

ITRON INC /WA/
Form 10-Q
November 02, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 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) 2111 N Molter Road, Liberty Lake, Washington 99019
91-1011792
(I.R.S. Employer Identification Number)

(509) 924-9900

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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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 September 30, 2010 there were outstanding 40,406,002 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Table of Contents

Itron, Inc.

Table of Contents

	Page
<u>PART I: FINANCIAL INFORMATION</u>	
Item 1: <u>Financial Statements (Unaudited)</u>	
<u>Consolidated Statements of Operations</u>	2
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2: <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	39
Item 3: <u>Quantitative and Qualitative Disclosures About Market Risk</u>	53
Item 4: <u>Controls and Procedures</u>	54
<u>PART II: OTHER INFORMATION</u>	
Item 1: <u>Legal Proceedings</u>	55
Item 1A: <u>Risk Factors</u>	55
Item 5: <u>Other Information</u>	55
Item 6: <u>Exhibits</u>	55
<u>SIGNATURE</u>	56

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Revenues	\$ 575,968	\$ 408,358	\$ 1,644,708	\$ 1,210,624
Cost of revenues	391,761	278,879	1,125,282	818,452
Gross profit	184,207	129,479	519,426	392,172
Operating expenses				
Sales and marketing	41,197	37,669	123,708	112,569
Product development	34,038	31,077	100,100	93,044
General and administrative	30,710	26,606	97,052	84,097
Amortization of intangible assets	16,882	25,121	51,459	72,788
Total operating expenses	122,827	120,473	372,319	362,498
Operating income	61,380	9,006	147,107	29,674
Other income (expense)				
Interest income	166	(45)	444	971
Interest expense	(13,328)	(20,075)	(42,216)	(53,319)
Loss on extinguishment of debt, net	-	(2,460)	-	(12,800)
Other income (expense), net	(4,423)	(4,534)	(5,440)	(9,445)
Total other income (expense)	(17,585)	(27,114)	(47,212)	(74,593)
Income (loss) before income taxes	43,795	(18,108)	99,895	(44,919)
Income tax (provision) benefit	(14,687)	15,146	(17,100)	37,517
Net income (loss)	\$ 29,108	\$ (2,962)	\$ 82,795	\$ (7,402)
Earnings (loss) per common share-Basic	\$ 0.72	\$ (0.07)	\$ 2.05	\$ (0.19)
Earnings (loss) per common share-Diluted	\$ 0.71	\$ (0.07)	\$ 2.02	\$ (0.19)
Weighted average common shares outstanding-Basic	40,400	40,039	40,307	38,003
Weighted average common shares outstanding-Diluted	40,828	40,039	40,950	38,003

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

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

(in thousands)

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	\$ 148,114	\$ 121,893
Accounts receivable, net	383,814	337,948
Inventories	225,765	170,084
Deferred tax assets current, net	22,965	20,762
Other current assets	72,371	75,229
Total current assets	853,029	725,916
Property, plant, and equipment, net	302,306	318,217
Prepaid debt fees	5,704	8,628
Deferred tax assets noncurrent, net	49,612	89,932
Other noncurrent assets	16,298	18,117
Intangible assets, net	315,756	388,212
Goodwill	1,236,583	1,305,599
Total assets	\$ 2,779,288	\$ 2,854,621
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 238,095	\$ 219,255
Other current liabilities	59,806	64,583
Wages and benefits payable	96,713	71,592
Taxes payable	22,879	14,377
Current portion of debt	226,246	10,871
Current portion of warranty	28,232	20,941
Unearned revenue	30,749	40,140
Deferred tax liabilities current, net	1,669	1,625
Total current liabilities	704,389	443,384
Long-term debt	436,704	770,893
Long-term warranty	24,993	12,932
Pension plan benefits	60,013	63,040
Deferred tax liabilities noncurrent, net	52,128	80,695
Other long-term obligations	68,417	83,163
Total liabilities	1,346,644	1,454,107
Commitments and contingencies		
Shareholders' equity		
Preferred stock	0	0
Common stock	1,321,287	1,299,134

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Accumulated other comprehensive income (loss), net	(1,688)	71,130
Retained earnings	113,045	30,250
Total shareholders' equity	1,432,644	1,400,514
Total liabilities and shareholders' equity	\$ 2,779,288	\$ 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)

	Nine Months Ended September 30,	
	2010	2009
	(in thousands)	
Operating activities		
Net income (loss)	\$ 82,795	\$ (7,402)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	97,184	113,812
Stock-based compensation	14,222	13,467
Amortization of prepaid debt fees	4,219	6,384
Amortization of convertible debt discount	7,505	7,262
Loss on extinguishment of debt, net	-	9,960
Deferred taxes, net	711	(51,341)
Other adjustments, net	4,008	1,768
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(53,770)	11,608
Inventories	(57,698)	(4,211)
Accounts payables, other current liabilities, and taxes payable	38,139	(2,473)
Wages and benefits payable	26,799	(10,404)
Unearned revenue	(8,564)	9,272
Warranty	16,087	(5,735)
Other operating, net	(4,521)	(4,880)
Net cash provided by operating activities	167,116	87,087
Investing activities		
Acquisitions of property, plant, and equipment	(45,507)	(38,023)
Business acquisitions & contingent consideration, net of cash equivalents acquired	-	(1,317)
Other investing, net	5,412	4,101
Net cash used in investing activities	(40,095)	(35,239)
Financing activities		
Payments on debt	(106,524)	(236,495)
Issuance of common stock	7,931	165,235
Prepaid debt fees	(1,347)	(3,936)
Other financing, net	(983)	(1,309)
Net cash used in financing activities	(100,923)	(76,505)
Effect of foreign exchange rate changes on cash and cash equivalents	123	4,988
Increase (decrease) in cash and cash equivalents	26,221	(19,669)
Cash and cash equivalents at beginning of period	121,893	144,390
Cash and cash equivalents at end of period	\$ 148,114	\$ 124,721

