,034 | (4,190) |
| Other operating, net | 3,663 | 2,609 |
| Net cash provided by operating activities | 117,086 | 67,353 |
| Investing activities | | |
| Acquisitions of property, plant, and equipment | (27,716) | (27,804) |
| Business acquisitions & contingent consideration, net of cash equivalents acquired | - | (1,317) |
| Other investing, net | 4,495 | 3,973 |
| Net cash used in investing activities | (23,221) | (25,148) |
| Financing activities | | |
| Payments on debt | (73,881) | (70,241) |
| Issuance of common stock | 6,812 | 162,153 |
| Prepaid debt fees | (1,340) | (3,992) |
| Other financing, net | (897) | (587) |
| Net cash (used in) provided by financing activities | (69,306) | 87,333 |
| Effect of foreign exchange rate changes on cash and cash equivalents | (9,081) | 2,200 |
| Increase in cash and cash equivalents | 15,478 | 131,738 |
| Cash and cash equivalents at beginning of period | 121,893 | 144,390 |
| Cash and cash equivalents at end of period | \$ 137,371 | \$ 276,128 |

Non-cash transactions:

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| | | | | |
|--|----|---------|----|---------|
| Fixed assets purchased but not yet paid, net | \$ | (3,491) | \$ | 5,149 |
| Exchange of debt (face value) for common stock | | - | | 120,984 |
| Contingent consideration payable for previous acquisitions | | - | | 2,000 |

Supplemental disclosure of cash flow information:

Cash paid during the period for:

| | | | | |
|--------------------------------------|----|--------|----|--------|
| Income taxes | \$ | 9,355 | \$ | 5,926 |
| Interest, net of amounts capitalized | | 21,178 | | 31,932 |

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

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ITRON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(UNAUDITED)

In this Quarterly Report on Form 10-Q, the terms we, us, our, Itron, and the Company refer to Itron, Inc.

Note 1: Summary of Significant Accounting Policies

We were incorporated in the state of Washington in 1977. We provide a portfolio of products and services to utilities for the energy and water markets throughout the world.

Financial Statement Preparation

The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009, the Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2009 audited financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the SEC on February 25, 2010. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation

We consolidate all entities in which we have a greater than 50% ownership interest. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. At June 30, 2010, our investments in variable interest entities and noncontrolling interests were not material. Intercompany transactions and balances have been eliminated upon consolidation.

Cash and Cash Equivalents

We consider all highly liquid instruments with remaining maturities of three months or less at the date of acquisition to be cash equivalents.

Derivative Instruments

All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments, which are primarily interest rate swaps, are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP.

The net fair value of our derivative instruments may switch between a net asset and a net liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) (OCI) and are

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recognized in earnings when the hedged item affects earnings. For our hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Ineffective portions of fair value changes or the changes in fair value of derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

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Derivatives are not used for trading or speculative purposes. Our derivatives are with major international financial institutions, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments. Refer to Note 7 and Note 12 for further disclosures of our derivative instruments and their impact on OCI.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded for invoices issued to customers in accordance with our contractual arrangements. Interest and late payment fees are minimal. Unbilled receivables are recorded when revenues are recognized upon product shipment or service delivery and invoicing occurs at a later date. The allowance for doubtful accounts is based on our historical experience of bad debts and our specific review of outstanding receivables at period-end. Accounts receivable are written-off against the allowance when we believe an account, or a portion thereof, is no longer collectible.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Cost includes raw materials and labor, plus applied direct and indirect costs.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally thirty years for buildings and improvements and three to five years for machinery and equipment, computers and purchased software, and furniture. Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Construction in process represents capital expenditures incurred for assets not yet placed in service. Costs related to internally developed software and software purchased for internal uses are capitalized and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. We have had no significant impairments of long-lived assets. Assets held for sale are classified within other current assets in the Consolidated Balance Sheets, are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. We had no assets held for sale at June 30, 2010 or December 31, 2009.

Prepaid Debt Fees

Prepaid debt fees represent the capitalized direct costs incurred related to the issuance of debt and are recorded as noncurrent assets. These costs are amortized to interest expense over the lives of the respective borrowings, including contingent maturity or call features, using the effective interest method, or straight-line method when associated with a revolving credit facility. When debt is repaid early, the related portion of unamortized prepaid debt fees is written-off and included in interest expense.

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree results of operations are also included as of the date of acquisition in the consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and development (IPR&D), are measured and recorded at fair value. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recorded at fair value. If not practicable, such assets and liabilities are measured and recorded when it is probable that a gain or loss has occurred and the amount can be reasonably estimated. We capitalize any future IPR&D as an intangible asset and amortize the balance over its estimated useful life. The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs are expensed as incurred. Restructuring costs are generally expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period are recognized as a component of provision for income taxes.

Goodwill and Intangible Assets

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Goodwill and intangible assets have resulted from our acquisitions. We use estimates in determining and assigning the fair value of goodwill and intangible assets, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations. Our intangible assets have finite lives, are amortized over their estimated useful lives based on estimated discounted cash flows, and are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

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Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the forecasted discounted cash flows associated with each reporting unit. Goodwill is tested for impairment as of October 1 of each year, or more frequently if a significant impairment indicator occurs. Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. We forecast discounted future cash flows at the reporting unit level using risk-adjusted discount rates and estimated future revenues and operating costs, which take into consideration factors such as existing backlog, expected future orders, supplier contracts, and expectations of competitive and economic environments. We also identify similar publicly traded companies and develop a correlation, referred to as a multiple, to apply to the operating results of our reporting units.

Warranty

We offer standard warranties on our hardware products and large application software products. We accrue the estimated cost of warranty claims based on historical and projected product performance trends and costs. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Continuing quality control efforts during manufacturing reduce our exposure to warranty claims. If our quality control efforts fail to detect a fault in one of our products, we could experience an increase in warranty claims. We track warranty claims to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The warranty allowances may fluctuate due to changes in estimates for material, labor, and other costs we may incur to repair or replace projected product failures, and we may incur additional warranty and related expenses in the future with respect to new or established products, which could adversely affect our financial position and results of operations. The long-term warranty balance includes estimated warranty claims beyond one year. Warranty expense is classified within cost of revenues.

Contingencies

A loss contingency is recorded if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We evaluate, among other factors, the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of the ultimate loss. Changes in these factors and related estimates could materially affect our financial position and results of operations.

Bonus and Profit Sharing

We have various employee bonus and profit sharing plans, which provide award amounts for the achievement of annual financial and nonfinancial targets. If management determines it probable that the targets will be achieved and the amounts can be reasonably estimated, a compensation accrual is recorded based on the proportional achievement of the financial and nonfinancial targets. Although we monitor and accrue expenses quarterly based on our progress toward the achievement of the annual targets, the actual results at the end of the year may require awards that are significantly greater or less than the estimates made in earlier quarters.

Defined Benefit Pension Plans

We sponsor both funded and unfunded non-U.S. defined benefit pension plans. We recognize a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. We also recognize the funded status of our defined benefit pension plans on our Consolidated Balance Sheets and recognize as a component of OCI, net of tax, the actuarial gains or losses and prior service costs or credits, if any, that arise during the period but that are not recognized as components of net periodic benefit cost.

Revenue Recognition

Revenues consist primarily of hardware sales, software license fees, software implementation, project management services, installation, consulting, and post-sale maintenance support.

On January 1, 2010, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Tax Force)* and ASU 2009-14, *Software (Topic 985), Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)* on a prospective basis for new arrangements and arrangements that are materially modified. This new guidance did not have a material impact on our financial statements for the three and six months ended June 30, 2010, as we already had the ability to divide the deliverables within our revenue arrangements into separate units of accounting. Further, there would have been no change to the amount of revenue recognized in the year ended December 31, 2009 if arrangements prior to the adoption of ASU 2009-13 and ASU 2009-14 had been subject to

the measurement requirements of this new guidance.

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We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using vendor specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP).

VSOE is generally limited to the price charged when the same or similar product is sold separately or, if applicable, the stated renewal rate in the agreement. If a product or service is seldom sold separately, it is unlikely that we can determine VSOE for the product or service. We define VSOE as a median price of recent standalone transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately.

For arrangements entered into or materially modified after January 1, 2010, if we are unable to establish selling price using VSOE or TPE, we will use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Specifically, we consider the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, our ongoing pricing strategy and policies (as evident in the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable, and the characteristics of the varying markets in which the deliverable is sold.

We plan to analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) have value to the customer on a standalone basis and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria considered for each unit of accounting. For our standard contract arrangements that combine deliverables such as hardware, meter reading system software, installation, and project management services, each deliverable is generally considered a single unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect and that is not contingent upon the delivery/performance of additional items.

Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Hardware revenues are generally recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.

For multiple element software arrangements that do not include hardware, revenue recognition is dependent upon the availability of VSOE for fair value for each of the elements. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for software arrangements.

We primarily enter into two types of multiple deliverable arrangements, which may include any combination of hardware and associated software and services.

Arrangements that do not include the deployment of our OpenWay® technology are recognized as follows:

Revenue from hardware shipments is recognized upon delivery once title and risk of loss pass to the customer.

If implementation services are essential to the functionality of the associated software, software and implementation revenues are recognized using either the percentage-of-completion methodology of contract accounting if project costs can be estimated, or the completed contract methodology if project costs cannot be reliably estimated.

Arrangements to deploy our OpenWay technology are recognized as follows:

Revenue from hardware shipments is recognized upon delivery once title and risk of loss pass to the customer.

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Revenue from associated software and services is recognized using the units-of-delivery method of contract accounting. This methodology often results in the deferral of costs and revenues as professional services and software implementation typically commence prior to deployment of hardware.

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In all cases, hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract.

Shipping and handling costs and incidental expenses billed to customers are recorded as revenue, with the associated cost charged to cost of revenues. We record sales, use, and value added taxes billed to our customers on a net basis.

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of \$43.5 million and \$45.4 million at June 30, 2010 and December 31, 2009 related primarily to professional services and software associated with our OpenWay contracts, extended warranty, and prepaid post contract support. Deferred cost is recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were \$12.7 million and \$19.7 million at June 30, 2010 and December 31, 2009.

Product and Software Development Costs

Product and software development costs primarily include employee compensation and third party contracting fees. For software we develop to be marketed or sold, we capitalize development costs after technological feasibility is established. Due to the relatively short period of time between technological feasibility and the completion of product and software development, and the immaterial nature of these costs, we generally do not capitalize product and software development expenses.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including stock options, stock sold pursuant to our Amended and Restated 2002 Employee Stock Purchase Plan (ESPP), and the issuance of restricted and unrestricted stock awards and units, based on estimated fair values. The fair values of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected life. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the vesting requirement period. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Loss on Extinguishment of Debt, Net

Upon partial or full redemption of our borrowings, we recognize a gain or loss for the difference between the cash paid and the net carrying amount of the debt redeemed. Included in the net carrying amount is any unamortized premium or discount from the original issuance of the debt. Due to the particular characteristics of our convertible notes, upon conversion or derecognition of our convertible notes, we recognize a gain or loss for the difference between the fair value of the consideration transferred to the holder that is allocated to the liability component, which is equal to the fair value of the liability component immediately prior to extinguishment, and the net carrying amount of the liability component (including any unamortized discount and debt issuance costs). In the case of an induced conversion, a loss is recognized for the amount of the fair value of the securities or other consideration transferred to the holder in excess of fair value of the consideration issuable in accordance with the original conversion terms of the debt.

Income Taxes

We account for income taxes using the asset and liability method of accounting. Deferred tax assets and liabilities are recognized based upon anticipated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards in each of the jurisdictions in which we operate. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of our tax liabilities involves applying complex tax regulations in different tax jurisdictions to our tax positions. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized. We do not record tax liabilities on undistributed earnings of international subsidiaries that are permanently reinvested.

We compute our interim income tax provision through the use of an estimated annual effective tax rate (ETR) applied to year-to-date operating results and specific events that are discretely recognized as they occur. In determining the estimated annual ETR, we analyze various factors, including projections of our annual earnings, taxing jurisdictions in which the

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earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than included in the estimated annual ETR.

A tax position is first evaluated for recognition based on its technical merits. Tax positions that have a greater than fifty percent likelihood of being realized upon ultimate settlement are then measured to determine amounts to be recognized in the financial statements. This measurement incorporates information about potential settlements with taxing authorities. A previously recognized tax position is derecognized in the first period in which the position no longer meets the more-likely-than-not recognition threshold. We classify interest expense and penalties related to uncertain tax positions and interest income on tax overpayments as part of income tax expense.

Foreign Exchange

Our consolidated financial statements are reported in U.S. dollars. Assets and liabilities of international subsidiaries with a non-U.S. dollar functional currency are translated to U.S. dollars at the exchange rates in effect on the balance sheet date, or the last business day of the period, if applicable. Gains and losses that arise from exchange rate fluctuations for monetary asset and liability balances that are not denominated in an entity's functional currency are included in the Consolidated Statements of Operations. Currency gains and losses of intercompany balances deemed to be long-term in nature or designated as a hedge of the net investment in international subsidiaries are included, net of tax, in OCI. Revenues and expenses for these subsidiaries are translated to U.S. dollars using a weighted average rate for the relevant reporting period. Translation adjustments resulting from this process are included, net of tax, in OCI.

Fair Value Measurements

For assets and liabilities measured at fair value, the GAAP fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility, credit risks, and default rates). We hold no assets or liabilities measured using Level 1 fair value inputs.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Due to various factors affecting future costs and operations, actual results could differ materially from these estimates.

New Accounting Pronouncements

In April 2010, the FASB issued ASU 2010-13, *Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Primarily Trades*, to eliminate disparity in practice. ASU 2010-13 clarifies that differences between currencies of the underlying equity securities of the share-based payment award and the functional currency of the employer entity or the employee's payroll currency should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This pronouncement will be effective on January 1, 2011 and will not have an impact on our consolidated financial statements as we treat this type of share-based payment award as equity.

Table of Contents**Note 2: Earnings Per Share and Capital Structure**

The following table sets forth the computation of basic and diluted earnings per share (EPS):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|---------------------------------------|-----------|---------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except per share data) | | | |
| Net income (loss) available to common shareholders | \$ 26,900 | \$ 15,289 | \$ 53,687 | \$ (4,440) |
| Weighted average common shares outstanding-Basic | 40,329 | 37,776 | 40,261 | 36,968 |
| Dilutive effect of convertible notes | 283 | 354 | 206 | - |
| Dilutive effect of stock-based awards | 549 | - | 544 | - |
| Weighted average common shares outstanding-Diluted | 41,161 | 38,130 | 41,011 | 36,968 |
| Earnings (loss) per common share-Basic | \$ 0.67 | \$ 0.40 | \$ 1.33 | \$ (0.12) |
| Earnings (loss) per common share-Diluted | \$ 0.65 | \$ 0.40 | \$ 1.31 | \$ (0.12) |

Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 374,000 and 671,000 stock-based awards were excluded from the calculation of diluted EPS for the three months ended June 30, 2010 and 2009, and approximately 419,000 and 1.0 million stock-based awards were excluded from the calculation of diluted EPS for the six months ended June 30, 2010 and 2009 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Convertible Notes

We are required, pursuant to the indenture for the convertible notes, to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares, or a combination. We include in the EPS calculation the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are converted. The average closing prices of our common stock for the three and six months ended June 30, 2010 and 2009 were used as the basis for determining the dilutive effect on EPS. The average price of our common stock for the three and six months ended June 30, 2010 exceeded the conversion price of \$65.16 and, therefore, approximately 283,000 and 206,000 shares have been included in the diluted EPS calculation for these respective periods. The average price of our common stock for the three and six months ended June 30, 2009 did not exceed the conversion price of \$65.16 and, therefore, did not have an effect on diluted shares outstanding.

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, rates, and subject to such adjustments as set by the Board of Directors. There was no preferred stock sold or outstanding at June 30, 2010 and December 31, 2009.

Table of Contents**Note 3: Certain Balance Sheet Components***Accounts receivable, net*

| | At June 30, | At December 31, |
|---|-------------------|-------------------|
| | 2010 | 2009 |
| | (in thousands) | |
| Trade receivables (net of allowance of \$6,298 and \$6,339) | \$ 334,498 | \$ 319,237 |
| Unbilled revenue | 31,978 | 18,711 |
| Total accounts receivable, net | \$ 366,476 | \$ 337,948 |

A summary of the allowance for doubtful accounts activity is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------------------|-----------------------------|-----------------|---------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Beginning balance | \$ 5,870 | \$ 5,213 | \$ 6,339 | \$ 5,954 |
| Provision for doubtful accounts, net | 742 | 2,008 | 662 | 1,890 |
| Accounts written off | (43) | (339) | (173) | (636) |
| Effects of change in exchange rates | (271) | 389 | (530) | 63 |
| Ending balance, June 30 | \$ 6,298 | \$ 7,271 | \$ 6,298 | \$ 7,271 |

Inventories

| | At June 30, | At December 31, |
|--------------------------|-------------------|-------------------|
| | 2010 | 2009 |
| | (in thousands) | |
| Materials | \$ 105,496 | \$ 85,358 |
| Work in process | 19,322 | 17,668 |
| Finished goods | 76,860 | 67,058 |
| Total inventories | \$ 201,678 | \$ 170,084 |

Our inventory levels may vary period to period as a result of our factory scheduling and timing of contract fulfillments.