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Non-cash transactions:

Property, plant, and equipment purchased but not yet paid, net	\$ (5,998)	\$ 5,492
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	\$ 17,447	\$ 19,308
Interest, net of amounts capitalized	31,666	43,207

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

Table of Contents

ITRON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 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 nine months ended September 30, 2010 and 2009, the Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009, and the Consolidated Statements of Cash Flows for the nine months ended September 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 notes 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 nine months ended September 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 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 September 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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 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

Table of Contents

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.

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 September 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, are measured and recorded at fair value, and amortized over the estimated useful life. 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. 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, including penalties and interest, after the measurement period are recognized as a component of provision for income taxes.

Table of Contents

Goodwill and Intangible Assets

Goodwill and intangible assets have resulted from our acquisitions. We use estimates in determining and assigning the fair value of goodwill and intangible assets at acquisition, 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.

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 is 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.

Table of Contents

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 Task 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 nine months ended September 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 analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices are 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.

Table of Contents

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.

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.

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 \$36.6 million and \$45.4 million at September 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 \$10.0 million and \$19.7 million at September 30, 2010 and December 31, 2009 and are recorded within other assets in the Consolidated Balance Sheets.

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 required vesting 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

Table of Contents

discount from the original issuance of the debt. Due to the particular characteristics of our convertible notes, we recognize a gain or loss upon conversion or derecognition for the difference between the net carrying amount of the liability component (including any unamortized discount and debt issuance costs) and 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. 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 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. 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. 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 within other income (expense), net 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.

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.

Table of Contents

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 September 30, Nine Months Ended September 30,			
	2010	2009	2010	2009
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	\$ 29,108	\$ (2,962)	\$ 82,795	\$ (7,402)
Weighted average common shares outstanding-Basic	40,400	40,039	40,307	38,003
Dilutive effect of convertible notes	-	-	138	-
Dilutive effect of stock-based awards	428	-	505	-
Weighted average common shares outstanding-Diluted	40,828	40,039	40,950	38,003
Earnings (loss) per common share-Basic	\$ 0.72	\$ (0.07)	\$ 2.05	\$ (0.19)
Earnings (loss) per common share-Diluted	\$ 0.71	\$ (0.07)	\$ 2.02	\$ (0.19)

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 nine months ended September 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 nine months ended September 30, 2010 exceeded the conversion price of \$65.16 and, therefore, approximately 138,000 shares have been included in the diluted EPS calculation for that period. The average price of our common stock for the three months ended September 30, 2010 and the three and nine months ended September 30, 2009 did not exceed the conversion price of \$65.16 and, therefore, did not have an effect on diluted shares outstanding.

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 526,000 and 1.0 million stock-based awards were excluded from the calculation of diluted EPS for the three months ended September 30, 2010 and 2009, and approximately 432,000 and 1.0 million stock-based awards were excluded from the calculation of diluted EPS for the nine months ended September 30, 2010 and 2009 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

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, and rates as defined in the Rights Agreement, which may be adjusted by the Board of Directors. There was no preferred stock sold or outstanding at September 30, 2010 and December 31, 2009.

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

At September 30, At December 31,

	2010	2009
	(in thousands)	
Trade receivables (net of allowance of \$5,766 and \$6,339)	\$ 343,358	\$ 319,237
Unbilled receivables	40,456	18,711
Total accounts receivable, net	\$ 383,814	\$ 337,948

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

	Three Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Beginning balance	\$ 6,298	\$ 7,271	\$ 6,339	\$ 5,954
Provision for (release of) doubtful accounts, net	(904)	(378)	(242)	1,512
Accounts written off	(21)	(112)	(194)	(748)
Effects of change in exchange rates	393	123	(137)	186
Ending balance	\$ 5,766	\$ 6,904	\$ 5,766	\$ 6,904

Inventories

At September 30, At December 31,

	2010	2009
	(in thousands)	
Materials	\$ 115,760	\$ 85,358
Work in process	20,832	17,668
Finished goods	89,173	67,058
Total inventories	\$ 225,765	\$ 170,084

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

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 \$15.5 million and \$10.6 million at September 30, 2010 and December 31, 2009, respectively.

Property, plant, and equipment, net

At September 30, At December 31,

	2010	2009
	(in thousands)	
Machinery and equipment	\$ 258,073	\$ 243,652
Computers and purchased software	61,248	66,787
Buildings, furniture, and improvements	144,705	144,639
Land	36,586	37,738
Construction in progress, including purchased equipment	22,464	22,009
Total cost	523,076	514,825
Accumulated depreciation	(220,770)	(196,608)
Property, plant, and equipment, net	\$ 302,306	\$ 318,217

Depreciation expense for the three and nine months ended September 30 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Depreciation expense	\$ 15.2	\$ 14.3	\$ 45.7	\$ 41.0

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 September 30, 2010 Accumulated			At December 31, 2009 Accumulated		
	Gross Assets	Amortization	Net	Gross Assets	Amortization	Net
	(in thousands)					
Core-developed technology	\$ 384,229	\$ (267,666)	\$ 116,563	\$ 398,043	\$ (244,545)	\$ 153,498
Customer contracts and relationships	289,533	(106,580)	182,953	306,061	(92,187)	213,874
Trademarks and trade names	74,378	(59,037)	15,341	77,439	(57,957)	19,482
Other	24,386	(23,487)	899	24,713	(23,355)	1,358
Total intangible assets	\$ 772,526	\$ (456,770)	\$ 315,756	\$ 806,256	\$ (418,044)	\$ 388,212

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

	Nine Months Ended September 30,	
	2010	2009
	(in thousands)	
Beginning balance, intangible assets, gross	\$ 806,256	\$ 796,236
Effect of change in exchange rates	(33,730)	18,996
Ending balance, intangible assets, gross	\$ 772,526	\$ 815,232

Intangible assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts 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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Amortization of intangible assets	\$ 16.9	\$ 25.1	\$ 51.5	\$ 72.8

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization

Edgar Filing: ITRON INC /WA/ - Form 10-Q

	(in thousands)
2010 (amount remaining at September 30, 2010)	\$ 17,488
2011	59,849
2012	46,096
2013	37,289
2014	30,616
Beyond 2014	124,418
Total intangible assets, net	\$ 315,756

Table of Contents**Note 5: Goodwill**

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

	Itron North America	Itron International (in thousands)	Total Company
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	1,218	34,761	35,979
Goodwill balance at September 30, 2009	\$ 196,916	\$ 1,127,016	\$ 1,323,932
Goodwill balance at January 1, 2010	\$ 197,515	\$ 1,108,084	\$ 1,305,599
Effect of change in exchange rates	130	(69,146)	(69,016)
Goodwill balance at September 30, 2010	\$ 197,645	\$ 1,038,938	\$ 1,236,583

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.

Adjustment of previous acquisitions in 2009 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 September 30, 2010	At December 31, 2009
	(in thousands)	
Term loans		
USD denominated term loan	\$ 220,154	\$ 284,693
EUR denominated term loan	227,123	288,902
Convertible senior subordinated notes	215,673	208,169
	662,950	781,764
Current portion of debt	(226,246)	(10,871)
Long-term debt	\$ 436,704	\$ 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 September 30, 2010 and December 31, 2009 was 168.3 million and 200.8 million, respectively. Interest rates on the credit facility are based on the respective borrowing's denominated London Interbank Offered Rate (LIBOR) or the Wells Fargo Bank, National Association's prime rate, plus an additional margin subject to our consolidated leverage ratio. The additional interest rate margin was

Edgar Filing: ITRON INC /WA/ - Form 10-Q

3.50% at September 30, 2010 and 3.75% at December 31, 2009. Our interest rates were 3.77% for the U.S. dollar denominated and 4.26% for the euro denominated term loans at September 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 the 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.

Table of Contents

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 September 30, 2010, there were no borrowings outstanding under the revolving line of credit, and \$46.8 million was utilized by outstanding standby letters of credit, resulting in \$193.2 million being available for additional borrowings.

We repaid \$32.6 million and \$106.5 million of the term loans during the three and nine months ended September 30, 2010, respectively. Repayments of \$57.0 million and \$127.2 million were made during the three and nine months ended September 30, 2009, respectively. These term loan 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 September 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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 September 30, 2010 was \$61.23 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.

Table of Contents

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 September 30, 2010.

On July 1, 2010, we classified 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 September 30, 2010	At December 31, 2009
	(in thousands)	
Face value of convertible debt	\$ 223,604	\$ 223,604
Unamortized discount	(7,931)	(15,435)
Net carrying amount of debt component	\$ 215,673	\$ 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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Contractual interest coupon	\$ 1,398	\$ 1,398	\$ 4,193	\$ 4,442
Amortization of the discount on the liability component	2,547	2,367	7,504	7,262
Total interest expense	\$ 3,945	\$ 3,765	\$ 11,697	\$ 11,704

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 nine months as of September 30, 2010.

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 were 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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*Senior Subordinated Notes*

On July 17, 2009, we paid the remaining \$111.7 million outstanding balance on our 7.75% senior subordinated notes and recognized a loss on extinguishment of \$2.5 million, which included the remaining unamortized debt discount of \$336,000. Unamortized prepaid debt fees of \$2.0 million were recorded to interest expense.

Note 7: Derivative Financial Instruments

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 September 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 September 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 September 30, 2010 and December 31, 2009 are as follows:

	Balance Sheet Location	Fair Value	
		At September 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	\$ 283	\$ 3,986
Liability Derivatives			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other current liabilities	\$ (7,775)	\$ (11,478)
Interest rate swap contracts	Other noncurrent obligations	(1,675)	(3,676)
Euro denominated term loan *	Current portion of long-term debt	(4,522)	(4,820)
Euro denominated term loan *	Long-term debt	(222,601)	(284,082)
Total derivatives designated as hedging instruments under ASC 815-20		\$ (236,573)	\$ (304,056)
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	\$ (87)	\$ (2,442)
Total liability derivatives		\$ (236,660)	\$ (306,498)

Edgar Filing: ITRON INC /WA/ - Form 10-Q

* 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.

Table of Contents

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
	(in thousands)	
Net unrealized loss on hedging instruments at January 1,	\$ (30,300)	\$ (29,772)
Unrealized gain (loss) on derivative instruments	(2,920)	(5,906)
Unrealized gain (loss) on a nonderivative net investment hedging instrument	12,203	(5,676)
Realized (gains) losses reclassified into net income (loss)	5,874	6,025
Net unrealized loss on hedging instruments at September 30,	\$ (15,143)	\$ (35,329)

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.