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Consigned inventory is held at third-party locations; however, we retain title to the inventory until purchased by the third-party. Consigned inventory, consisting of raw materials and finished goods, was \$9.7 million and \$10.6 million at June 30, 2010 and December 31, 2009, respectively.

Property, plant, and equipment, net

| | At June 30, | At December 31, |
|---|-----------------------|------------------------|
| | 2010 | 2009 |
| | (in thousands) | |
| Machinery and equipment | \$ 244,891 | \$ 243,652 |
| Computers and purchased software | 58,744 | 66,787 |
| Buildings, furniture, and improvements | 136,669 | 144,639 |
| Land | 34,505 | 37,738 |
| Construction in progress, including purchased equipment | 18,104 | 22,009 |
| | | |
| Total cost | 492,913 | 514,825 |
| Accumulated depreciation | (203,504) | (196,608) |
| | | |
| Property, plant, and equipment, net | \$ 289,409 | \$ 318,217 |

Depreciation expense was \$15.0 million and \$14.0 million for the three months ended June 30, 2010 and 2009, and \$30.5 million and \$26.7 million for the six months ended June 30, 2010 and 2009, respectively.

Table of Contents**Note 4: Intangible Assets**

The gross carrying amount and accumulated amortization of our intangible assets, other than goodwill, are as follows:

| | At June 30, 2010 Accumulated | | | At December 31, 2009 Accumulated | | |
|--------------------------------------|---------------------------------|---------------------|-----------------------|-------------------------------------|---------------------|-------------------|
| | Gross Assets | Amortization | Net (in thousands) | Gross Assets | Amortization | Net |
| Core-developed technology | \$ 366,175 | \$ (247,896) | \$ 118,279 | \$ 398,043 | \$ (244,545) | \$ 153,498 |
| Customer contracts and relationships | 267,365 | (93,021) | 174,344 | 306,061 | (92,187) | 213,874 |
| Trademarks and trade names | 70,608 | (55,253) | 15,355 | 77,439 | (57,957) | 19,482 |
| Other | 23,953 | (22,901) | 1,052 | 24,713 | (23,355) | 1,358 |
| Total intangible assets | \$ 728,101 | \$ (419,071) | \$ 309,030 | \$ 806,256 | \$ (418,044) | \$ 388,212 |

A summary of the intangible asset account activity is as follows:

| | Six Months Ended June 30, 2010 | | 2009 | |
|---|-----------------------------------|----------------|-----------|----------------|
| | (in thousands) | | | |
| Beginning balance, intangible assets, gross | \$ | 806,256 | \$ | 796,236 |
| Effect of change in exchange rates | | (78,155) | | (3,685) |
| Ending balance, intangible assets, gross | \$ | 728,101 | \$ | 792,551 |

Intangible assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amount of intangible assets increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates.

Intangible asset amortization expense is as follows:

| | Three Months Ended June 30, 2010 | | 2009 | |
|-----------------------------------|-------------------------------------|------|------|------|
| | (in millions) | | | |
| Amortization of intangible assets | \$ | 16.8 | \$ | 24.2 |
| | | | \$ | 34.6 |
| | | | \$ | 47.7 |

Estimated future annual amortization expense is as follows:

Estimated Annual

Years ending December 31,

Amortization
(in thousands)

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| | | |
|--|----|---------|
| 2010 (amount remaining at June 30, 2010) | \$ | 32,700 |
| 2011 | | 55,950 |
| 2012 | | 42,834 |
| 2013 | | 34,557 |
| 2014 | | 28,330 |
| Beyond 2014 | | 114,659 |
| Total intangible assets, net | \$ | 309,030 |

Table of Contents**Note 5: Goodwill**

The following table reflects goodwill allocated to each reporting segment at June 30, 2010 and 2009:

| | Itron North | | Itron | Total Company (in thousands) |
|-------------------------------------|-------------|---------------|-------|---------------------------------|
| | America | International | | |
| Goodwill balance at January 1, 2009 | \$ 193,598 | \$ 1,092,255 | | \$ 1,285,853 |
| Adjustment of previous acquisitions | 2,100 | - | | 2,100 |
| Effect of change in exchange rates | 596 | (10,285) | | (9,689) |
| Goodwill balance at June 30, 2009 | \$ 196,294 | \$ 1,081,970 | | \$ 1,278,264 |
| Goodwill balance at January 1, 2010 | \$ 197,515 | \$ 1,108,084 | | \$ 1,305,599 |
| Effect of change in exchange rates | 89 | (159,606) | | (159,517) |
| Goodwill balance at June 30, 2010 | \$ 197,604 | \$ 948,478 | | \$ 1,146,082 |

Due to continued refinements of our management and geographic reporting structures, minor amounts of goodwill have been reallocated between our reporting segments. Historical segment information has been revised to conform to our current segment reporting structure.

In 2009, the *adjustment of previous acquisitions* represents contingent consideration that became payable associated with two acquisitions completed in 2006.

Note 6: Debt

The components of our borrowings are as follows:

| | At June 30, | At December 31, |
|---------------------------------------|----------------|-----------------|
| | 2010 | 2009 |
| | (in thousands) | |
| Term loans | | |
| USD denominated term loan | \$ 251,667 | \$ 284,693 |
| EUR denominated term loan | 208,548 | 288,902 |
| Convertible senior subordinated notes | 213,126 | 208,169 |
| | 673,341 | 781,764 |
| Current portion of long-term debt | (10,182) | (10,871) |
| Total long-term debt | \$ 663,159 | \$ 770,893 |

Credit Facility

Our credit facility is dated April 18, 2007 and includes two amendments dated April 24, 2009 and February 10, 2010. The principal balance of our euro denominated term loan at June 30, 2010 and December 31, 2009 was 169.1 million and 200.8 million, respectively. Interest rates on the credit facility are based on the respective borrowings denominated London Interbank Offered Rate (LIBOR) or the Wells Fargo Bank, National

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Association's prime rate, plus an additional margin subject to our consolidated leverage ratio. The additional interest rate margin was 3.50% at June 30, 2010 and 3.75% at December 31, 2009. Our interest rates were 3.86% for the U.S. dollar denominated and 4.14% for the euro denominated term loans at June 30, 2010. Scheduled amortization of principal payments is 1% per year (0.25% quarterly) with an excess cash flow provision for additional annual principal repayment requirements. The amount of the excess cash flow provision payment varies according to our consolidated leverage ratio. Maturities of the term loans and multicurrency revolving line of credit are in April 2014 and 2013, respectively. The credit facility is secured by substantially all of the assets of Itron, Inc. and our U.S. domestic operating subsidiaries and includes covenants, which contain certain financial ratios and place restrictions on the incurrence of debt, the payment of dividends, certain investments, incurrence of capital expenditures above a set limit, and mergers.

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The credit facility includes a multicurrency revolving line of credit, which was increased from \$115 million to \$240 million on June 9, 2010. The increase was completed without amending the credit facility. Prepaid debt fees of \$1.1 million were capitalized associated with the increase in the credit line. There were no other changes to the credit facility.

At June 30, 2010, there were no borrowings outstanding under the revolving line of credit, and \$30.1 million was utilized by outstanding standby letters of credit resulting in \$209.9 million being available for additional borrowings.

We repaid \$21.1 million and \$73.9 million of the term loans during the three and six months ended June 30, 2010, respectively. Repayments of \$2.7 million and \$70.2 million were made during the three and six months ended June 30, 2009, respectively. These repayments were made with cash flows from operations and cash on hand. We were in compliance with the debt covenants under the credit facility at June 30, 2010.

Convertible Senior Subordinated Notes

On August 4, 2006, we issued \$345 million of 2.50% convertible notes due August 2026. Fixed interest payments are required every six months, in February and August of each year. For each six month period beginning August 2011, contingent interest payments of approximately 0.19% of the average trading price of the convertible notes will be made if certain thresholds are met or events occur, as outlined in the indenture. The convertible notes are registered with the SEC and are generally transferable. Our convertible notes are not considered conventional convertible debt as the number of shares, or cash, to be received by the holders was not fixed at the inception of the obligation. We have concluded that the conversion feature of our convertible notes does not need to be bifurcated from the host contract and accounted for as a freestanding derivative, as the conversion feature is indexed to our own stock and would be classified within stockholders' equity if it were a freestanding instrument.

The convertible notes may be converted at the option of the holder at a conversion rate of 15.3478 shares of our common stock for each \$1,000 principal amount of the convertible notes, under the following circumstances, as defined in the indenture:

i

if the closing sale price per share of our common stock exceeds \$78.19, which is 120% of the conversion price of \$65.16, for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding fiscal quarter;

i between July 1, 2011 and August 1, 2011, and any time after August 1, 2024;

i

during the five business days after any five consecutive trading day period in which the trading price of the convertible notes for each day was less than 98% of the average conversion value of the convertible notes;

i if the convertible notes are called for redemption;

i if a fundamental change occurs; or

upon the occurrence of defined corporate events.

ⁱ
The amount payable upon conversion is the result of a formula based on the closing prices of our common stock for 20 consecutive trading days following the date of the conversion notice. Based on the conversion ratio of 15.3478 shares per \$1,000 principal amount of the convertible notes, if our stock price is lower than the conversion price of \$65.16, the amount payable will be less than the \$1,000 principal amount and will be settled in cash. Our closing stock price at June 30, 2010 was \$61.82 per share.

Upon conversion, the principal amount of the convertible notes will be settled in cash and, at our option, the remaining conversion obligation (stock price in excess of conversion price) may be settled in cash, shares, or a combination. The conversion rate for the convertible notes is subject to adjustment upon the occurrence of certain corporate events, as defined in the indenture, to ensure that the economic rights of the convertible note holders are preserved.

The convertible notes also contain purchase options, at the option of the holders, which if exercised would require us to repurchase all or a portion of the convertible notes on August 1, 2011, August 1, 2016, and August 1, 2021 at 100% of the principal amount, plus accrued and unpaid interest.

On or after August 1, 2011, we have the option to redeem all or a portion of the convertible notes at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest.

The convertible notes are unsecured, subordinated to our credit facility (senior secured borrowings), and are guaranteed by one U.S. subsidiary, which is 100% owned. The convertible notes contain covenants, which place restrictions on the incurrence of debt and certain mergers. We were in compliance with these debt covenants at June 30, 2010.

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At June 30, 2010 and December 31, 2009, the contingent conversion threshold was not exceeded and, therefore, the aggregate principal amount of the convertible notes is included in long-term debt. The contingent conversion threshold may be triggered during any quarter prior to July 2011, and the notes become convertible, as our stock price is subject to fluctuation. Effective July 1, 2010, we will classify the convertible notes as current on the Consolidated Balance Sheet due to the combination of put, call, and conversion options occurring within the next 12 months.

Our convertible notes were separated between the liability and equity components, in a manner that reflected our non-convertible debt borrowing rate. Our non-convertible debt borrowing rate at the time of our convertible notes issuance was determined to be 7.38%, which also reflects the effective interest rate on the liability component. The carrying amounts of the debt and equity components are as follows:

| | At June 30, 2010 | At December 31, 2009 |
|--|---------------------|----------------------------|
| | (in thousands) | |
| Face value of convertible debt | \$ 223,604 | \$ 223,604 |
| Unamortized discount | (10,478) | (15,435) |
| Net carrying amount of debt component | \$ 213,126 | \$ 208,169 |
| | | |
| Carrying amount of equity component | \$ 31,831 | \$ 31,831 |

The interest expense relating to both the contractual interest coupon and amortization of the discount on the liability component are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------------|---------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Contractual interest coupon | \$ 1,397 | \$ 1,397 | \$ 2,795 | \$ 3,044 |
| Amortization of the discount on the liability component | 2,501 | 2,324 | 4,957 | 4,895 |
| Total interest expense | \$ 3,898 | \$ 3,721 | \$ 7,752 | \$ 7,939 |

Due to the combination of put, call, and conversion options that are part of the terms of the convertible note agreement, the remaining discount on the liability component will be amortized over 12 months.

During the first quarter of 2009, we entered into exchange agreements with certain holders of our convertible notes to issue, in the aggregate, approximately 2.3 million shares of common stock, valued at \$132.9 million, in exchange for, in the aggregate, \$121.0 million principal amount of the convertible notes, representing 35% of the aggregate principal outstanding at the date of the exchanges. All of the convertible notes we acquired pursuant to the exchange agreements were retired upon the closing of the exchanges.

The exchange agreements were treated as induced conversions as the holders received a greater number of shares of common stock than would have been issued under the original conversion terms of the convertible notes. At the time of the exchange agreements, none of the conversion contingencies were met. Under the original terms of the convertible notes, the amount payable on conversion was to be paid in cash, and the remaining conversion obligation (stock price in excess of conversion price) was payable in cash or shares of common stock, at our option. Under the terms of the exchange agreements, all of the settlement was paid in shares. The difference in the value of the shares of common stock issued under the exchange agreement and the value of the shares of common stock used to derive the amount payable under the original conversion agreement resulted in a loss on extinguishment of debt of \$23.3 million (the inducement loss). Upon derecognition of the convertible notes, we remeasured the fair value of the liability and equity components using a borrowing rate for similar non-convertible debt that would be applicable to us at the date of the exchange agreements. Because borrowing rates increased, the remeasurement of the components of the convertible notes resulted in a gain on extinguishment of \$13.4 million (the revaluation gain). As a result, we recognized a net loss on extinguishment of debt of \$10.3 million, calculated as the inducement loss, plus an allocation of advisory fees, less the revaluation gain. The remaining settlement consideration of \$9.5 million, including an allocation of advisory fees, was recorded as a reduction of common stock.

Table of Contents**Note 7: Derivative Financial Instruments and Hedging Activities**

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to Note 1, Note 12, and Note 13 for additional disclosures on our derivative instruments.

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as Level 2), as defined by Accounting Standards Codification (ASC) 820-10-20, *Fair Value Measurements*. We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs used at June 30, 2010 included interest rate yield curves (swap rates and futures) and foreign exchange spot and forward rates, all of which are available in an active market. We have utilized the mid-market pricing convention for these inputs at June 30, 2010. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

The fair values of our derivative instruments determined using the fair value measurement of significant other observable inputs (Level 2) at June 30, 2010 and December 31, 2009 are as follows:

| | Balance Sheet Location | Fair Value | |
|--|-----------------------------------|------------------------|----------------------------|
| | | At June 30, 2010 | At December 31, 2009 |
| (in thousands) | | | |
| Asset Derivatives | | | |
| Derivatives not designated as hedging instruments under ASC 815-20 | | | |
| Foreign exchange forward contracts | Other current assets | \$ 74 | \$ 3,986 |
| Liability Derivatives | | | |
| Derivatives designated as hedging instruments under ASC 815-20 | | | |
| Interest rate swap contracts | Other current liabilities | \$ (8,453) | \$ (11,478) |
| Interest rate swap contracts | Other noncurrent obligations | (2,315) | (3,676) |
| Euro denominated term loan * | Current portion of long-term debt | (4,131) | (4,820) |
| Euro denominated term loan * | Long-term debt | (204,417) | (284,082) |
| Total derivatives designated as hedging instruments under Subtopic 815-20 | | \$ (219,316) | \$ (304,056) |
| Derivatives not designated as hedging instruments under ASC 815-20 | | | |
| Foreign exchange forward contracts | Other current liabilities | \$ (271) | \$ (2,442) |
| Total liability derivatives | | \$ (219,587) | \$ (306,498) |

* The euro denominated term loan is a nonderivative financial instrument designated as a hedge of our net investment in international operations. It is recorded at its carrying value in the Consolidated Balance Sheets and is not recorded at fair value.

OCI during the reporting period for our derivative and nonderivative instruments designated as hedging instruments (collectively, hedging instruments), net of tax, was as follows:

2010

2009

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| | (in thousands) | |
|---|----------------|-------------|
| Net unrealized loss on hedging instruments at January 1, | \$ (30,300) | \$ (29,772) |
| Unrealized gain (loss) on derivative instruments | (2,542) | (3,804) |
| Unrealized gain (loss) on a nonderivative net investment hedging instrument | 24,352 | 2,848 |
| Realized (gains) losses reclassified into net income (loss) | 4,197 | 3,803 |
| Net unrealized loss on hedging instruments at June 30, | \$ (4,293) | \$ (26,925) |

Cash Flow Hedges

We are exposed to interest rate risk through our credit facility. We enter into swaps to achieve a fixed rate of interest on the hedged portion of debt in order to increase our ability to forecast interest expense. The objective of these swaps is to protect us from increases in the LIBOR base borrowing rates on our floating rate credit facility. The swaps do not protect us from changes to the applicable margin under our credit facility.