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. Our outstanding swaps are as follows:

Transaction Date	Effective Date of Swap	Notional amount (in thousands)	Fixed Interest Rate
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 September 30, 2010 and December 31, 2009, our U.S. dollar term loan had a balance of \$220.2 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 \$2.7 million, which was based on the Bloomberg U.S. dollar swap yield curve as of September 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 \$173.1 million (128.3 million) and \$252.9 million (175.8 million) as of September 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 \$4.9 million (3.6 million), which was based on the Bloomberg euro swap yield curve as of September 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.

Table of Contents

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 nine months ended September 30 are as follows:

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	Recognized in OCI on		Location		Location	
	Derivative (Effective Portion)		Amount		Amount	
	2010	2009	2010	2009	2010	2009
	(in thousands)		(in thousands)		(in thousands)	
Three months ended September 30,						
Interest rate swap contracts	\$ (603)	\$ (3,588)	Interest expense	\$ (2,715)	\$ (3,808)	Interest expense \$ (11) \$ (88)
Nine months ended September 30,						
Interest rate swap contracts	\$ (4,725)	\$ (9,753)	Interest expense	\$ (9,525)	\$ (9,970)	Interest expense \$ (85) \$ (272)
<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 \$227.1 million (168.3 million) and \$288.9 million (200.8 million) as of September 30, 2010 and December 31, 2009, respectively. We had no hedge ineffectiveness.

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

Investment Hedging Relationships	Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Gain (loss) recognized in OCI on derivative (Effective Portion)				
Before tax	\$ (19,703)	\$ (13,770)	\$ 19,795	\$ (9,157)
Net of tax	\$ (12,149)	\$ (8,524)	\$ 12,203	\$ (5,676)
<i>Derivatives Not Designated as Hedging Relationships</i>				

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 (170 during the nine months ended September 30, 2010), not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. The notional amounts of the contracts ranged from less than \$1 million to \$50 million, offsetting our exposures from the euro, British pound, Canadian dollar, Czech koruna, Hungarian forint, and various other currencies.

Edgar Filing: ITRON INC /WA/ - Form 10-Q

The effect of our foreign exchange option and forward derivative instruments on the Consolidated Statements of Operations for the three and nine months ended September 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 September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(in thousands)			
Foreign exchange option and forward contracts	\$ (803)	\$ (1,976)	\$ 2,244	\$ (2,503)

Table of Contents**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.

Our defined benefit pension plans are denominated in the functional currencies of the respective countries in which the plans are sponsored; therefore, the balances increase or decrease, with a corresponding change in OCI, due to changes in foreign currency exchange rates. Amounts recognized on the Consolidated Balance Sheets consist of:

	At September 30, 2010	At December 31, 2009
	(in thousands)	
Plan assets in other noncurrent assets	\$ (577)	\$ (613)
Current portion of pension plan liability in wages and benefits payable	3,390	2,975
Long-term portion of pension plan liability	60,013	63,040
Net pension plan benefit liability	\$ 62,826	\$ 65,402

Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. 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 \$37,000 and \$375,000 to the defined benefit pension plans for the three and nine months ended September 30, 2010, and \$49,000 and \$101,000 for the three and nine months ended September 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Service cost	\$ 493	\$ 457	\$ 1,493	\$ 1,325
Interest cost	858	933	2,608	2,673
Expected return on plan assets	(73)	(74)	(221)	(215)
Amortization of actuarial net gain	(6)	(106)	(19)	(288)
Amortization of unrecognized prior service costs	-	7	-	20
Net periodic benefit cost	\$ 1,272	\$ 1,217	\$ 3,861	\$ 3,515

Table of Contents**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 nine months ended September 30, stock-based compensation expense and the related tax benefit were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Stock options	\$ 843	\$ 1,600	\$ 3,138	\$ 6,172
Restricted stock awards and units	3,962	2,336	10,344	6,629
Unrestricted stock awards	175	119	364	254
ESPP	121	115	376	394
Total stock-based compensation	\$ 5,101	\$ 4,170	\$ 14,222	\$ 13,449
Related tax benefit	\$ 1,421	\$ 1,031	\$ 4,153	\$ 3,487

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 September 30,		Nine Months Ended September 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)	-	-	4.60	4.91
	ESPP			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Dividend yield	-	-	-	-
Expected volatility	42.6%	51.9%	36.0%	75.8%
Risk-free interest rate	0.2%	0.2%	0.1%	0.4%
Expected life (years)	0.25	0.25	0.25	0.25

⁽¹⁾There were no employee stock options issued for the three months ended September 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 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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.

Table of Contents

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 September 30, 2010, shares available for issuance under the Stock Incentive Plan were 2,946,065.

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 nine months ended September 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	(134)	20.20		\$ 4,565	
Forfeited	(18)	58.98			
Expired	(7)	57.23			
Outstanding, September 30, 2009	1,265	\$ 54.96	6.66	\$ 20,408	
Exercisable and expected to vest, September 30, 2009	1,203	\$ 53.22	6.56	\$ 20,373	
Exercisable, September 30, 2009	971	\$ 46.91	6.11	\$ 20,052	
Outstanding, January 1, 2010	1,179	\$ 52.93	5.90	\$ 22,863	
Granted	71	61.97			\$ 27.18
Exercised	(144)	40.82		\$ 4,413	
Outstanding, September 30, 2010	1,106	\$ 55.11	5.83	\$ 14,660	
Exercisable and expected to vest, September 30, 2010	1,096	\$ 54.99	5.80	\$ 14,449	
Exercisable, September 30, 2010	952	\$ 52.25	5.40	\$ 14,551	

Edgar Filing: ITRON INC /WA/ - Form 10-Q

⁽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 September 30, 2010, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$2.5 million, which is expected to be recognized over a weighted average period of approximately 17 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.

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.

Table of Contents

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 that 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 subsequent 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 nine months ended September 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	59	\$ 69.44	
Released	(23)		\$ 1,472
Forfeited	(6)		
Outstanding, September 30, 2009	343		
Outstanding, January 1, 2010	326		
Granted ⁽²⁾	215	\$ 63.42	
Released	(78)		\$ 5,216
Forfeited	(14)		
Outstanding, September 30, 2010	449		
Vested, September 30, 2010	2		\$ 97
Expected to vest, September 30, 2010	372		\$ 22,788

⁽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 September 30, 2010, unrecognized compensation expense was \$19.0 million, which is expected to be recognized over a weighted average period of approximately 24 months.

Unrestricted Stock Awards

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

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Shares of unrestricted stock issued	2,896	2,168	5,662	4,284
Weighted average grant date fair value <i>Employee Stock Purchase Plan</i>	\$ 60.39	\$ 55.27	\$ 64.35	\$ 59.40

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 nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Shares of stock sold to employees ⁽¹⁾	14,819	16,663	37,905	49,413
Weighted average fair value per ESPP award ⁽²⁾	\$ 9.16	\$ 9.62	\$ 9.69	\$ 8.13

⁽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 nine months ended September 30.

The fair value of ESPP awards is estimated using the Black-Scholes option-pricing model. At September 30, 2010, all compensation cost associated with the ESPP had been recognized. There were approximately 210,000 shares of common stock available for future issuance under the ESPP at September 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 nine months ended September 30, 2010, we had tax provisions of 34% and 17%, based on a percentage of income before tax, as compared with tax benefits of 84% 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 an election under U.S. Internal Revenue Code Section 338 with respect to a foreign acquisition 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 an election under U.S. Internal Revenue Code Section 338 with respect to a foreign acquisition in 2007, as well as the forecasted mix of earnings in different tax jurisdictions, which included lower income in higher tax jurisdictions.

Table of Contents

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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Interest and penalties expense	\$ 277	\$ 656	\$ 1,463	\$ 1,988
Interest and penalties benefit	(449)	(98)	(1,339)	(137)
Net interest and penalties recognized	\$ (172)	\$ 558	\$ 124	\$ 1,851

	At September 30,	At December 31,
	2010	2009
	(in millions)	
Accrued interest	\$ 4.7	\$ 4.1
Accrued penalties	2.9	3.4

	At September 30,	At December 31,
	2010	2009
	(in millions)	
Unrecognized tax benefits related to uncertain tax positions	\$ 33.3	\$ 46.2
The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate	33.3	46.2

At September 30, 2010, we expect to pay \$630,000 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 \$5.9 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.

Table of Contents

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

	At September 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	(46.8)	(39.9)
Net available for additional borrowings and LOC s	\$ 193.2	\$ 75.1
Unsecured multicurrency revolving lines of credit with various financial institutions		
Total lines of credit	\$ 46.1	\$ 38.7
Standby LOC s issued and outstanding	(18.5)	(10.9)
Short-term borrowings ⁽²⁾	(1.5)	(2.1)
Net available for additional borrowings and LOC s	\$ 26.1	\$ 25.7
Unsecured surety bonds in force	\$ 97.7	\$ 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 September 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 were filed with the Arbitration Institute of the Stockholm Chamber of Commerce. In both arbitrations, Cinclus claimed the meters provided by Itron UK failed to meet specifications because

Edgar Filing: ITRON INC /WA/ - Form 10-Q

in certain environments the meters were affected by high frequency pollution from third party devices in the home environment, which impairs the meters' capability to measure energy accurately. Cinclus asserted 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 resolved the claim by Cinclus related to the E.ON project in the second quarter of 2010. Itron UK resolved the claim by Cinclus related to the Fortum claim in the third quarter of 2010.

Table of Contents*Warranty*

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Beginning balance	\$ 49,203	\$ 34,065	\$ 33,873	\$ 38,255
New product warranties	3,516	2,223	9,212	5,345
Other changes/adjustments to warranties	7,845	1,641	23,438	4,750
Reclassification from other current liabilities	-	-	2,878	-
Claims activity	(9,585)	(5,067)	(16,648)	(15,788)
Effect of change in exchange rates	2,246	653	472	953
Ending balance, September 30	53,225	33,515	53,225	33,515
Less: current portion of warranty	(28,232)	(20,751)	(28,232)	(20,751)
Long-term warranty	\$ 24,993	\$ 12,764	\$ 24,993	\$ 12,764

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 for the three and nine months ended September 30 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Warranty expense	\$ 11.4	\$ 3.9	\$ 32.7	\$ 10.1

Warranty expense associated with our segments was as follows for the nine months ended September 30:

	2010	2009
Itron North America	50%	85%
Itron International	50%	15%

The increase in Itron International's warranty expense was primarily the result of \$13.8 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 September 30,	Nine Months Ended September 30,
--	---	--

Edgar Filing: ITRON INC /WA/ - Form 10-Q

	2010	2009	2010	2009
	(in millions)			
Plan costs	\$ 5.1	\$ 5.4	\$ 14.5	\$ 15.4

	At September 30, 2010	At December 31, 2009
	(in millions)	
IBNR accrual	\$ 2.0	\$ 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, the

Table of Contents

IBNR accrual is lower at September 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.