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We have entered into one-year pay-fixed receive one-month LIBOR interest rate swaps to convert \$200 million of our U.S. dollar term loan from a floating LIBOR interest rate to a fixed interest rate as follows:

| Transaction Date | Effective Date of Swap | Notional amount | Fixed Interest Rate |
|------------------|-------------------------------|-----------------|---------------------|
| | | (in thousands) | |
| October 27, 2008 | June 30, 2009 - June 30, 2010 | \$ 200,000 | 2.68% |
| July 1, 2009 | June 30, 2010 - June 30, 2011 | \$ 100,000 | 2.15% |
| July 1, 2009 | June 30, 2010 - June 30, 2011 | \$ 100,000 | 2.11% |

At June 30, 2010 and December 31, 2009, our U.S. dollar term loan had a balance of \$251.7 million and \$284.7 million, respectively. The cash flow hedges have been and are expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swap are recorded as a component of OCI and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as adjustments to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is approximately \$3.1 million, which was based on the Bloomberg U.S. dollar swap yield curve as of June 30, 2010.

In 2007, we entered into a pay fixed 6.59% receive three-month Euro Interbank Offered Rate (EURIBOR), plus 2%, amortizing interest rate swap to convert a significant portion of our euro denominated variable-rate term loan to fixed-rate debt, plus or minus the variance in the applicable margin from 2%, through December 31, 2012. The cash flow hedge is currently, and is expected to be, highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swap are recorded as a component of OCI and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as adjustments to interest expense. The notional amount of the swap is reduced each quarter and was \$177.7 million (144.1 million) and \$252.9 million (175.8 million) as of June 30, 2010 and December 31, 2009, respectively. The amount of net losses expected to be reclassified into earnings in the next 12 months is approximately \$5.4 million (4.4 million), which was based on the Bloomberg euro swap yield curve as of June 30, 2010.

We will continue to monitor and assess our interest rate risk and may institute additional interest rate swaps or other derivative instruments to manage such risk in the future.

The before tax effect of our cash flow derivative instruments on the Consolidated Balance Sheets and the Consolidated Statements of Operations for the three months and six months ended June 30 are as follows:

| Derivatives in ASC 815-20 Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | | Gain (Loss) Reclassified from Accumulated OCI into Income Location | Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Amount | | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) Location | Amount | |
|---|---|------------|--|--|------------|---|---------|----------|
| | 2010 | 2009 | | 2010 | 2009 | | 2010 | 2009 |
| | | | | | | | | |
| Three months ended June 30, | | | | | | | | |
| Interest rate swap contracts | \$ (839) | \$ (1,658) | Interest expense | \$ (3,238) | \$ (3,605) | Interest expense | \$ (14) | \$ (136) |
| Six months ended June 30, | | | | | | | | |
| Interest rate swap contracts | \$ (4,122) | \$ (6,165) | Interest expense | \$ (6,810) | \$ (6,162) | Interest expense | \$ (74) | \$ (184) |
| <i>Net Investment Hedge</i> | | | | | | | | |

We are exposed to foreign exchange risk through our international subsidiaries. As a result of our acquisition of an international company in 2007, we entered into a euro denominated term loan, which exposes us to fluctuations in the euro foreign exchange rate. Therefore, we have designated this foreign currency denominated term loan as a hedge of our net investment in international operations. The non-functional currency term loan is revalued into U.S. dollars at each balance sheet date, and the changes in value associated with currency fluctuations are recorded as adjustments to long-term debt with offsetting gains and losses recorded in OCI. The notional amount of the term loan declines each quarter due to repayments and was \$208.5 million (169.1 million) and \$288.9 million (200.8 million) as of June 30, 2010 and December 31, 2009, respectively. We had no hedge ineffectiveness.

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The before tax and net of tax effect of our net investment hedge nonderivative financial instrument on OCI for the three and six months ended June 30 are as follows:

| Nonderivative Financial Instruments in ASC 815-20 Net Investment Hedging Relationships | Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations | | | |
|---|---|-------------|------------------------------|----------|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Gain (loss) recognized in OCI on derivative (Effective Portion) | | | | |
| Before tax | \$ 20,943 | \$ (18,328) | \$ 39,498 | \$ 4,613 |
| Net of tax | \$ 12,908 | \$ (11,325) | \$ 24,352 | \$ 2,848 |

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, foreign currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts, not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. During the six months ended June 30, 2010, we entered into 51 foreign currency option and forward transactions. The notional amounts of the contracts ranged from less than \$1 million to \$48 million, offsetting our exposures from the euro, British pound, Canadian dollar, Czech koruna, Hungarian forint, and various other currencies.

The effect of our foreign exchange option and forward derivative instruments on the Consolidated Statements of Operations for the three and six months ended June 30 are as follows:

Derivatives Not Designated as Hedging

| Instrument under ASC 815-20 | Gain (Loss) Recognized on Derivatives in Other Income (Expense) | | | |
|---|--|----------|---------------------------|----------|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Foreign exchange option and forward contracts | \$ 3,316 | \$ (606) | \$ 3,047 | \$ (527) |

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our employees in Germany, France, Spain, Italy, Belgium, Chile, Portugal, Hungary, and Indonesia offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2009.

Amounts recognized on the Consolidated Balance Sheets consist of:

| | At June 30, 2010 | At December 31, 2009 |
|---|---------------------|-------------------------|
| | (in thousands) | |
| Current portion of pension plan liability in wages and benefits payable | \$ 2,872 | \$ 2,975 |
| Long-term portion of pension plan liability | 54,953 | 63,040 |
| Plan assets in other noncurrent assets | (518) | (613) |
| Net pension plan benefit liability | \$ 57,307 | \$ 65,402 |

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The decrease in the net pension plan liability from December 31, 2009 to June 30, 2010 is primarily due to the decrease in the value of the euro, as compared with the U.S. dollar. Our defined benefit pension plans are denominated in the functional currencies of the respective countries in which the plans are sponsored.

Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan. We contributed \$313,000 and \$338,000 to the defined benefit pension plans for the three and six months ended June 30, 2010, and \$30,000 and \$53,000 for the three and six months ended June 30, 2009, respectively. The timing of when contributions are made can vary by plan from year to year. For 2010, assuming that actual plan asset returns are consistent with our expected rate of return, and that interest rates remain constant, we expect to contribute approximately \$500,000 in 2010 to our defined benefit pension plans. We contributed \$397,000 to the defined benefit pension plans for the year ended December 31, 2009.

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Net periodic pension benefit costs for our plans include the following components:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Service cost | \$ 475 | \$ 419 | \$ 1,000 | \$ 868 |
| Interest cost | 844 | 886 | 1,750 | 1,740 |
| Expected return on plan assets | (71) | (72) | (148) | (141) |
| Amortization of actuarial net gain | (6) | (99) | (13) | (182) |
| Amortization of unrecognized prior service costs | - | 7 | - | 13 |
| Net periodic benefit cost | \$ 1,242 | \$ 1,141 | \$ 2,589 | \$ 2,298 |

Note 9: Stock-Based Compensation

We record stock-based compensation expense for awards of stock options, stock sold pursuant to our ESPP, and the issuance of restricted and unrestricted stock awards and units. We expense stock-based compensation using the straight-line method over the vesting requirement period. For the three and six months ended June 30, stock-based compensation expense and the related tax benefit were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|-----------------------------|----------|---------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Stock options | \$ 952 | \$ 2,262 | \$ 2,295 | \$ 4,572 |
| Restricted stock awards and units | 3,441 | 2,377 | 6,382 | 4,293 |
| Unrestricted stock awards | 14 | 15 | 189 | 135 |
| ESPP | 138 | 138 | 255 | 279 |
| Total stock-based compensation | \$ 4,545 | \$ 4,792 | \$ 9,121 | \$ 9,279 |
| Related tax benefit | \$ 1,324 | \$ 1,192 | \$ 2,732 | \$ 2,456 |

We issue new shares of common stock upon the exercise of stock options or when vesting conditions on restricted awards are fully satisfied.

The fair value of stock options and ESPP awards issued were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Employee Stock Options | | | |
|-------------------------|-----------------------------|------|---------------------------|-------|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Dividend yield | (1) | (1) | - | - |
| Expected volatility | - | - | 48.7% | 50.2% |
| Risk-free interest rate | - | - | 2.3% | 1.8% |
| Expected life (years) | - | - | 4.61 | 4.91 |

| | ESPP | |
|--|-----------------------------|---------------------------|
| | Three Months Ended June 30, | Six Months Ended June 30, |

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| | 2010 | 2009 | 2010 | 2009 |
|-------------------------|-------|-------|-------|-------|
| Dividend yield | - | - | - | - |
| Expected volatility | 36.2% | 75.7% | 32.7% | 87.7% |
| Risk-free interest rate | 0.2% | 0.2% | 0.1% | 0.5% |
| Expected life (years) | 0.25 | 0.25 | 0.25 | 0.25 |

⁽¹⁾ There were no employee stock options issued for the three months ended June 30, 2010 and 2009.

Expected volatility is based on a combination of historical volatility of our common stock and the implied volatility of our traded options for the related expected life period. We believe this combined approach is reflective of current and historical

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market conditions and an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected life of the award. The expected life is the weighted average expected life of an award based on the period of time between the date the award is granted and the date an estimate of the award is fully exercised. Factors considered in estimating the expected life include historical experience of similar awards, contractual terms, vesting schedules, and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

Subject to stock splits, dividends, and other similar events, 3,500,000 shares of common stock are reserved and authorized for issuance under our 2010 Stock Incentive Plan (Stock Incentive Plan). Awards consist of stock options, restricted stock units, restricted stock awards, and unrestricted stock awards. At June 30, 2010, shares available for issuance under the Stock Incentive Plan were 2,956,386.

Stock Options

Options to purchase our common stock are granted to employees and the Board of Directors with an exercise price equal to the market close price of the stock on the date the Board of Directors approves the grant. Options generally become exercisable in three equal annual installments beginning one year from the date of grant and generally expire 10 years from the date of grant. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations.

A summary of our stock option activity for the six months ended June 30 is as follows:

| | Shares (in thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value ⁽¹⁾ (in thousands) | Weighted Average Grant Date Fair Value |
|--|--------------------------|---|--|--|--|
| Outstanding, January 1, 2009 | 1,374 | \$ 51.53 | 6.99 | \$ 25,809 | |
| Granted | 50 | 57.96 | | | \$ 25.94 |
| Exercised | (14) | 30.16 | | \$ 338 | |
| Forfeited | (17) | 59.59 | | | |
| Expired | (5) | 48.93 | | | |
| Outstanding, June 30, 2009 | 1,388 | \$ 51.89 | 6.64 | \$ 17,681 | |
| Exercisable and expected to vest, June 30, 2009 | 1,313 | \$ 49.89 | 6.52 | \$ 17,671 | |
| Exercisable, June 30, 2009 | 937 | \$ 43.15 | 5.90 | \$ 16,654 | |
| Outstanding, January 1, 2010 | 1,179 | \$ 52.93 | 5.90 | \$ 22,863 | |
| Granted | 71 | 61.97 | | | \$ 27.18 |
| Exercised | (133) | 41.51 | | \$ 4,114 | |
| Outstanding, June 30, 2010 | 1,117 | \$ 54.89 | 6.04 | \$ 15,391 | |
| Exercisable and expected to vest, June 30, 2010 | 1,104 | \$ 54.73 | 6.01 | \$ 15,379 | |
| Exercisable, June 30, 2010 | 963 | \$ 52.03 | 5.61 | \$ 15,241 | |

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⁽¹⁾ The aggregate intrinsic value is the amount by which the market value of the underlying stock exceeded the exercise price of the outstanding options before applicable income taxes, based on the closing stock price on the last business day of the period, which represents amounts that would have been received by the optionees had all options been exercised on that date.

As of June 30, 2010, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$3.3 million, which is expected to be recognized over a weighted average period of approximately 18 months.

Restricted Stock Awards

Certain employees and senior management receive restricted stock units or restricted stock awards (collectively, restricted awards) as a component of their total compensation. The fair value of a restricted award is the market close price of our common stock on the date of grant. Restricted awards generally vest over a three year period. Compensation expense, net of forfeitures, is recognized over the vesting period.

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Subsequent to vesting, the restricted awards are converted into shares of our common stock on a one-for-one basis and issued to employees. We are entitled to an income tax deduction in an amount equal to the taxable income reported by the employees upon vesting of the restricted awards.

The restricted awards issued under the Long Term Performance Restricted Stock Unit Award Agreement (Performance Award Agreement) are determined based on the attainment of annual performance goals after the end of the calendar year performance period. During the year, if management determines it is probable that the targets will be achieved, compensation expense, net of forfeitures, is recognized on a straight-line basis over the annual performance and vesting period. Performance Awards typically vest and are released in three equal installments at the beginning of each year following attainment of the performance goals. For U.S. participants who retire during the performance period, a pro-rated number of restricted awards (based on the number of days of employment during the performance period) immediately vest based on the attainment of the performance goals as assessed after the end of the performance period. During the vesting period, unvested restricted awards immediately vest at the date of retirement for U.S. participants who retire during that period. For U.S. participants who are or will become retirement eligible during either the annual performance or vesting period, compensation expense is accelerated and recognized over the greater of the performance period (one year) or the participant's retirement eligible date. For the 2010 Performance Awards, the maximum restricted awards that may become eligible for vesting is 133,000 with a grant date fair value of \$61.49.

The following table summarizes restricted award activity for the six months ended June 30:

| | Number of Restricted Awards (in thousands) | Weighted Average Grant Date Fair Value | Aggregate Intrinsic Value ⁽¹⁾ (in thousands) |
|---------------------------------|--|--|--|
| Outstanding, January 1, 2009 | 313 | | |
| Granted | 54 | \$ 70.76 | |
| Released | (20) | | \$ 1,309 |
| Forfeited | (4) | | |
| Outstanding, June 30, 2009 | 343 | | |
| Outstanding, January 1, 2010 | 326 | | |
| Granted ⁽²⁾ | 210 | \$ 63.52 | |
| Released | (75) | | \$ 4,965 |
| Forfeited | (12) | | |
| Outstanding, June 30, 2010 | 449 | | |
| Vested, June 30, 2010 | 2 | | \$ 115 |
| Expected to vest, June 30, 2010 | 366 | | \$ 22,609 |

⁽¹⁾ The aggregate intrinsic value is the market value of the stock released, vested, or expected to vest, before applicable income taxes, based on the closing price on the stock release dates or at the end of the period for stock vested but not released.

⁽²⁾ These restricted awards do not include the 2010 awards under the Performance Awards Agreement, which are not eligible for vesting until December 31, 2010.

At June 30, 2010, unrecognized compensation expense was \$22.8 million, which is expected to be recognized over a weighted average period of approximately 26 months.

Unrestricted Stock Awards

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We issue unrestricted stock awards to our Board of Directors as part of their compensation. Awards are fully vested at issuance and are expensed when issued. The fair value of unrestricted stock awards is the market close price of our common stock on the date of grant.

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The following table summarizes unrestricted stock award activity for the three and six months ended June 30:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------|---------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Shares of unrestricted stock issued | 192 | 300 | 2,766 | 2,116 |
| Weighted average grant date fair value <i>Employee Stock Purchase Plan</i> | \$ 77.69 | \$ 49.55 | \$ 68.49 | \$ 63.62 |

Under the terms of the ESPP, eligible employees can elect to deduct up to 10% of their regular cash compensation to purchase our common stock at a discounted price. The purchase price of the common stock is 85% of the fair market value of the stock at the end of each fiscal quarter. The sale of the stock occurs at the beginning of the subsequent quarter.

The following table summarizes ESPP activity for the three and six months ended June 30:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|---------|---------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| Shares of stock sold to employees ⁽¹⁾ | 10,736 | 19,831 | 23,086 | 32,750 |
| Weighted average fair value per ESPP award ⁽²⁾ | \$ 9.27 | \$ 8.28 | \$ 9.95 | \$ 7.64 |

⁽¹⁾ Stock sold to employees during each fiscal quarter under the ESPP is associated with the offering period ending on the last day of the previous fiscal quarter.

⁽²⁾ Relating to awards associated with the offering period(s) during the three and six months ended June 30.

The fair value of ESPP awards is estimated using the Black-Scholes option-pricing model. At June 30, 2010, all compensation cost associated with the ESPP had been recognized. There were approximately 224,000 shares of common stock available for future issuance under the ESPP at June 30, 2010.

Note 10: Income Taxes

Our tax provisions (benefits) as a percentage of income (loss) before tax typically differs from the federal statutory rate of 35%, and may vary from period to period, due to fluctuations in the forecasted mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items.

For the three and six months ended June 30, 2010, we had a tax provisions of 29% and 4%, based on a percentage of income before tax, as compared with a tax benefits of 316% and 83% for the same periods in 2009.

Our tax provisions in 2010 reflect higher projected pretax earnings in high tax jurisdictions, the benefit of certain interest expense deductions, and the election under U.S. Internal Revenue Code Section 338 with respect to the acquisition of Actaris Metering Systems SA (Actaris) in 2007. The 2010 tax provisions also include a benefit for the receipt of a clean energy manufacturing tax credit awarded as part of the American Recovery and Reinvestment Act and a benefit related to the reduction of tax reserves for certain foreign subsidiaries.

Our tax benefits in 2009 are the result of certain interest expense deductions and the election under U.S. Internal Revenue Code Section 338 with respect to the acquisition of Actaris in 2007, as well as the forecasted mix of earnings in different tax jurisdictions, which included lower income in higher tax jurisdictions.

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We classify interest expense and penalties related to unrecognized tax liabilities and interest income on tax overpayments as components of income tax expense. Interest and penalties recognized, and accrued interest and penalties recorded, are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|---------------|----------------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Interest and penalties expense | \$ 289 | \$ 619 | \$ 1,186 | \$ 1,332 |
| Interest and penalties benefit | (791) | (13) | (890) | (39) |
| Net interest and penalties recognized | \$ (502) | \$ 606 | \$ 296 | \$ 1,293 |

| | At June 30, | At December 31, |
|-------------------|----------------------|------------------------|
| | 2010 | 2009 |
| | (in millions) | |
| Accrued interest | \$ 4.4 | \$ 4.1 |
| Accrued penalties | 2.9 | 3.4 |

| | At June 30, | At December 31, |
|--|----------------------|------------------------|
| | 2010 | 2009 |
| | (in millions) | |
| Unrecognized tax benefits related to uncertain tax positions | \$ 34.4 | \$ 46.2 |
| The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate | 34.4 | 46.2 |

At June 30, 2010, we expect to pay \$1.9 million in income taxes, interest, or penalties related to uncertain tax positions over the next twelve months. We are not able to reasonably estimate the timing of future cash flows relating to the remaining balance.

We believe it is reasonably possible that our unrecognized tax benefits may decrease by approximately \$6.2 million within the next twelve months due to the potential lapse of certain applicable statutes of limitations and the final resolution of certain tax audits.

Note 11: Commitments and Contingencies*Guarantees and Indemnifications*

We are often required to obtain standby letters of credit (LOC s) or bonds in support of our obligations for customer contracts. These standby LOC s or bonds typically provide a guarantee to the customer for future performance, which usually covers the installation phase of a contract and may on occasion cover the operations and maintenance phase of outsourcing contracts.

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Our available lines of credit, outstanding standby LOC s, and bonds are as follows:

| | At June 30, 2010 | At December 31, 2009 |
|--|---------------------|-------------------------|
| | (in millions) | |
| Credit facility⁽¹⁾ | | |
| Multicurrency revolving line of credit | \$ 240.0 | \$ 115.0 |
| Standby LOC s issued and outstanding | 30.1 | 39.9 |
| Net available for additional borrowings and LOC s | \$ 209.9 | \$ 75.1 |
| Unsecured multicurrency revolving lines of credit with various financial institutions | | |
| Total lines of credit | \$ 38.7 | \$ 38.7 |
| Standby LOC s issued and outstanding | (15.1) | (10.9) |
| Short-term borrowings ⁽²⁾ | (1.2) | (2.1) |
| Net available for additional borrowings and LOC s | \$ 22.4 | \$ 25.7 |
| Unsecured surety bonds in force | \$ 92.1 | \$ 71.4 |

⁽¹⁾ See Note 6 for details regarding our credit facility, which is secured.

⁽²⁾ Short-term borrowings are included in Other current liabilities on the Consolidated Balance Sheets.

In the event any such bond or standby LOC is called, we would be obligated to reimburse the issuer of the standby LOC or bond; however, we do not believe that any currently outstanding bond or LOC will be called.

We generally provide an indemnification related to the infringement of any patent, copyright, trademark, or other intellectual property right on software or equipment within our sales contracts, which indemnifies the customer from and pays the resulting costs, damages, and attorney s fees awarded against a customer with respect to such a claim provided that (a) the customer promptly notifies us in writing of the claim and (b) we have the sole control of the defense and all related settlement negotiations. We also provide an indemnification to our customers for third party claims resulting from damages caused by the negligence or willful misconduct of our employees/agents in connection with the performance of certain contracts. The terms of our indemnifications generally do not limit the maximum potential payments. It is not possible to predict the maximum potential amount of future payments under these or similar agreements.

Legal Matters

We are subject to various legal proceedings and claims of which the outcomes are subject to significant uncertainty. Our policy is to assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the liability required, if any, for these contingencies is made after an analysis of each known issue. A liability is recorded and charged to operating expense when we determine that a loss is probable and the amount can be reasonably estimated. Additionally, we disclose contingencies for which a material loss is reasonably possible, but not probable. Liabilities recorded for legal contingencies at June 30, 2010 were not material to our financial condition or results of operations.

On December 18, 2009, we received a statement of claim in the matter of an arbitration between Cinclus Technology (Cinclus) and Itron Metering Solutions UK Ltd (Itron UK). The claim relates to an alleged defect in meters sold to Cinclus during 2007 for installation on a project Cinclus was managing for E.ON, a utility with customers in Sweden. On December 23, 2009, we received a statement of claim in the matter of an arbitration between Cinclus and Itron UK relating to an alleged defect in meters sold to Cinclus during 2007 - 2009 for installation on a project Cinclus was managing for Fortum, a utility with customers in Sweden. Both arbitrations have been filed with the Arbitration Institute of the Stockholm Chamber of Commerce. In both arbitrations, Cinclus claims the meters provided by Itron UK fail to meet specifications because in certain environments the meters are affected by high frequency pollution from third party devices in the home environment, which impairs the meters capability to measure energy accurately. Cinclus asserts that all meters must be replaced at Itron UK s cost and expense, including the cost of field work to replace the meters, plus other losses and damages to be specified at a later date. Itron UK has resolved the claim by Cinclus

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related to the E.ON project. The arbitration in the Cinclus proceeding related to the Fortum project was heard in June 2010, and the arbitration panel has taken the matter under advisement. Itron UK continues to deny the allegations raised by Cinclus related to the Fortum project and will continue to defend these claims.

We do not believe that any of the legal matters, including the arbitration between Itron UK and Cinclus related to the Fortum Project noted in the preceding paragraph, will have a material adverse effect on our business or financial condition, although an unfavorable outcome could have a material adverse effect on Itron's results of operations for the period in which such a loss is recognized.

Table of Contents*Warranty*

A summary of the warranty accrual account activity is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|------------------------------------|------------------|----------------------------------|------------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Beginning balance | \$ 33,353 | \$ 34,838 | \$ 33,873 | \$ 38,255 |
| New product warranties | 2,900 | 1,588 | 5,696 | 3,122 |
| Other changes/adjustments to warranties | 14,366 | 1,519 | 15,596 | 3,109 |
| Reclassification from other current liabilities | 2,687 | - | 2,878 | - |
| Claims activity | (3,317) | (5,085) | (7,063) | (10,721) |
| Effect of change in exchange rates | (786) | 1,205 | (1,777) | 300 |
| Ending balance, June 30 | 49,203 | 34,065 | 49,203 | 34,065 |
| Less: current portion of warranty | (26,250) | (20,271) | (26,250) | (20,271) |
| Long-term warranty | \$ 22,953 | \$ 13,794 | \$ 22,953 | \$ 13,794 |

Total warranty expense is classified within cost of revenues and consists of new product warranties issued and other changes and adjustments to warranties. Warranty expense was \$17.3 million and \$21.3 million for the three and six months ended June 30, 2010, compared with \$3.1 million and \$6.2 million in the same periods last year. During 2010, warranty expense was approximately 30% and 70% for Itron North America and Itron International, respectively, compared with approximately 90% and 10% in 2009. The increase in Itron International's warranty expense was primarily the result of \$9.6 million recorded for the arbitration claims in Sweden noted above in legal matters.

Health Benefits

We are self insured for a substantial portion of the cost of our U.S. employee group health insurance. We purchase insurance from a third party, which provides individual and aggregate stop loss protection for these costs. Each reporting period, we expense the costs of our health insurance plan including paid claims, the change in the estimate of incurred but not reported (IBNR) claims, taxes, and administrative fees (collectively, the plan costs). Plan costs and the IBNR accrual, which is included in wages and benefits payable, are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------|------------------------------------|-------------|----------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| Plan costs | \$ 4.3 | \$ 5.2 | \$ 9.4 | \$ 10.0 |

| | At June 30, | At December 31, |
|--------------|----------------------|------------------------|
| | 2010 | 2009 |
| | (in millions) | |
| IBNR accrual | \$ 2.3 | \$ 3.3 |

Our IBNR accrual and expenses may fluctuate due to the number of plan participants, claims activity, and deductible limits. Due to a change in our medical plan administrator, we have reduced our claims processing time. Therefore, IBNR accrual is lower at June 30, 2010 compared with December 31, 2009. For our employees located outside of the United States, health benefits are provided primarily through governmental social plans, which are funded through employee and employer tax withholdings.

Table of Contents**Note 12: Other Comprehensive Income (Loss)**

OCI is reflected as a net increase (decrease) to shareholders' equity and is not reflected in our results of operations. Total comprehensive income (loss) during the reporting periods, net of tax, was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-------------------|---------------------------|-------------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Net income (loss) | \$ 26,900 | \$ 15,289 | \$ 53,687 | \$ (4,440) |
| Foreign currency translation adjustment, net | (115,005) | 97,556 | (212,471) | (2,924) |
| Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges, net | (517) | (1,059) | (2,542) | (3,804) |
| Net unrealized gain (loss) on a nonderivative net investment hedging instrument, net | 12,908 | (11,325) | 24,352 | 2,848 |
| Net hedging (gain) loss reclassified into net income (loss), net | 1,995 | 2,228 | 4,197 | 3,803 |
| Pension plan benefits liability adjustment, net | (117) | (105) | (685) | (158) |
| Total comprehensive income (loss) | \$ (73,836) | \$ 102,584 | \$ (133,462) | \$ (4,675) |

Income tax (provision) benefit related to OCI during the reporting periods was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------------|---------------------------|-------------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Income tax (provision) benefit on foreign currency translation adjustment | \$ (72) | \$ (2,145) | \$ (585) | \$ (3,676) |
| Income tax (provision) benefit on net unrealized gain (loss) on derivative instruments ⁽¹⁾ | 322 | 598 | 1,580 | 2,361 |
| Income tax (provision) benefit on net unrealized gain (loss) on a nonderivative net investment hedging instrument | (8,035) | 7,003 | (15,146) | (1,765) |
| Income tax (provision) benefit on net hedging (gain) loss reclassified into net income (loss) | (1,243) | (1,377) | (2,613) | (2,359) |
| Income tax benefit on pension plan benefits liability adjustment | 38 | 45 | 221 | 67 |
| Total income tax (provision) benefit on other comprehensive income (loss) | \$ (8,990) | \$ 4,124 | \$ (16,543) | \$ (5,372) |

⁽¹⁾ Designated as cash flow hedges

Accumulated other comprehensive income (loss), net of tax, was (\$116.0) million at June 30, 2010 and \$71.1 million at December 31, 2009. These amounts consisted of the adjustments for foreign currency translation, the unrealized gain (loss) on our hedging instruments, the hedging gain (loss), and the pension liability adjustment as indicated above.

Note 13: Fair Values of Financial Instruments

The fair values provided are representative of fair values only at June 30, 2010 and December 31, 2009 and do not reflect subsequent changes in the economy, interest rates, tax rates, and other variables that may affect the determination of fair value.

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| | At June 30, 2010 | | At December 31, 2009 | |
|---------------------------------------|------------------|------------|----------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| (in thousands) | | | | |
| Assets | | | | |
| Cash and cash equivalents | \$ 137,371 | \$ 137,371 | \$ 121,893 | \$ 121,893 |
| Foreign exchange forwards | 74 | 74 | 3,986 | 3,986 |
| Liabilities | | | | |
| Term loans | | | | |
| USD denominated term loan | \$ 251,667 | \$ 250,723 | \$ 284,693 | \$ 284,693 |
| EUR denominated term loan | 208,548 | 207,767 | 288,902 | 288,902 |
| Convertible senior subordinated notes | 213,126 | 248,301 | 208,169 | 282,859 |
| Interest rate swaps | 10,768 | 10,768 | 15,154 | 15,154 |
| Foreign exchange forwards | 271 | 271 | 2,442 | 2,442 |

The following methods and assumptions were used in estimating fair values:

Cash and cash equivalents: Due to the liquid nature of these instruments, the carrying value approximates fair value.

Term loans: The term loans are not registered with the SEC but are generally transferable through banks that hold the debt and make a market. The fair value is based on quoted prices from recent trades of the term loans.

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Convertible senior subordinated notes: The convertible notes are registered with the SEC and are generally transferable. The fair value is based on quoted prices from recent broker trades of the convertible notes. The carrying value is lower than the face value of the convertible notes as a result of separating the liability and equity components. The face value of the convertible notes was \$223.6 million at June 30, 2010 and December 31, 2009. See Note 6 for further discussion.

Derivatives: See Note 7 for a description of our methods and assumptions in determining the fair value of our derivatives, which were determined using fair value measurements of significant other observable inputs (Level 2).

Note 14: Segment Information

We have two operating segments: Itron North America and Itron International. Itron North America generates a majority of its revenues in the United States and Canada, while Itron International generates a majority of its revenues in Europe, and the balance primarily in Africa, South America, and Asia/Pacific. Due to the continued refinement of our management and geographic reporting structures, as of January 1, 2010, Itron International includes our Taiwan operations, which were previously part of Itron North America. Historical segment information has been revised to conform to our current segment reporting structure.

We have three measures of segment performance: revenue, gross profit (margin), and operating income (margin). Intersegment revenues were minimal. Corporate operating expenses, interest income, interest expense, gain (loss) on extinguishment of debt, other income (expense), and income tax provision (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss.

Depreciation and amortization expense allocated to our segments was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------|-----------------------------|---------|---------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| Itron North America | \$ 11.4 | \$ 11.6 | \$ 22.7 | \$ 23.0 |
| Itron International | 20.4 | 26.6 | 42.4 | 51.4 |
| Total Company | \$ 31.8 | \$ 38.2 | \$ 65.1 | \$ 74.4 |

Segment Products

Itron North America Electronic and smart electricity meters; gas and water meters; electricity, gas, and water automated meter reading (AMR) and advanced metering infrastructure (AMI)/smart meter modules; handheld, mobile, and network AMR data collection technologies; AMI network technologies; software, installation, implementation, consulting, maintenance support, and other services.

Itron International Electromechanical, electronic, and smart electricity meters; mechanical and ultrasonic water and heat meters; diaphragm, turbine, and rotary gas meters; one-way and two-way electricity prepayment systems, including smart key, keypad, and smart card; two-way gas prepayment systems using smart card; AMR and AMI data collection technologies; installation, implementation, maintenance support, and other managed services.

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|-----------------------------|------------|---------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Revenues | | | | |
| Itron North America | \$ 303,155 | \$ 142,938 | \$ 546,272 | \$ 282,307 |
| Itron International | 266,305 | 270,810 | 522,468 | 519,959 |
| Total Company | \$ 569,460 | \$ 413,748 | \$ 1,068,740 | \$ 802,266 |
| Gross profit | | | | |
| Itron North America | \$ 103,131 | \$ 49,937 | \$ 183,022 | \$ 102,213 |
| Itron International | 73,193 | 83,172 | 152,197 | 160,480 |
| Total Company | \$ 176,324 | \$ 133,109 | \$ 335,219 | \$ 262,693 |
| Operating income (loss) | | | | |
| Itron North America | \$ 57,543 | \$ 5,854 | \$ 91,311 | \$ 13,647 |
| Itron International | 5,126 | 12,914 | 15,662 | 22,699 |
| Corporate unallocated | (10,392) | (7,049) | (21,246) | (15,678) |
| Total Company | 52,277 | 11,719 | 85,727 | 20,668 |
| Total other income (expense) | (14,279) | (18,795) | (29,627) | (47,479) |
| Income (loss) before income taxes | \$ 37,998 | \$ (7,076) | \$ 56,100 | \$ (26,811) |

One customer represented more than 10% of total Company revenues for the three and six months ended June 30, 2010, while no single customer did for the same periods in 2009. Three customers each accounted for more than 10% of Itron North America revenues for the three and six months ended June 30, 2010, while no single customer did for the same periods in 2009. No single customer represented more than 10% of Itron International revenues for the three and six months ended June 30, 2010 and 2009.