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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Net income (loss)	\$ 29,108	\$ (2,962)	\$ 82,795	\$ (7,402)
Foreign currency translation adjustment, net	125,179	65,895	(87,292)	62,971
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges, net	(378)	(2,102)	(2,920)	(5,906)
Net unrealized gain (loss) on a nonderivative net investment hedging instrument, net	(12,149)	(8,524)	12,203	(5,676)
Net hedging (gain) loss reclassified into net income (loss), net	1,677	2,222	5,874	6,025
Pension plan benefits liability adjustment, net	2	(29)	(683)	(187)
Total comprehensive income (loss)	\$ 143,439	\$ 54,500	\$ 9,977	\$ 49,825

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Income tax (provision) benefit on foreign currency translation adjustment	\$ (750)	\$ (1,691)	\$ (1,335)	\$ (5,367)
Income tax (provision) benefit on net unrealized gain (loss) on derivative instruments ⁽¹⁾	225	1,266	1,805	3,627
Income tax (provision) benefit on net unrealized gain (loss) on a nonderivative net investment hedging instrument	7,554	5,246	(7,592)	3,481
Income tax (provision) benefit on net hedging (gain) loss reclassified into net income (loss)	(1,038)	(1,366)	(3,651)	(3,725)
Income tax benefit on pension plan benefits liability adjustment	(1)	13	220	80
Total income tax (provision) benefit on other comprehensive income (loss)	\$ 5,990	\$ 3,468	\$ (10,553)	\$ (1,904)

⁽¹⁾ Designated as cash flow hedges

Accumulated other comprehensive income (loss), net of tax, was (\$1.7) million at September 30, 2010 and \$71.1 million at December 31, 2009. These amounts include 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

The fair values provided are representative of fair values only at September 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.

	At September 30, 2010		At December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Assets				
Cash and cash equivalents	\$ 148,114	\$ 148,114	\$ 121,893	\$ 121,893
Foreign exchange forwards	283	283	3,986	3,986
Liabilities				
Term loans				
USD denominated term loan	\$ 220,154	\$ 220,704	\$ 284,693	\$ 284,693
EUR denominated term loan	227,123	227,691	288,902	288,902
Convertible senior subordinated notes	215,673	248,199	208,169	282,859
Interest rate swaps	9,450	9,450	15,154	15,154
Foreign exchange forwards	87	87	2,442	2,442

Table of Contents

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.

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 September 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 associated with our segments was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Itron North America	\$ 11.5	\$ 12.4	\$ 34.2	\$ 35.4
Itron International	20.6	27.0	63.0	78.4
Total Company	\$ 32.1	\$ 39.4	\$ 97.2	\$ 113.8

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.

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Revenues				
Itron North America	\$ 315,335	\$ 137,351	\$ 861,607	\$ 419,658
Itron International	260,633	271,007	783,101	790,966
Total Company	\$ 575,968	\$ 408,358	\$ 1,644,708	\$ 1,210,624
Gross profit				
Itron North America	\$ 111,858	\$ 42,524	\$ 294,880	\$ 144,737
Itron International	72,349	86,955	224,546	247,435
Total Company	\$ 184,207	\$ 129,479	\$ 519,426	\$ 392,172
Operating income (loss)				
Itron North America	\$ 64,581	\$ (1,188)	\$ 155,892	\$ 12,459
Itron International	7,652	17,319	23,314	40,018
Corporate unallocated	(10,853)	(7,125)	(32,099)	(22,803)
Total Company	61,380	9,006	147,107	29,674
Total other income (expense)	(17,585)	(27,114)	(47,212)	(74,593)
Income (loss) before income taxes	\$ 43,795	\$ (18,108)	\$ 99,895	\$ (44,919)

One customer represented more than 10% of total Company revenues for the three and nine months ended September 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 nine months ended September 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 nine months ended September 30, 2010 and 2009.

Revenues by region were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
United States and Canada	\$ 312,851	\$ 131,986	\$ 854,923	\$ 402,761
Europe	173,936	203,834	562,284	610,869
Other	89,181	72,538	227,501	196,994
Total revenues	\$ 575,968	\$ 408,358	\$ 1,644,708	\$ 1,210,624

Table of Contents**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 as they are immaterial.

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.

Consolidating Statement of Operations**Three Months Ended September 30, 2010**

	Parent	Guarantor Subsidiary	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Revenues	\$ 313,593	\$ -	\$ 276,771	\$ (14,396)	\$ 575,968
Cost of revenues	204,233	-	201,924	(14,396)	391,761
Gross profit	109,360	-	74,847	-	184,207
Operating expenses					
Sales and marketing	16,090	-	25,107	-	41,197
Product development	21,855	-	12,183	-	34,038
General and administrative	14,174	-	16,536	-	30,710
Amortization of intangible assets	4,084	-	12,798	-	16,882
Total operating expenses	56,203	-	66,624	-	122,827
Operating income	53,157	-	8,223	-	61,380
Other income (expense)					
Interest income	62	888	137	(921)	166
Interest expense	(14,157)	-	(92)	921	(13,328)
Other income (expense), net	(1,716)	-	(2,707)	-	(4,423)
Total other income (expense)	(15,811)	888	(2,662)	-	(17,585)
Income before income taxes	37,346	888	5,561	-	43,795
Income tax provision	(12,814)	-	(1,873)	-	(14,687)
Equity in earnings of guarantor and non-guarantor subsidiaries, net	4,576	-	-	(4,576)	-
Net income	\$ 29,108	\$ 888	\$ 3,688	\$ (4,576)	\$ 29,108

Table of Contents**Consolidating Statement of Operations****Three Months Ended September 30, 2009**

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Revenues	\$ 133,898	\$ 1,005	\$ 282,183	\$ (8,728)	\$ 408,358
Cost of revenues	93,219	940	193,448	(8,728)	278,879
Gross profit	40,679	65	88,735	-	129,479
Operating expenses					
Sales and marketing	14,400	-	23,269	-	37,669
Product development	19,207	-	11,870	-	31,077
General and administrative	9,941	-	16,665	-	26,606
Amortization of intangible assets	5,874	-	19,247	-	25,121
Total operating expenses	49,422	-	71,051	-	120,473
Operating income (loss)	(8,743)	65	17,684	-	9,006
Other income (expense)					
Interest income	29,145	877	(112)	(29,955)	(45)
Interest expense	(20,499)	-	(29,818)	30,242	(20,075)
Loss on extinguishment of debt, net	(2,460)	-	-	-	(2,460)
Other income (expense), net	(912)	(7)	(3,328)	(287)	(4,534)
Total other income (expense)	5,274	870	(33,258)	-	(27,114)
Income (loss) before income taxes	(3,469)	935	(15,574)	-	(18,108)
Income tax benefit	13,252	-	1,894	-	15,146
Equity in losses of guarantor and non-guarantor subsidiaries, net	(12,745)	(2,428)	-	15,173	-
Net loss	\$ (2,962)	\$ (1,493)	\$ (13,680)	\$ 15,173	\$ (2,962)

Table of Contents**Consolidating Statement of Operations****Nine Months Ended September 30, 2010**

	Parent	Guarantor Subsidiary	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Revenues	\$ 856,416	\$ -	\$ 828,890	\$ (40,598)	\$ 1,644,708
Cost of revenues	568,684	-	597,196	(40,598)	1,125,282
Gross profit	287,732	-	231,694	-	519,426
Operating expenses					
Sales and marketing	47,363	-	76,345	-	123,708
Product development	64,084	-	36,016	-	100,100
General and administrative	41,424	-	55,628	-	97,052
Amortization of intangible assets	12,256	-	39,203	-	51,459
Total operating expenses	165,127	-	207,192	-	372,319
Operating income	122,605	-	24,502	-	147,107
Other income (expense)					
Interest income	537	2,422	363	(2,878)	444
Interest expense	(44,357)	-	(736)	2,877	(42,216)
Other income (expense), net	1,256	-	(6,697)	1	(5,440)
Total other income (expense)	(42,564)	2,422	(7,070)	-	(47,212)
Income before income taxes	80,041	2,422	17,432	-	99,895
Income tax provision	(16,579)	-	(521)	-	(17,100)
Equity in earnings of guarantor and non-guarantor subsidiaries, net	19,333	-	-	(19,333)	-
Net income	\$ 82,795	\$ 2,422	\$ 16,911	\$ (19,333)	\$ 82,795

Consolidating Statement of Operations**Nine Months Ended September 30, 2009**

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Revenues	\$ 410,367	\$ 3,116	\$ 829,870	\$ (32,729)	\$ 1,210,624
Cost of revenues	270,709	3,298	577,174	(32,729)	818,452
Gross profit (loss)	139,658	(182)	252,696	-	392,172

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Operating expenses					
Sales and marketing	42,546	-	70,023	-	112,569
Product development	58,869	-	34,175	-	93,044
General and administrative	31,495	-	52,602	-	84,097
Amortization of intangible assets	17,633	-	55,155	-	72,788
Total operating expenses	150,543	-	211,955	-	362,498
Operating income (loss)	(10,885)	(182)	40,741	-	29,674
Other income (expense)					
Interest income	83,472	2,876	537	(85,914)	971
Interest expense	(56,003)	-	(83,517)	86,201	(53,319)
Loss on extinguishment of debt, net	(12,800)	-	-	-	(12,800)
Other income (expense), net	(2,802)	(3)	(6,353)	(287)	(9,445)
Total other income (expense)	11,867	2,873	(89,333)	-	(74,593)
Income (loss) before income taxes	982	2,691	(48,592)	-	(44,919)
Income tax benefit	36,938	-	579	-	37,517
Equity in losses of guarantor and non-guarantor subsidiaries, net	(45,322)	(5,466)	-	50,788	-
Net loss	\$ (7,402)	\$ (2,775)	\$ (48,013)	\$ 50,788	\$ (7,402)