Revenues by region were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------|-----------------------------|------------|---------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| United States and Canada | \$ 301,514 | \$ 135,924 | \$ 542,072 | \$ 270,775 |
| Europe | 192,863 | 209,558 | 388,348 | 407,035 |
| Other | 75,083 | 68,266 | 138,320 | 124,456 |
| Total revenues | \$ 569,460 | \$ 413,748 | \$ 1,068,740 | \$ 802,266 |

Note 15: Consolidating Financial Information

Our convertible notes, issued by Itron, Inc., are guaranteed by one U.S. subsidiary, which is 100% owned. Our senior subordinated notes issued in May 2004, which were redeemed in 2009, were guaranteed by multiple U.S. operating subsidiaries. We have not restated the comparative prior period results to reflect the change in certain U.S. subsidiaries from guarantors to non-guarantors due to their immaterial nature.

The guaranty by our U.S. subsidiary is joint and several, full, complete, and unconditional. There are currently no restrictions on the ability of the subsidiary guarantor to transfer funds to the parent company.

Table of Contents**Consolidating Statement of Operations****Three Months Ended June 30, 2010**

| | Parent | Guarantor Subsidiary | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------------|---|---------------------|---------------------|
| Revenues | \$ 300,392 | \$ - | \$ 283,191 | \$ (14,123) | \$ 569,460 |
| Cost of revenues | 199,735 | - | 207,524 | (14,123) | 393,136 |
| Gross profit | 100,657 | - | 75,667 | - | 176,324 |
| Operating expenses | | | | | |
| Sales and marketing | 15,706 | - | 25,268 | - | 40,974 |
| Product development | 21,051 | - | 11,971 | - | 33,022 |
| General and administrative | 13,467 | - | 19,818 | - | 33,285 |
| Amortization of intangible assets | 4,086 | - | 12,680 | - | 16,766 |
| Total operating expenses | 54,310 | - | 69,737 | - | 124,047 |
| Operating income | 46,347 | - | 5,930 | - | 52,277 |
| Other income (expense) | | | | | |
| Interest income | 116 | 776 | 87 | (868) | 111 |
| Interest expense | (14,621) | - | (212) | 868 | (13,965) |
| Other income (expense), net | 4,002 | - | (4,427) | - | (425) |
| Total other income (expense) | (10,503) | 776 | (4,552) | - | (14,279) |
| Income before income taxes | 35,844 | 776 | 1,378 | - | 37,998 |
| Income tax benefit (provision) | (13,218) | - | 2,120 | - | (11,098) |
| Equity in earnings of guarantor and non-guarantor subsidiaries, net | 4,274 | - | - | (4,274) | - |
| Net income | \$ 26,900 | \$ 776 | \$ 3,498 | \$ (4,274) | \$ 26,900 |

Consolidating Statement of Operations**Three Months Ended June 30, 2009**

| | Parent | Combined Guarantor Subsidiaries | Combined Non-guarantor Subsidiaries | Eliminations | Consolidated |
|---------------------|---------------|--|--|---------------------|---------------------|
| Revenues | \$ 140,861 | \$ 885 | \$ 283,011 | \$ (11,009) | \$ 413,748 |
| Cost of revenues | 92,309 | 1,234 | 198,105 | (11,009) | 280,639 |
| Gross profit (loss) | 48,552 | (349) | 84,906 | - | 133,109 |
| Operating expenses | | | | | |
| Sales and marketing | 14,260 | - | 23,665 | - | 37,925 |
| Product development | 19,407 | - | 11,402 | - | 30,809 |

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| | | | | | |
|---|------------------|-----------------|--------------------|------------------|------------------|
| General and administrative | 9,578 | - | 18,889 | - | 28,467 |
| Amortization of intangible assets | 5,874 | - | 18,315 | - | 24,189 |
| Total operating expenses | 49,119 | - | 72,271 | - | 121,390 |
| Operating income | (567) | (349) | 12,635 | - | 11,719 |
| Other income (expense) | | | | | |
| Interest income | 27,781 | 978 | 356 | (28,634) | 481 |
| Interest expense | (17,700) | - | (27,333) | 28,634 | (16,399) |
| Other income (expense), net | (964) | (12) | (1,901) | - | (2,877) |
| Total other income (expense) | 9,117 | 966 | (28,878) | - | (18,795) |
| Income (loss) before income taxes | 8,550 | 617 | (16,243) | - | (7,076) |
| Income tax benefit | 20,764 | - | 1,601 | - | 22,365 |
| Equity in losses of guarantor and non-guarantor subsidiaries, net | (14,025) | (949) | - | 14,974 | - |
| Net income (loss) | \$ 15,289 | \$ (332) | \$ (14,642) | \$ 14,974 | \$ 15,289 |

Table of Contents**Consolidating Statement of Operations****Six Months Ended June 30, 2010**

| | Parent | Guarantor Subsidiary | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------------|---|---------------------|---------------------|
| Revenues | \$ 542,823 | \$ - | \$ 552,119 | \$ (26,202) | \$ 1,068,740 |
| Cost of revenues | 364,451 | - | 395,272 | (26,202) | 733,521 |
| Gross profit | 178,372 | - | 156,847 | - | 335,219 |
| Operating expenses | | | | | |
| Sales and marketing | 31,273 | - | 51,238 | - | 82,511 |
| Product development | 42,229 | - | 23,833 | - | 66,062 |
| General and administrative | 27,250 | - | 39,092 | - | 66,342 |
| Amortization of intangible assets | 8,172 | - | 26,405 | - | 34,577 |
| Total operating expenses | 108,924 | - | 140,568 | - | 249,492 |
| Operating income | 69,448 | - | 16,279 | - | 85,727 |
| Other income (expense) | | | | | |
| Interest income | 475 | 1,534 | 226 | (1,957) | 278 |
| Interest expense | (30,201) | - | (644) | 1,957 | (28,888) |
| Other income (expense), net | 2,973 | - | (3,990) | - | (1,017) |
| Total other income (expense) | (26,753) | 1,534 | (4,408) | - | (29,627) |
| Income before income taxes | 42,695 | 1,534 | 11,871 | - | 56,100 |
| Income tax benefit (provision) | (3,765) | - | 1,352 | - | (2,413) |
| Equity in earnings of guarantor and non-guarantor subsidiaries, net | 14,757 | - | - | (14,757) | - |
| Net income | \$ 53,687 | \$ 1,534 | \$ 13,223 | \$ (14,757) | \$ 53,687 |

Consolidating Statement of Operations**Six Months Ended June 30, 2009**

| | Parent | Combined Guarantor Subsidiaries | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---------------------|---------------|--|---|---------------------|---------------------|
| Revenues | \$ 276,470 | \$ 2,111 | \$ 547,687 | \$ (24,002) | \$ 802,266 |
| Cost of revenues | 177,491 | 2,358 | 383,726 | (24,002) | 539,573 |
| Gross profit (loss) | 98,979 | (247) | 163,961 | - | 262,693 |
| Operating expenses | | | | | |
| Sales and marketing | 28,146 | - | 46,754 | - | 74,900 |
| Product development | 39,662 | - | 22,305 | - | 61,967 |

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| | | | | | |
|---|------------|------------|-------------|-----------|------------|
| General and administrative | 21,554 | - | 35,937 | - | 57,491 |
| Amortization of intangible assets | 11,759 | - | 35,908 | - | 47,667 |
| Total operating expenses | 101,121 | - | 140,904 | - | 242,025 |
| Operating income | (2,142) | (247) | 23,057 | - | 20,668 |
| Other income (expense) | | | | | |
| Interest income | 54,327 | 1,999 | 649 | (55,959) | 1,016 |
| Interest expense | (35,504) | - | (53,699) | 55,959 | (33,244) |
| Loss on extinguishment of debt, net | (10,340) | - | - | - | (10,340) |
| Other income (expense), net | (1,890) | 4 | (3,025) | - | (4,911) |
| Total other income (expense) | 6,593 | 2,003 | (56,075) | - | (47,479) |
| Income (loss) before income taxes | 4,451 | 1,756 | (33,018) | - | (26,811) |
| Income tax benefit (provision) | 23,686 | - | (1,315) | - | 22,371 |
| Equity in losses of guarantor and non-guarantor subsidiaries, net | (32,577) | (3,038) | - | 35,615 | - |
| Net loss | \$ (4,440) | \$ (1,282) | \$ (34,333) | \$ 35,615 | \$ (4,440) |

Table of Contents**Consolidating Balance Sheet****June 30, 2010**

| | Parent | Guarantor Subsidiary | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|--|---------------------|---------------------------------|---|-----------------------|---------------------|
| ASSETS | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 25,727 | \$ - | \$ 111,644 | \$ - | \$ 137,371 |
| Accounts receivable, net | 150,184 | - | 216,292 | - | 366,476 |
| Intercompany accounts receivable | 8,084 | - | 2,965 | (11,049) | - |
| Inventories | 106,127 | - | 96,579 | (1,028) | 201,678 |
| Deferred tax assets current, net | 13,800 | - | 7,033 | - | 20,833 |
| Other current assets | 22,030 | - | 43,306 | - | 65,336 |
| Intercompany other | 3,152 | - | (1) | (3,151) | - |
| Total current assets | 329,104 | - | 477,818 | (15,228) | 791,694 |
| Property, plant, and equipment, net | 116,208 | - | 173,201 | - | 289,409 |
| Prepaid debt fees | 7,109 | - | - | - | 7,109 |
| Deferred tax assets noncurrent, net | 43,820 | - | 23,864 | - | 67,684 |
| Other noncurrent assets | 4,410 | - | 11,202 | - | 15,612 |
| Intangible assets, net | 49,998 | - | 259,032 | - | 309,030 |
| Goodwill | 184,750 | - | 961,332 | - | 1,146,082 |
| Investment in subsidiaries | 298,872 | - | - | (298,872) | - |
| Intercompany notes receivable | 1,204,244 | 99,703 | (2) | (1,303,945) | - |
| Total assets | \$ 2,238,515 | \$ 99,703 | \$ 1,906,447 | \$ (1,618,045) | \$ 2,626,620 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ 88,501 | \$ - | \$ 146,940 | \$ - | \$ 235,441 |
| Other current liabilities | 16,447 | - | 43,230 | - | 59,677 |
| Intercompany accounts payable | 3,018 | - | 8,031 | (11,049) | - |
| Wages and benefits payable | 37,549 | - | 47,837 | - | 85,386 |
| Taxes payable | 2,422 | - | 15,675 | - | 18,097 |
| Current portion of long-term debt | 10,182 | - | - | - | 10,182 |
| Current portion of warranty | 10,674 | - | 15,576 | - | 26,250 |
| Unearned revenue | 32,128 | - | 5,859 | - | 37,987 |
| Deferred tax liabilities current, net | (3) | - | 1,628 | - | 1,625 |
| Short-term intercompany advances | - | - | 3,151 | (3,151) | - |
| Total current liabilities | 200,918 | - | 287,927 | (14,200) | 474,645 |
| Long-term debt | 663,159 | - | - | - | 663,159 |
| Warranty | 11,034 | - | 11,919 | - | 22,953 |
| Pension plan benefits | - | - | 54,953 | - | 54,953 |
| Intercompany notes payable | 99,703 | - | 1,204,242 | (1,303,945) | - |
| Deferred tax liabilities noncurrent, net | (35,676) | - | 95,693 | - | 60,017 |
| Other noncurrent obligations | 16,392 | - | 51,516 | - | 67,908 |

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| | | | | | |
|--|--------------|-----------|--------------|----------------|--------------|
| Total liabilities | 955,530 | - | 1,706,250 | (1,318,145) | 1,343,635 |
| Shareholders' equity | | | | | |
| Preferred stock | - | - | - | - | - |
| Common stock | 1,315,067 | 97,377 | 64,315 | (161,692) | 1,315,067 |
| Accumulated other comprehensive income (loss), net | (116,019) | (7,787) | 33,327 | (25,540) | (116,019) |
| Retained earnings | 83,937 | 10,113 | 102,555 | (112,668) | 83,937 |
| Total shareholders' equity | 1,282,985 | 99,703 | 200,197 | (299,900) | 1,282,985 |
| Total liabilities and shareholders' equity | \$ 2,238,515 | \$ 99,703 | \$ 1,906,447 | \$ (1,618,045) | \$ 2,626,620 |

Table of Contents**Consolidating Balance Sheet****December 31, 2009**

| | Parent | Combined Guarantor Subsidiaries | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|---------------------|--|---|-----------------------|---------------------|
| ASSETS | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 16,385 | \$ 379 | \$ 105,129 | \$ - | \$ 121,893 |
| Accounts receivable, net | 117,104 | 2,316 | 218,528 | - | 337,948 |
| Intercompany accounts receivable | 9,524 | 52 | 1,572 | (11,148) | - |
| Inventories | 71,581 | - | 98,881 | (378) | 170,084 |
| Deferred tax assets current, net | 13,085 | (44) | 7,721 | - | 20,762 |
| Other current assets | 32,349 | 108 | 42,772 | - | 75,229 |
| Intercompany other | 32,456 | 3,658 | 4,999 | (41,113) | - |
| Total current assets | 292,484 | 6,469 | 479,602 | (52,639) | 725,916 |
| Property, plant, and equipment, net | 116,081 | - | 202,136 | - | 318,217 |
| Prepaid debt fees | 8,628 | - | - | - | 8,628 |
| Deferred tax assets noncurrent, net | 67,195 | - | 22,737 | - | 89,932 |
| Other noncurrent assets | 5,625 | - | 12,492 | - | 18,117 |
| Intangible assets, net | 58,168 | - | 330,044 | - | 388,212 |
| Goodwill | 174,781 | - | 1,130,818 | - | 1,305,599 |
| Investment in subsidiaries | (9,081) | (12,444) | - | 21,525 | - |
| Intercompany notes receivable | 1,723,587 | 94,511 | - | (1,818,098) | - |
| Total assets | \$ 2,437,468 | \$ 88,536 | \$ 2,177,829 | \$ (1,849,212) | \$ 2,854,621 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ 67,480 | \$ 66 | \$ 151,709 | \$ - | \$ 219,255 |
| Other current liabilities | 21,147 | - | 43,436 | - | 64,583 |
| Intercompany accounts payable | 1,674 | 184 | 9,290 | (11,148) | - |
| Wages and benefits payable | 20,621 | 102 | 50,869 | - | 71,592 |
| Taxes payable | 1,776 | (43) | 12,644 | - | 14,377 |
| Current portion of long-term debt | 10,871 | - | - | - | 10,871 |
| Current portion of warranty | 8,418 | - | 12,523 | - | 20,941 |
| Unearned revenue | 36,421 | - | 3,719 | - | 40,140 |
| Deferred tax liabilities current, net | (1,550) | - | 3,175 | - | 1,625 |
| Short-term intercompany advances | 8,661 | 2,450 | 30,002 | (41,113) | - |
| Total current liabilities | 175,519 | 2,759 | 317,367 | (52,261) | 443,384 |
| Long-term debt | 770,893 | - | - | - | 770,893 |
| Warranty | 9,919 | - | 3,013 | - | 12,932 |
| Pension plan benefits | - | - | 63,040 | - | 63,040 |
| Intercompany notes payable | 94,512 | - | 1,723,586 | (1,818,098) | - |
| Deferred tax liabilities noncurrent, net | (37,176) | - | 117,871 | - | 80,695 |
| Other noncurrent obligations | 23,287 | - | 59,876 | - | 83,163 |

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| | | | | | |
|--|--------------|-----------|--------------|----------------|--------------|
| Total liabilities | 1,036,954 | 2,759 | 2,284,753 | (1,870,359) | 1,454,107 |
| Shareholders' equity | | | | | |
| Preferred stock | - | - | - | - | - |
| Common stock | 1,299,134 | 107,165 | 80,723 | (187,888) | 1,299,134 |
| Accumulated other comprehensive income (loss), net | 71,130 | (9,200) | 19,689 | (10,489) | 71,130 |
| Retained earnings (accumulated deficit) | 30,250 | (12,188) | (207,336) | 219,524 | 30,250 |
| Total shareholders' equity | 1,400,514 | 85,777 | (106,924) | 21,147 | 1,400,514 |
| Total liabilities and shareholders' equity | \$ 2,437,468 | \$ 88,536 | \$ 2,177,829 | \$ (1,849,212) | \$ 2,854,621 |

Table of Contents**Consolidating Statement of Cash Flows****Six Months Ended June 30, 2010**

| | Parent | Guarantor Subsidiary | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|-----------------|-------------------------|---|-----------------|-----------------|
| Operating activities | | | | | |
| Net income | \$ 53,687 | \$ 1,534 | \$ 13,223 | \$ (14,757) | \$ 53,687 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | 22,655 | - | 42,416 | - | 65,071 |
| Stock-based compensation | 9,121 | - | - | - | 9,121 |
| Amortization of prepaid debt fees | 2,762 | - | - | - | 2,762 |
| Amortization of convertible debt discount | 4,957 | - | - | - | 4,957 |
| Deferred taxes, net | 3,612 | - | (10,771) | - | (7,159) |
| Equity in losses of guarantor and non-guarantor subsidiaries, net | (14,757) | - | - | 14,757 | - |
| Other adjustments, net | 1,972 | - | 1,334 | - | 3,306 |
| Changes in operating assets and liabilities, net of acquisitions: | | | | | |
| Accounts receivable | (33,080) | - | (19,252) | - | (52,332) |
| Inventories | (33,896) | - | (7,034) | - | (40,930) |
| Accounts payables, other current liabilities, and taxes payable | 22,873 | - | 19,590 | - | 42,463 |
| Wages and benefits payable | 16,928 | - | 2,720 | - | 19,648 |
| Unearned revenue | (3,900) | - | 2,695 | - | (1,205) |
| Warranty | 3,371 | - | 10,663 | - | 14,034 |
| Intercompany transactions, net | 2,784 | - | (2,784) | - | - |
| Other operating, net | 7,787 | - | (4,124) | - | 3,663 |
| Net cash provided by operating activities | 66,876 | 1,534 | 48,676 | - | 117,086 |
| Investing activities | | | | | |
| Acquisitions of property, plant, and equipment | (15,490) | - | (12,226) | - | (27,716) |
| Current intercompany notes, net | 27,259 | (1,534) | 5,000 | (30,725) | - |
| Other investing, net | 2,572 | - | 1,923 | - | 4,495 |
| Net cash provided by (used in) investing activities | 14,341 | (1,534) | (5,303) | (30,725) | (23,221) |
| Financing activities | | | | | |
| Payments on debt | (73,881) | - | - | - | (73,881) |
| Issuance of common stock | 6,812 | - | - | - | 6,812 |
| Current intercompany notes, net | (3,466) | - | (27,259) | 30,725 | - |
| Prepaid debt fees | (1,340) | - | - | - | (1,340) |
| Other financing, net | - | - | (897) | - | (897) |
| Net cash used in financing activities | (71,875) | - | (28,156) | 30,725 | (69,306) |
| Effect of foreign exchange rate changes on cash and cash equivalents | - | - | (9,081) | - | (9,081) |
| Increase in cash and cash equivalents | 9,342 | - | 6,136 | - | 15,478 |

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| | | | | | |
|--|-----------|------|------------|------|------------|
| Cash and cash equivalents at beginning of period | 16,385 | - | 105,508 | - | 121,893 |
| Cash and cash equivalents at end of period | \$ 25,727 | \$ - | \$ 111,644 | \$ - | \$ 137,371 |
| <i>Non-cash transactions:</i> | | | | | |
| Fixed assets purchased but not yet paid, net | \$ 245 | \$ - | \$ 3,246 | \$ - | \$ 3,491 |
| <i>Supplemental disclosure of cash flow information:</i> | | | | | |
| Cash paid during the period for: | | | | | |
| Income taxes | \$ 9,191 | \$ - | \$ 164 | \$ - | \$ 9,355 |
| Interest, net of amounts capitalized | 20,958 | - | 220 | - | 21,178 |

Table of Contents**Consolidating Statement of Cash Flows****Six Months Ended June 30, 2009**

| | Parent | Combined Guarantor Subsidiaries | Combined Non-guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|-----------------|--|---|---------------------|---------------------|
| Operating activities | | | | | |
| Net loss | \$ (4,440) | \$ (1,282) | \$ (34,333) | \$ 35,615 | \$ (4,440) |
| Adjustments to reconcile net loss to net cash provided (used in) by operating activities: | | | | | |
| Depreciation and amortization | 22,943 | - | 51,464 | - | 74,407 |
| Stock-based compensation | 9,279 | - | - | - | 9,279 |
| Amortization of prepaid debt fees | 2,272 | - | - | - | 2,272 |
| Amortization of convertible debt discount | 4,895 | - | - | - | 4,895 |
| Loss on extinguishment of debt, net | 9,960 | - | - | - | 9,960 |
| Deferred taxes, net | (21,902) | - | (13,098) | - | (35,000) |
| Equity in losses of guarantor and non-guarantor subsidiaries, net | 32,577 | 3,038 | - | (35,615) | - |
| Other, net | (511) | - | 46 | - | (465) |
| Changes in operating assets and liabilities, net of acquisitions: | | | | | |
| Accounts receivable | 14,472 | (491) | (4,041) | - | 9,940 |
| Inventories | 5,134 | - | (6,709) | - | (1,575) |
| Accounts payables, other current liabilities, and taxes payable | (5,708) | 353 | 1,301 | - | (4,054) |
| Wages and benefits payable | (7,515) | (77) | (1,412) | - | (9,004) |
| Unearned revenue | 13,050 | 82 | (413) | - | 12,719 |
| Warranty | (2,579) | - | (1,611) | - | (4,190) |
| Intercompany transactions, net | 1,633 | 692 | (2,325) | - | - |
| Other, net | (4,639) | 51 | 7,197 | - | 2,609 |
| Net cash provided by (used in) operating activities | 68,921 | 2,366 | (3,934) | - | 67,353 |
| Investing activities | | | | | |
| Acquisitions of property, plant, and equipment | (11,678) | (346) | (15,780) | - | (27,804) |
| Business acquisitions & contingent consideration, net of cash equivalents acquired | (1,317) | - | - | - | (1,317) |
| Current intercompany notes, net | (13,481) | - | 1,217 | 12,264 | - |
| Long-term intercompany notes receivable, net | 3,689 | (1,998) | 1,135 | (2,826) | - |
| Other, net | (2,447) | (1) | 6,421 | - | 3,973 |
| Net cash used in investing activities | (25,234) | (2,345) | (7,007) | 9,438 | (25,148) |
| Financing activities | | | | | |
| Payments on debt | (70,241) | - | - | - | (70,241) |
| Issuance of common stock | 162,153 | - | - | - | 162,153 |
| Current intercompany notes, net | (1,254) | - | 13,518 | (12,264) | - |
| Long-term intercompany notes payable, net | (2,637) | - | (189) | 2,826 | - |
| Prepaid debt fees | (3,992) | - | - | - | (3,992) |
| Other, net | (587) | - | - | - | (587) |
| Net cash provided by financing activities | 83,442 | - | 13,329 | (9,438) | 87,333 |

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| | | | | | |
|--|------------|---------|-----------|------|------------|
| Effect of foreign exchange rate changes on cash and cash equivalents | - | - | 2,200 | - | 2,200 |
| Increase in cash and cash equivalents | 127,129 | 21 | 4,588 | - | 131,738 |
| Cash and cash equivalents at beginning of period | 67,404 | 3,180 | 73,806 | - | 144,390 |
| Cash transferred from guarantor to parent | 2,940 | (2,940) | - | - | - |
| Cash and cash equivalents at end of period | \$ 197,473 | \$ 261 | \$ 78,394 | \$ - | \$ 276,128 |

Non-cash transactions:

| | | | | | |
|--|----------|--------|----------|------|----------|
| Fixed assets purchased but not yet paid, net | \$ 3,253 | \$ 137 | \$ 1,759 | \$ - | \$ 5,149 |
| Exchange of debt for common stock (see Note 6) | 120,984 | - | - | - | 120,984 |
| Contingent consideration payable for previous acquisitions | 2,000 | - | - | - | 2,000 |

Supplemental disclosure of cash flow information:

| | | | | | |
|--------------------------------------|--------|------|----------|------|----------|
| Cash paid during the period for: | | | | | |
| Income taxes | \$ 374 | \$ - | \$ 5,552 | \$ - | \$ 5,926 |
| Interest, net of amounts capitalized | 31,681 | 115 | 136 | - | 31,932 |

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ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

In this Quarterly Report on Form 10-Q, the terms we, us, our, Itron, and the Company refer to Itron, Inc.

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes included in this report and with our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission (SEC) on February 25, 2010.

Documents we provide to the SEC are available free of charge under the Investors section of our website at www.itron.com as soon as practicable after they are filed with or furnished to the SEC. In addition, these documents are available at the SEC's website (<http://www.sec.gov>) and at the SEC's Headquarters at 100 F Street, NE, Washington, DC 20549, or by calling 1-800-SEC-0330.

Certain Forward-Looking Statements

This document contains forward-looking statements concerning our operations, financial performance, revenues, earnings growth, liquidity, and other items. This document reflects our current plans and expectations and is based on information currently available as of the date of this Quarterly Report on Form 10-Q. When we use the words expect, intend, anticipate, believe, plan, project, estimate, future, objective, may, will, will continue, and similar expressions, they are intended to identify forward-looking statements. Forward-looking statements rely on a number of assumptions and estimates. These assumptions and estimates could be inaccurate and cause our actual results to vary materially from expected results. Risks and uncertainties include 1) the rate and timing of customer demand for our products, 2) rescheduling or cancellations of current customer orders and commitments, 3) competition, 4) changes in estimated liabilities for product warranties and/or litigation, 5) our dependence on customers' acceptance of new products and their performance, 6) changes in domestic and international laws and regulations, 7) future business combinations, 8) changes in estimates for stock-based compensation and pension costs, 9) changes in foreign currency exchange rates and interest rates, 10) international business risks, 11) our own and our customers' or suppliers' access to and cost of capital, and 12) other factors. You should not solely rely on these forward-looking statements as they are only valid as of the date of this Quarterly Report on Form 10-Q. We do not have any obligation to publicly update or revise any forward-looking statement in this document. For a more complete description of these and other risks, refer to Item 1A: Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which was filed with the SEC on February 25, 2010.

Results of Operations

We derive the majority of our revenues from sales of products and services to utilities. Our products and services include hardware, software, managed services, and consulting. Cost of revenues includes materials, labor, overhead, warranty expense, and distribution and documentation costs for software.

Overview

Revenues for the three and six months ended June 30, 2010 increased 38% and 33%, compared with the same periods in 2009, primarily due to the rollout of our advanced metering infrastructure (AMI) contracts. Total backlog was \$1.7 billion and twelve-month backlog was \$1.0 billion at June 30, 2010.

North America meter volumes increased 124% and 95%, driven by AMI, while International meter volumes decreased 3% and 8% for the three and six months ended June 30, 2010, compared with the same periods in 2009.

Term debt repayments during the first half of 2010 were \$73.9 million, bringing the total debt outstanding to \$673.3 million at June 30, 2010.

Table of Contents**Total Company Revenues, Gross Profit and Margin, and Unit Shipments**

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|--------------|-----------------------------|----------|----------|---------------------------|----------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| | (in millions) | | | (in millions) | | |
| Revenues | \$ 569.4 | \$ 413.7 | 38% | \$ 1,068.7 | \$ 802.2 | 33% |
| Gross Profit | \$ 176.3 | \$ 133.1 | 32% | \$ 335.2 | \$ 262.7 | 28% |
| Gross Margin | 31.0% | 32.2% | | 31.4% | 32.7% | |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------|-----------------------------|----------|---------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| Revenues by region | | | | |
| United States and Canada | \$ 301.5 | \$ 135.9 | \$ 542.1 | \$ 270.7 |
| Europe | 192.8 | 209.5 | 388.3 | 407.0 |
| Other | 75.1 | 68.3 | 138.3 | 124.5 |
| Total revenues | \$ 569.4 | \$ 413.7 | \$ 1,068.7 | \$ 802.2 |

Revenues

Revenues increased \$155.7 million and \$266.5 million, or 38% and 33%, for the three and six months ended June 30, 2010 compared with the same periods in 2009. The net translation effect of our operations denominated in foreign currencies to the U.S. dollar was minor in the second quarter of 2010 and accounted for 7% of the increase in revenues in the first half of 2010. A more detailed analysis of these fluctuations is provided in *Operating Segment Results*.

One customer, Southern California Edison, represented approximately 12% and 11% of total revenues for the three and six months ended 2010, while no single customer represented more than 10% of total Company revenues for the same periods in 2009. Our 10 largest customers accounted for approximately 34% and 33% of total revenues for the three and six months ended June 30, 2010, compared with 15% and 13% for the three and six months ended June 30, 2009, respectively.

Gross Margins

Gross margin was 31.0% and 31.4% for the three and six months ended 2010, compared with 32.2% and 32.7% during the same periods in 2009. The decrease in gross margin was due to a decline in both operating segment gross margins, partially offset by a higher percentage of Itron North America revenues, which are at higher gross margins compared with Itron International. A more detailed analysis of these fluctuations is provided in *Operating Segment Results*.

Meter and Module Summary

Meters are sold with and without advanced functionality. In addition, smart meter modules (AMR/AMI) can be sold separately from the meter. Depending on customers' preferences, we also incorporate other vendors' technology in our meters. A summary of our meter and AMR/AMI module volumes is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------|---------------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| | (units in thousands) | | | |
| Total meters (with and without AMR/AMI) | | | | |
| Itron North America | | | | |
| Electricity | 1,740 | 760 | 3,190 | 1,600 |

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| | | | | |
|---|--------------|--------------|---------------|---------------|
| Gas | 160 | 90 | 260 | 170 |
| Itron International | | | | |
| Electricity | 1,930 | 1,970 | 3,570 | 3,780 |
| Gas | 1,020 | 1,400 | 2,000 | 2,720 |
| Water | 2,380 | 2,130 | 4,670 | 4,580 |
| Total meters | 7,230 | 6,350 | 13,690 | 12,850 |
| Additional meter information (Total Company) | | | | |
| Meters with AMR | 1,050 | 760 | 1,720 | 1,540 |
| Meters with AMI | 1,050 | 80 | 1,860 | 100 |
| Standalone AMR/AMI modules | 1,600 | 1,010 | 2,790 | 2,010 |
| Meters with AMR/AMI and modules | 3,700 | 1,850 | 6,370 | 3,650 |
| Meters with other vendors' AMR/AMI | 70 | 120 | 260 | 310 |

Table of Contents**Operating Segment Results**

For a description of our operating segments, refer to Item 1: Financial Statements Note 14: Segment Information .

| <i>Segment Revenues</i> | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|-------------------------|-----------------------------|----------|----------|---------------------------|----------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| | (in millions) | | | (in millions) | | |
| Itron North America | \$ 303.2 | \$ 142.8 | 112% | \$ 546.3 | \$ 282.2 | 94% |
| Itron International | 266.3 | 270.9 | (2%) | 522.5 | 520.0 | 0% |
| Total revenues | \$ 569.5 | \$ 413.7 | 38% | \$ 1,068.8 | \$ 802.2 | 33% |

| <i>Segment Gross Profit and Margin</i> | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|--|-----------------------------|--------------|---------------|--------------|---------------------------|--------------|---------------|--------------|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | Gross Profit | Gross Margin | Gross Profit | Gross Margin | Gross Profit | Gross Margin | Gross Profit | Gross Margin |
| | (in millions) | | (in millions) | | (in millions) | | (in millions) | |
| Itron North America | \$ 103.1 | 34.0% | \$ 49.9 | 34.9% | \$ 183.0 | 33.5% | \$ 102.2 | 36.2% |
| Itron International | 73.2 | 27.5% | 83.2 | 30.7% | 152.2 | 29.1% | 160.5 | 30.9% |
| Total gross profit and margin | \$ 176.3 | 31.0% | \$ 133.1 | 32.2% | \$ 335.2 | 31.4% | \$ 262.7 | 32.7% |

| <i>Segment Operating Income (Loss) and Operating Margin</i> | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|-----------------------------|------------------|-------------------------|------------------|---------------------------|------------------|-------------------------|------------------|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | Operating Income (Loss) | Operating Margin | Operating Income (Loss) | Operating Margin | Operating Income (Loss) | Operating Margin | Operating Income (Loss) | Operating Margin |
| | (in millions) | | (in millions) | | (in millions) | | (in millions) | |
| Itron North America | \$ 57.5 | 19% | \$ 5.9 | 4% | \$ 91.3 | 17% | \$ 13.7 | 5% |
| Itron International | 5.2 | 2% | 12.9 | 5% | 15.7 | 3% | 22.7 | 4% |
| Corporate unallocated | (10.5) | | (7.1) | | (21.3) | | (15.7) | |
| Total Company | \$ 52.2 | 9% | \$ 11.7 | 3% | \$ 85.7 | 8% | \$ 20.7 | 3% |

Itron North America: Revenues increased \$160.4 million and \$264.1 million, or 112% and 94%, during the three and six months ended June 30, 2010 from 2009 levels. The increase in revenues was primarily due to the rollout of our OpenWay® projects. AMI meter volumes (inclusive of OpenWay) were 1.1 million and 1.9 million in the second quarter and first half of 2010. Our OpenWay contracts accounted for 48% and 47% of operating segment revenues for the three and six months ended June 30, 2010, compared with 8% and 5% in the same periods last year. Revenues of non-AMI meters and modules increased 20% and 4% for the three and six months ended June 30, 2010, compared with the same periods last year.

Gross margin decreased 0.9% and 2.7% in the three and six months end June 30, 2010, compared with the same periods in 2009, primarily due to the significant increase in revenue from shipments of our first generation AMI meters, which currently have lower gross margins, and increased service revenues, which also have lower gross margins. In addition, gross margin was lower due to increased compensation costs resulting from the reinstatement of our annual incentive plans.

Three customers each represented more than 10% of Itron North America revenues in the three and six months ended June 30, 2010. No customer represented more than 10% of Itron North America operating segment revenues in the three and six months ended June 30, 2009.

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Itron North America operating expenses increased \$1.6 million and \$3.2 million, or 4%, for the second quarter and first half of 2010, compared with the same periods in 2009, primarily due to increased compensation expense. These higher costs were partially offset by lower amortization of intangible assets. As a result of higher revenues, operating expenses as a percentage of revenues were 15% and 17% for the second quarter and first half of 2010, compared with 31% for the same periods in 2009.

Itron International: Revenues decreased \$4.6 million, or 2%, for the three months ended June 30, 2010, and remained relatively flat for the six months ended June 30, 2010, compared with the same period in 2009. Excluding the translation effect of a stronger U.S. dollar against most foreign currencies in the second quarter of 2010, compared with the second quarter of 2009, revenues increased 1%. Excluding the translation effect of a weaker U.S. dollar against most foreign currencies in the first half of 2010, compared with the first half of 2009, revenues declined 3%. Due to Itron International's diverse regional operations, revenue variability occurs due to the diverse economies in which it operates.

Gross margin decreased 3.2% and 1.8% in the three and six months end June 30, 2010, compared with the same periods in 2009, due to increased warranty expense of \$9.6 million recorded for the arbitration claims in Sweden, as discussed in Item 1: Financial Statements Note 11: Commitments and Contingencies. Excluding the additional warranty expense, gross margins remained constant.

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Business line revenues as a percentage of total Itron International operating segment revenues were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------|-----------------------------|------|---------------------------|------|
| | 2010 | 2009 | 2010 | 2009 |
| Electricity | 39% | 41% | 38% | 39% |
| Water | 31% | 29% | 33% | 32% |
| Gas | 30% | 30% | 29% | 29% |

No single customer represented more than 10% of Itron International operating segment revenues in the three and six months ended June 30, 2010 and 2009.

Operating expenses for Itron International were \$68.0 million and \$70.3 million for the three months ended June 30, 2010 and 2009, or 26% of revenues for the respective periods. Operating expenses for the six months ended June 30, 2010 and 2009 were \$136.5 million and \$137.8 million or 26% and 27% of revenues for the respective periods. Operating expenses, excluding amortization expense and before the impact of foreign currency exchange rate changes, increased 10% and 5% for the three and six months ended June 30, 2010, compared with the same periods in 2009.

Corporate unallocated: Operating expenses not directly associated with an operating segment are classified as Corporate unallocated. These expenses increased \$3.4 million and \$5.6 million in the three and six months ended June 30, 2010, compared with the same periods last year, primarily due to compensation expense, including the reinstatement of bonus and profit sharing plans.

Bookings and Backlog of Orders

Bookings for a reported period represent customer contracts and purchase orders received during the period that have met certain conditions, such as regulatory approval. Total backlog represents committed but undelivered contracts and purchase orders at period-end. Twelve-month backlog represents the portion of total backlog that we estimate will be recognized as revenue over the next 12 months. Backlog is not a complete measure of our future business as we have significant book-and-ship orders. Bookings and backlog may fluctuate significantly due to the timing of large project awards. In addition, annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. Beginning total backlog, plus bookings, minus revenues, will not equal ending total backlog due to miscellaneous contract adjustments, foreign currency fluctuations, and other factors.

Information on bookings and backlog is summarized as follows:

| Quarter Ended | Quarterly Bookings | Ending Total Backlog (in millions) | Ending 12-Month Backlog |
|--------------------|--------------------|------------------------------------|-------------------------|
| June 30, 2010 | \$ 806 | \$ 1,686 | \$ 1,017 |
| March 31, 2010 | 481 | 1,459 | 981 |
| December 31, 2009 | 397 | 1,488 | 807 |
| September 30, 2009 | 400 | 1,577 | 749 |
| June 30, 2009 | 427 | 1,573 | 646 |

When we sign project agreements to deploy our meter and communication systems, we include these contracts in bookings and backlog when regulatory approvals are received or certain other conditions are met. Bookings and backlog for the second quarter of 2010 include \$339 million related to an OpenWay contract with Detroit Edison. A significant portion of this contract is not included in 12-month backlog as it is a multi-year contract.

Table of Contents**Operating Expenses**

The following table details our total operating expenses in dollars and as a percentage of revenues:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|-----------------------------------|-----------------------------|------------------|-----------------------|------------------|---------------------------|-----------------|-----------------------|-----------------|
| | 2010 (in millions) | % of Revenues | 2009 (in millions) | % of Revenues | 2010 (in millions) | % of Revenue | 2009 (in millions) | % of Revenue |
| Sales and marketing | \$ 41.0 | 7% | \$ 37.9 | 9% | \$ 82.5 | 8% | \$ 74.9 | 9% |
| Product development | 33.0 | 6% | 30.8 | 7% | 66.1 | 6% | 61.9 | 8% |
| General and administrative | 33.3 | 6% | 28.5 | 7% | 66.3 | 6% | 57.5 | 7% |
| Amortization of intangible assets | 16.8 | 3% | 24.2 | 6% | 34.6 | 3% | 47.7 | 6% |
| Total operating expenses | \$ 124.1 | 22% | \$ 121.4 | 29% | \$ 249.5 | 23% | \$ 242.0 | 30% |

Operating expenses increased 2% and 3% for the three and six months ended June 30, 2010, compared with the same periods in 2009, respectively. The translation of foreign currencies to the U.S. dollar represented a decrease of \$2.1 million for the three months ended June 30, 2010 and an increase of \$3.7 million for the six months ended June 30, 2010. The net increase in operating expenses was primarily due to increased compensation expense, partially offset by lower amortization of intangible assets.

Other Income (Expense)

The following table shows the components of other income (expense):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|-----------------------------|--------------------|---------------------------|--------------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Interest income | \$ 111 | \$ 481 | \$ 278 | \$ 1,016 |
| Interest expense | (12,455) | (15,967) | (26,126) | (30,972) |
| Amortization of prepaid debt fees | (1,510) | (432) | (2,762) | (2,272) |
| Loss on extinguishment of debt, net | - | - | - | (10,340) |
| Other income (expense), net | (425) | (2,877) | (1,017) | (4,911) |
| Total other income (expense) | \$ (14,279) | \$ (18,795) | \$ (29,627) | \$ (47,479) |

Interest income: Interest income decreased in 2010, compared with 2009, primarily due to lower interest rates in 2010. Average cash and cash equivalent balances also decreased 12% and 1% in the three and six months ended June 30, 2010, compared with the same periods in 2009.

Interest expense: Interest expense decreased 22% and 16% for the three and six months ended June 30, 2010, compared with the same periods in 2009, primarily due to the decline in the principal balance of our debt outstanding. At June 30, 2010, inclusive of our interest rate swaps, 88% of our borrowings were at fixed rates. Refer to Item 1: Financial Statements Note 6: Debt for additional details related to our long-term borrowings.

Amortization of prepaid debt fees: The increase in amortization of prepaid debt fees for the three and six months ended June 30, 2010 was primarily the result of slightly higher debt repayments. Repayments on our borrowings were \$21.1 million and \$73.8 million for the three and six months ended June 30, 2010, compared with \$2.6 million and \$67.6 million for the three and six months ended June 30, 2009. When debt is repaid early, the related portion of unamortized prepaid debt fees is written off and included in interest expense.

Loss on extinguishment of debt: During the first quarter of 2009, we entered into exchange agreements with certain holders of our convertible notes to issue, in the aggregate, approximately 2.3 million shares of common stock, valued at \$132.9 million, in exchange for, in the aggregate, \$121.0 million principal amount of the convertible notes, representing 35% of the aggregate principal amount outstanding at the date of the exchanges. As a result, we recognized a net loss on extinguishment of debt of \$10.3 million, calculated as the inducement loss, plus an allocation

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of advisory fees less the revaluation gain. For a description of the induced conversion of a portion of our convertible notes, refer to Item 1:
Financial Statements Note 6: Debt .

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Other income (expense), net: Other expenses, net, typically result from foreign currency fluctuations due to the revaluation of monetary asset and liability balances denominated in a currency other than the reporting entity's functional currency. In the first quarter of 2009, other expense also included \$1.5 million in consulting and legal fees associated with the amendment to our credit facility.

Financial Condition**Cash Flow Information:**

| | Six Months Ended June 30, | |
|---|---------------------------|----------|
| | 2010 | 2009 |
| | (in millions) | |
| Operating activities | \$ 117.1 | \$ 67.3 |
| Investing activities | (23.2) | (25.1) |
| Financing activities | (69.3) | 87.3 |
| Effect of exchange rates on cash and cash equivalents | (9.1) | 2.2 |
| Increase in cash and cash equivalents | \$ 15.5 | \$ 131.7 |

Cash and cash equivalents was \$137.4 million at June 30, 2010, compared with \$121.9 million at December 31, 2009. The increase was primarily due to increased revenues from the Itron North America operating segment, partially offset by lower proceeds from the issuance of common stock in 2010.

Operating activities

Cash provided by operating activities for the first half of 2010 was \$49.8 million higher, compared with the same period in 2009, primarily due to increased revenues.

Investing activities

Investing activities consist primarily of capital expenditures associated with the expansion of our manufacturing capacity. Acquisitions of property, plant, and equipment have consisted primarily of machinery and equipment for increased operating capacity.

Financing activities

During the first half 2010, we repaid \$73.9 million in borrowings, compared with \$70.2 million during the same period in 2009. Cash generated from the exercise of stock-based awards was \$6.8 million for the first half of 2010, compared with \$1.9 million during the same period in 2009. During the first half of 2009, we completed an underwritten public offering of approximately 3.2 million shares of common stock for net proceeds of \$160.4 million.

Effect of exchange rates on cash and cash equivalents

The effect of exchange rates on the cash balances of currencies held in foreign denominations for the first half of 2010 was a decrease of \$9.1 million, compared with an increase of \$2.2 million for the same period in 2009.

Non-cash transactions

During the first quarter of 2009, we completed exchanges with certain holders of our convertible notes in which we issued, in the aggregate, approximately 2.3 million shares of common stock valued at \$132.9 million, in exchange for, in the aggregate, \$121.0 million principal amount of the convertible notes. Refer to Item 1: Financial Statements Note 6: Debt for further discussion.

Off-balance sheet arrangements

We have no off-balance sheet financing agreements or guarantees as defined by Item 303 of Regulation S-K at June 30, 2010 and December 31, 2009 that we believe are reasonably likely to have a current or future effect on our financial condition, results of operations, or cash flows.

Liquidity, Sources and Uses of Capital:

Our principal sources of liquidity are cash flows from operations, borrowings, and sales of common stock. Cash flows may fluctuate and are sensitive to many factors including changes in working capital and the timing and magnitude of capital expenditures and payments on debt.

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Our credit facility contains scheduled minimum principal payments of 1% per year (.25% quarterly) and an annual excess cash flow provision payment, payable within 90 days of our fiscal year end. The amount of the excess cash flow provision payment varies according to our consolidated leverage ratio.

The credit facility includes a multicurrency revolving line of credit, which was increased from \$115 million to \$240 million on June 9, 2010. The increase was completed without amending the credit facility.

Effective July 1, 2010, we will classify the convertible senior subordinated notes as current on the Consolidated Balance Sheet due to the combination of put, call, and conversion options occurring within the next 12 months.

For a description of the term loans under our credit facility and convertible senior subordinated notes, refer to Item 1: Financial Statements Note 6: Debt .

For a description of our letters of credit and performance bonds, and the amounts available for additional borrowings or letters of credit under our lines of credit, including the multicurrency revolving line of credit that is part of our credit facility, refer to Item 1: Financial Statements Note 11: Commitments and Contingencies .

For a description of our funded and unfunded non-U.S. defined benefit pension plans and our expected 2010 contributions, refer to Item 1: Financial Statements Note 8: Defined Benefit Pension Plans .

For a description of our bonus and profit sharing plans, including the amounts accrued at June 30, 2010 and the expected timing of payment, refer to *Bonus and Profit Sharing* within Critical Accounting Estimates below.

Our net deferred tax assets consist primarily of accumulated net operating loss carryforwards, hedging activities, and tax credits that can be carried forward, some of which are limited by Internal Revenue Code Sections 382 and 383. The limited deferred income tax assets resulted primarily from acquisitions. Based on current projections, we expect to pay \$342,000 in U.S. federal and state taxes and approximately \$22.9 million in local and foreign taxes in 2010. See Item 1: Financial Statements Note 10: Income Taxes for a discussion of our tax provision (benefit) and unrecognized tax benefits.

Working capital, which represents current assets less current liabilities, was \$317.0 million at June 30, 2010, compared with \$282.5 million at December 31, 2009.

We expect to continue to expand our operations and grow our business through a combination of internal new product development, licensing technology from and to others, distribution agreements, partnership arrangements, and acquisitions of technology or other companies. We expect these activities to be funded with existing cash, cash flow from operations, borrowings, and the sale of common stock or other securities. We believe existing sources of liquidity will be sufficient to fund our existing operations and obligations for the next 12 months and into the foreseeable future, but offer no assurances. Our liquidity could be affected by the stability of the energy and water industries, competitive pressures, international risks, intellectual property claims, capital market fluctuations, and other factors described under Risk Factors within Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which was filed with the SEC on February 25, 2010, as well as in our Quantitative and Qualitative Disclosures About Market Risk within Item 3 of Part 1, included in this Quarterly Report on Form 10-Q.

Contingencies

Refer to Item 1: Financial Statements Note 11: Commitments and Contingencies .

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Critical Accounting Estimates

Revenue Recognition

On January 1, 2010, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Tax Force)* (ASU 2009-13) and ASU No. 2009-14, Software (Topic 985), *Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)* (ASU 2009-14) on a prospective basis for new arrangements and arrangements that are materially modified. This new guidance did not have a material impact on our financial statements for the three and six months ended June 30, 2010, as we already had the ability to divide the deliverables within our revenue arrangements into separate units of accounting. Further, there would have been no change to the amount of revenue recognized in the year ended December 31, 2009 if arrangements prior to the adoption of ASU 2009-13 and ASU 2009-14 had been subject to the measurement requirements of this new guidance.

We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using vendor specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP).

VSOE is generally limited to the price charged when the same or similar product is sold separately or, if applicable, the stated renewal rate in the agreement. If a product or service is seldom sold separately, it is unlikely that we can determine VSOE for the product or service. We define VSOE as a median price of recent standalone transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately.

For arrangements entered into or materially modified after January 1, 2010, if we are unable to establish selling price using VSOE or TPE, we will use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Specifically, we consider the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, our ongoing pricing strategy and policies (as evident in the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable, and the characteristics of the varying markets in which the deliverable is sold.

We plan to analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

The majority of our revenue arrangements involve multiple elements, which require us to determine the fair value of each element and then allocate the total arrangement consideration among the separate elements based on the relative fair value percentages. Revenues for each element are then recognized based on the type of element, such as 1) when the products are shipped, 2) services are delivered, 3) percentage-of-completion when implementation services are essential to other elements in the arrangements, 4) upon receipt of customer acceptance, or 5) transfer of title. A majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

Fair value represents the estimated price charged when an item is sold separately. If the fair value of any undelivered element included in a multiple element arrangement cannot be objectively determined, revenue is deferred until all elements are delivered and services have been performed, or until the fair value can be objectively determined for any remaining undelivered elements. We review our fair values on an annual basis or more frequently if a significant trend is noted.

If implementation services are essential to a software arrangement, revenue is recognized using either the percentage-of-completion methodology if project costs can be estimated or the completed contract methodology if project costs cannot be reliably estimated. The estimation of costs through completion of a project is subject to many variables such as the length of time to complete, changes in wages, subcontractor performance, supplier information, and business volume assumptions. Changes in underlying assumptions/estimates may adversely or positively affect financial performance. Hardware and software post-sale maintenance support fees are recognized ratably over the performance period. Shipping and handling costs and incidental expenses billed to customers are recorded as revenue, with the associated cost charged to cost of revenues. We record sales, use, and value added taxes billed to our customers on a net basis.

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues relate primarily to professional services and software associated with our OpenWay® contracts, extended

warranty, and prepaid post contract support. Unearned revenue is recognized when

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the applicable revenue recognition criteria are met. Deferred cost is recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs are recognized when the applicable revenue recognition criteria are met. Refer to Item 1: Financial Statements, Note 1: Summary of Significant Accounting Policies for unearned revenue and deferred costs outstanding at June 30, 2010 and December 31, 2009.

Warranty

We offer standard warranties on our hardware products and large application software products. We accrue the estimated cost of warranty claims based on historical and projected product performance trends and costs. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Continuing quality control efforts during manufacturing reduce our exposure to warranty claims. If our quality control efforts fail to detect a fault in one of our products, we could experience an increase in warranty claims. We track warranty claims to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. When new products are introduced, our process relies on historical averages until sufficient data are available. As actual experience becomes available, it is used to modify the historical averages to ensure the expected warranty costs are within a range of likely outcomes. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The warranty allowances may fluctuate due to changes in estimates for material, labor, and other costs we may incur to repair or replace projected product failures, and we may incur additional warranty and related expenses in the future with respect to new or established products, which could adversely affect our gross margin. The long-term warranty balance includes estimated warranty claims beyond one year.

Income Taxes

We estimate income taxes in each of the taxing jurisdictions in which we operate. Changes in our effective tax rate are subject to several factors, including fluctuations in the forecasted mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items. Significant judgment is required in determining our annual tax rate and in evaluating our tax positions. Changes in tax laws, including the extension of the research tax credit, and unanticipated tax liabilities could significantly impact our actual tax rate and profitability. We assess the likelihood of recovering our deferred tax assets, which include net operating loss and credit carryforwards and temporary differences expected to be deductible in future years.

We record valuation allowances to reduce deferred tax assets to the extent we believe it is more likely than not that a portion of such assets will not be realized. In making such determinations, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and our ability to carry back losses to prior years. We are required to make assumptions and judgments about potential outcomes that lie outside management's control. Our most sensitive and critical factor is the projection and character of future taxable income. Although realization is not assured, management believes it is more likely than not that deferred tax assets will be realized. The amount of deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward periods are reduced or current tax planning strategies are not implemented.

We are subject to audit in multiple taxing jurisdictions in which we operate. These audits may involve complex issues, which may require an extended period of time to resolve. We believe we have recorded adequate income tax provisions and reserves for uncertain tax positions.

In evaluating uncertain tax positions, we consider the relative risks and merits of positions taken in tax returns filed and to be filed, considering statutory, judicial, and regulatory guidance applicable to those positions. We make assumptions and judgments about potential outcomes that lie outside management's control. To the extent the tax authorities disagree with our conclusions and depending on the final resolution of those disagreements, our actual tax rate may be materially affected in the period of final settlement with the tax authorities.

Inventories

Items are removed from inventory using the first-in, first-out method. Inventories include raw materials, sub-assemblies, and finished goods. Inventory amounts include the cost to manufacture the item, such as the cost of raw materials, labor, and other applied direct and indirect costs. We also review idle facility expense, freight, handling costs, and wasted materials to determine if abnormal amounts should be recognized as current-period charges. We review our inventory for obsolescence and marketability. If the estimated market value, which is based upon assumptions about future demand and market conditions, falls below the original cost, the inventory value is reduced to the market value. If technology rapidly changes or actual market conditions are less favorable than those projected by management, inventory write-downs may be required. Our inventory levels may vary period to period as a result of our factory scheduling and timing of contract fulfillments.

Table of Contents*Goodwill and Intangible Assets*

Goodwill and intangible assets result from our acquisitions. We use estimates, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations, in determining the value assigned to goodwill and intangible assets. Our intangible assets have a finite life and are amortized over their estimated useful lives based on estimated discounted cash flows. Intangible assets are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. Our Itron North America operating segment represents one reporting unit, while our Itron International operating segment has three reporting units.

Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. We forecast discounted future cash flows at the reporting unit level using risk-adjusted discount rates and estimated future revenues and operating costs, which take into consideration factors such as existing backlog, expected future orders, supplier contracts, and expectations of competitive and economic environments. We also identify similar publicly traded companies and develop a correlation, referred to as a multiple, to apply to the operating results of the reporting units. Our 2009 annual goodwill impairment analysis did not result in an impairment charge as the fair value of each reporting unit exceeded its carrying value. The percentage by which the fair value of each reporting unit exceeded its carrying value and the amount of goodwill allocated to each reporting unit at October 1, 2009 was as follows:

| | October 1, 2009 | |
|-----------------------------------|------------------------|----------------------------|
| | Goodwill | Fair Value Exceeded |
| | (in millions) | Carrying Value |
| Itron North America | \$ 187.9 | 85% |
| Itron International - Electricity | 379.7 | 3% |
| Itron International - Water | 419.0 | 4% |
| Itron International - Gas | 337.3 | 24% |
| | \$ 1,323.9 | |

Changes in market demand, the volatility and decline in the worldwide equity markets, and the decline in our market capitalization could negatively impact our annual goodwill impairment test, which could have a significant effect on our current and future results of operations and financial condition.

Derivative Instruments

All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments, which are primarily interest rate swaps, are determined using the fair value measurements of significant other observable inputs (also known as Level 2), as defined by FASB Accounting Standards Codification (ASC) 820-10-20, *Fair Value Measurements*. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position. Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility, credit risks, and default rates). Derivatives are not used for trading or speculative purposes. Our derivatives are with major international financial institutions, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments.

Convertible Debt

Our convertible notes are separated into their liability and equity components in a manner that reflects our non-convertible debt borrowing rate, which we determined to be 7.38% at the time of the convertible notes issuance in August 2006. Upon derecognition of the convertible notes, we are required to remeasure the fair value of the liability and equity components using a borrowing rate for similar non-convertible debt that would be applicable to Itron at the date of the derecognition. Any

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increase or decrease in borrowing rates from the inception of the debt to the date of derecognition could result in a gain or loss, respectively, on extinguishment. Based on market conditions and our credit rating at the date of derecognition, the borrowing rate could be materially different from the rate determined at the inception of the convertible debt.

Defined Benefit Pension Plans

We sponsor both funded and unfunded non-U.S. defined benefit pension plans. We recognize a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. We also recognize the funded status of our defined benefit pension plans on our Consolidated Balance Sheets and recognize as a component of other comprehensive income (loss) (OCI), net of tax, the actuarial gains or losses and prior service costs or credits, if any, that arise during the period but are not recognized as components of net periodic benefit cost.

Several economic assumptions and actuarial data are used in calculating the expense and obligations related to these plans. The assumptions are updated annually at December 31 and include the discount rate, the expected remaining service life, the expected rate of return on plan assets, and rate of future compensation increase. The discount rate is a significant assumption used to value our pension benefit obligation. We determine a discount rate for our plans based on the estimated duration of each plan's liabilities. For our euro denominated defined benefit pension plans, which consist of 95% of our benefit obligation, we match the plans' expected future benefit payments against select bonds (bonds with market values that exceed \$500 million, have a maturity greater than one year with no special features, and have a spread between the bid and ask prices of less than 5% of the average bid and ask prices). The yield curve derived for the euro denominated plans was 5.5%. The weighted average discount rate used to measure the projected benefit obligation for all of the plans as of December 31, 2009 was 5.6%. A change of 25 basis points in the discount rate would change our pension benefit obligation by approximately \$2 million. The financial and actuarial assumptions used at December 31, 2009 may differ materially from actual results due to changing market and economic conditions and other factors. These differences could result in a significant change in the amount of pension expense recorded in future periods. Gains and losses resulting from changes in actuarial assumptions, including the discount rate, are recognized in OCI in the period in which they occur.

Our general funding policy for these qualified pension plans is to contribute amounts at least sufficient to satisfy funding standards of the respective countries for each plan. Refer to Item 1: Financial Statements Note 8: Defined Benefit Pension Plans for our expected contributions for 2010.

Bonus and Profit Sharing

We have employee bonus and profit sharing plans which provide award amounts for the achievement of annual financial and nonfinancial targets. If management determines it probable that the targets will be achieved and the amounts can be reasonably estimated, a compensation accrual is recorded based on the proportional achievement of the financial and nonfinancial targets. Although we monitor and accrue expenses quarterly based on our estimated progress toward the achievement of the annual targets, the actual results at the end of the year may require awards that are significantly greater or less than the estimates made in earlier quarters. For the three and six months ended June 30, 2010, we accrued \$11.3 million and \$23.4 million for such awards, compared with \$2.8 million and \$5.2 million in the same periods in 2009. Awards are typically paid in the first quarter of the following year.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including awards of stock options, stock sold pursuant to our Amended and Restated 2002 Employee Stock Purchase Plan (ESPP), and the issuance of restricted and unrestricted stock awards and units, based on estimated fair values. The fair values of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected life. In valuing our stock-based awards, significant judgment is required in determining the expected volatility of our common stock and the expected life that individuals will hold their stock-based awards prior to exercising. Expected volatility is based on the historical and implied volatility of our own common stock. The expected life of stock option grants is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option. While volatility and estimated life are assumptions that do not bear the risk of change subsequent to the grant date of stock-based awards, these assumptions may be difficult to measure as they represent future expectations based on historical experience. Further, our expected volatility and expected life may change in the future, which could substantially change the grant-date fair value of future awards of stock options and ultimately the expense we record. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates. We expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the vesting requirement. Our excess tax benefit cannot be credited to common stock until the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the

Consolidated Statements of Cash Flows.

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New Accounting Pronouncements

Refer to Item 1: Financial Statements Note 1: Summary of Significant Accounting Policies .

Table of Contents**Item 3: Quantitative and Qualitative Disclosures about Market Risk**

In the normal course of business, we are exposed to interest rate and foreign currency exchange rate risks that could impact our financial position and results of operations. As part of our risk management strategy, we use derivative financial instruments to hedge certain foreign currency and interest rate exposures. Our objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, therefore reducing the impact of volatility on earnings or protecting the fair values of assets and liabilities. We use derivative contracts only to manage existing underlying exposures. Accordingly, we do not use derivative contracts for trading or speculative purposes.

Interest Rate Risk

The table below provides information about our financial instruments that are sensitive to changes in interest rates and the scheduled minimum repayment of principal and estimated cash interest payments over the remaining lives of our debt at June 30, 2010. Including the effect of our interest rate swaps at June 30, 2010, 88% of our borrowings are at fixed rates. Weighted average variable rates in the table are based on implied forward rates in the Bloomberg U.S. dollar yield curve as of June 30, 2010, our estimated leverage ratio, which determines our additional interest rate margin, and a static foreign exchange rate at June 30, 2010.

| | 2010 | 2011 | 2012 | 2013 | 2014 | Total |
|--|---------------|----------|---------|--------|----------|----------|
| | (in millions) | | | | | |
| <i>Fixed Rate Debt</i> | | | | | | |
| Principal: Convertible notes ⁽¹⁾ | \$ | \$ 223.6 | \$ | \$ | \$ | \$ 223.6 |
| Interest rate | 2.50% | 2.50% | | | | |
| <i>Variable Rate Debt</i> | | | | | | |
| Principal: U.S. dollar term loan | \$ 3.0 | \$ 6.1 | \$ 6.1 | \$ 6.1 | \$ 230.4 | \$ 251.7 |
| Average interest rate | 3.96% | 4.25% | 4.67% | 4.46% | 4.82% | |
| Principal: Euro term loan | \$ 2.1 | \$ 4.1 | \$ 4.1 | \$ 4.1 | \$ 194.1 | \$ 208.5 |
| Average interest rate | 4.27% | 4.54% | 4.81% | 4.86% | 5.08% | |
| <i>Interest rate swaps on U.S. dollar term loan ⁽²⁾</i> | | | | | | |
| Average interest rate (Pay) | 2.13% | 2.13% | | | | |
| Average interest rate (Receive) | 0.47% | 0.75% | | | | |
| Net/Spread | (1.66%) | (1.38%) | | | | |
| <i>Interest rate swap on euro term loan ⁽³⁾</i> | | | | | | |
| Average interest rate (Pay) | 6.59% | 6.59% | 6.59% | | | |
| Average interest rate (Receive) | 2.76% | 3.04% | 3.31% | | | |
| Net/Spread | (3.83%) | (3.55%) | (3.28%) | | | |

⁽¹⁾ The face value of our convertible notes is \$223.6 million, while the carrying value is \$213.1 million. (Refer to Item 1: Financial Statements Note 6: Debt for a summary of our convertible note terms and a reconciliation between the face and carrying values). Our convertible notes mature in August 2026. We are amortizing the remaining \$10.5 million discount on the liability component of the convertible notes to interest expense over the next 12 months and have reflected the principal repayment in 2011 due to the combination of put, call, and conversion options.

⁽²⁾ The one-year interest rate swaps are used to convert \$200 million of our \$251.7 million U.S. dollar denominated variable rate term loan from a floating London Interbank Offered Rate (LIBOR) interest rate, plus the applicable margin, to a fixed interest rate, plus the applicable margin (refer to Item 1: Financial Statements Note 7: Derivative Financial Instruments and Hedging Activities).

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- ⁽³⁾ The amortizing euro denominated interest rate swap is used to convert \$177.7 million (144.1 million) of our \$208.5 million (169.1 million) euro denominated variable rate term loan from a floating Euro Interbank Offered Rate (EURIBOR), plus the applicable margin, to a fixed interest rate of 6.59%, through December 31, 2012, plus or minus the variance in the applicable margin from 2%. As a result of the amortization schedule, the interest rate swap will terminate before the stated maturity of the term loan (refer to Item 1: Financial Statements Note 7: Derivative Financial Instruments and Hedging Activities).

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Based on a sensitivity analysis as of June 30, 2010, we estimate that if market interest rates average one percentage point higher in 2010 than in the table above, our earnings before income taxes in 2010 would not be materially impacted due to our interest rate swaps in place at June 30, 2010.

We continually monitor and assess our interest rate risk and may institute additional interest rate swaps or other derivative instruments to manage such risk in the future.

Foreign Currency Exchange Rate Risk

We conduct business in a number of countries. As a result, the majority of our revenues and operating expenses are denominated in foreign currencies, which expose our account balances to movements in foreign currency exchange rates that could have a material effect on our financial results. Our primary foreign currency exposure relates to non-U.S. dollar denominated transactions in our international subsidiary operations, the most significant of which is the euro. Revenues denominated in foreign currencies were 54% of total revenues for the first quarter of 2010, compared with 65% for the same period in 2009.

As a result of our acquisition of Actaris Metering Systems SA, which was an international company, we entered into a euro denominated term loan in 2007 that exposes us to fluctuations in the euro foreign exchange rate. We have designated this foreign currency denominated term loan as a hedge of our net investment in international operations. The non-functional currency term loan is revalued into U.S. dollar at each balance sheet date, and the changes in value associated with currency fluctuations are recorded as adjustments to long-term debt with offsetting gains and losses recorded in other comprehensive income. We had no hedge ineffectiveness (refer to Item 1: Financial Statements Note 7: Derivative Financial Instruments and Hedging Activities).

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, foreign currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts, not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. During the six months ended June 30, 2010, we entered into 51 foreign currency option and forward transactions. The notional amounts of the contracts ranged from less than \$1 million to \$48 million, offsetting our exposures from the euro, British pound, Canadian dollar, Czech koruna, Hungarian forint, and various other currencies.

In future periods, we may use additional derivative contracts to protect against foreign currency exchange rate risks.

Item 4: Controls and Procedures

- (a) *Evaluation of disclosure controls and procedures.* An evaluation was performed under the supervision and with the participation of our Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e)) under the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of June 30, 2010, the Company's disclosure controls and procedures were effective to ensure the information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.
- (b) *Changes in internal controls over financial reporting.* There have been no changes in internal control over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents**PART II: OTHER INFORMATION****Item 1: Legal Proceedings**

There were no material changes, as defined by Item 103 of Regulation S-K, during the second quarter of 2010.

Item 1A: Risk Factors

There were no material changes to risk factors during the second quarter of 2010 from those previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which was filed with the SEC on February 25, 2010.

Item 5: Other Information

(a) No information was required to be disclosed in a report on Form 8-K during the second quarter of 2010 that was not reported.

(b) Not applicable.

Item 6: Exhibits

| Exhibit Number | Description of Exhibits |
|-----------------------|---|
| 12.1 | Statement re Computation of Ratios |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase |

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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SIGNATURE

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.

August 3, 2010
Date

By:

ITRON, INC.

/s/ STEVEN M. HELMBRECHT
Steven M. Helmbrecht
Sr. Vice President and Chief Financial Officer