Table of Contents**Consolidating Balance Sheet**

September 30, 2010

	Parent	Guarantor Subsidiary	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
ASSETS					
Current assets					
Cash and cash equivalents	\$ 18,517	\$ -	\$ 129,597	\$ -	\$ 148,114
Accounts receivable, net	157,970	-	225,844	-	383,814
Intercompany accounts receivable	5,821	-	1,350	(7,171)	-
Inventories	112,223	-	114,160	(618)	225,765
Deferred tax assets current, net	11,952	-	11,013	-	22,965
Other current assets	20,110	-	52,261	-	72,371
Intercompany other	2,021	888	2	(2,911)	-
Total current assets	328,614	888	534,227	(10,700)	853,029
Property, plant, and equipment, net	116,610	-	185,696	-	302,306
Prepaid debt fees	5,704	-	-	-	5,704
Deferred tax assets noncurrent, net	28,038	-	21,574	-	49,612
Other noncurrent assets	4,368	-	11,930	-	16,298
Intangible assets, net	45,914	-	269,842	-	315,756
Goodwill	184,751	-	1,051,832	-	1,236,583
Investment in subsidiaries	317,383	-	-	(317,383)	-
Intercompany notes receivable	1,317,923	99,703	-	(1,417,626)	-
Total assets	\$ 2,349,305	\$ 100,591	\$ 2,075,101	\$ (1,745,709)	\$ 2,779,288
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities					
Accounts payable	\$ 74,970	\$ -	\$ 163,125	\$ -	\$ 238,095
Other current liabilities	14,723	-	45,083	-	59,806
Intercompany accounts payable	1,389	-	5,782	(7,171)	-
Wages and benefits payable	42,018	-	54,695	-	96,713
Taxes payable	1,500	-	21,379	-	22,879
Current portion of debt	226,246	-	-	-	226,246
Current portion of warranty	11,498	-	16,734	-	28,232
Unearned revenue	23,896	-	6,853	-	30,749
Deferred tax liabilities current, net	1,015	-	654	-	1,669
Short-term intercompany advances	887	-	2,024	(2,911)	-
Total current liabilities	398,142	-	316,329	(10,082)	704,389
Long-term debt	436,704	-	-	-	436,704
Long-term warranty	12,468	-	12,525	-	24,993
Pension plan benefits	-	-	60,013	-	60,013
Intercompany notes payable	99,703	-	1,317,923	(1,417,626)	-
Deferred tax liabilities noncurrent, net	(46,436)	-	98,564	-	52,128
Other long-term obligations	16,080	-	52,337	-	68,417

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Total liabilities	916,661	-	1,857,691	(1,427,708)	1,346,644
Shareholders' equity					
Preferred stock	-	-	-	-	-
Common stock	1,321,287	97,377	65,511	(162,888)	1,321,287
Accumulated other comprehensive income (loss), net	(1,688)	(7,787)	45,658	(37,871)	(1,688)
Retained earnings	113,045	11,001	106,241	(117,242)	113,045
Total shareholders' equity	1,432,644	100,591	217,410	(318,001)	1,432,644
Total liabilities and shareholders' equity	\$ 2,349,305	\$ 100,591	\$ 2,075,101	\$ (1,745,709)	\$ 2,779,288

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 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Long-term 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 long-term obligations	23,287	-	59,876	-	83,163
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****Nine Months Ended September 30, 2010**

	Parent	Guarantor Subsidiary	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Operating activities					
Net income	\$ 82,795	\$ 2,422	\$ 16,911	\$ (19,333)	\$ 82,795
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	34,101	-	63,083	-	97,184
Stock-based compensation	14,222	-	-	-	14,222
Amortization of prepaid debt fees	4,219	-	-	-	4,219
Amortization of convertible debt discount	7,505	-	-	-	7,505
Deferred taxes, net	17,072	-	(16,361)	-	711
Equity in earnings of guarantor and non-guarantor subsidiaries, net	(19,333)	-	-	19,333	-
Other adjustments, net	1,707	-	2,301	-	4,008
Changes in operating assets and liabilities, net of acquisitions:					
Accounts receivable	(40,866)	-	(12,904)	-	(53,770)
Inventories	(40,402)	-	(17,296)	-	(57,698)
Accounts payables, other current liabilities, and taxes payable	10,323	-	27,816	-	38,139
Wages and benefits payable	21,397	-	5,402	-	26,799
Unearned revenue	(11,829)	-	3,265	-	(8,564)
Warranty	5,629	-	10,458	-	16,087
Intercompany transactions, net	3,418	-	(3,418)	-	-
Other operating, net	11,026	-	(15,547)	-	(4,521)
Net cash provided by operating activities	100,984	2,422	63,710	-	167,116
Investing activities					
Acquisitions of property, plant, and equipment	(26,163)	-	(19,344)	-	(45,507)
Current intercompany notes, net	28,563	(2,422)	5,000	(31,141)	-
Other investing, net	1,266	-	4,146	-	5,412
Net cash provided by (used in) investing activities	3,666	(2,422)	(10,198)	(31,141)	(40,095)
Financing activities					
Payments on debt	(106,524)	-	-	-	(106,524)
Issuance of common stock	7,931	-	-	-	7,931
Current intercompany notes, net	(2,578)	-	(28,563)	31,141	-
Prepaid debt fees	(1,347)	-	-	-	(1,347)
Other financing, net	-	-	(983)	-	(983)

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Net cash used in financing activities	(102,518)	-	(29,546)	31,141	(100,923)
Effect of foreign exchange rate changes on cash and cash equivalents	-	-	123	-	123
Cash transferred from guarantor to combined non-guarantor	-	(379)	379	-	-
Increase (decrease) in cash and cash equivalents	2,132	(379)	24,468	-	26,221
Cash and cash equivalents at beginning of period	16,385	379	105,129	-	121,893
Cash and cash equivalents at end of period	\$ 18,517	\$ -	\$ 129,597	\$ -	\$ 148,114

Non-cash transactions:

Property, plant, and equipment purchased but not yet paid, net	\$ (2,752)	\$ -	\$ (3,246)	\$ -	\$ (5,998)
--	------------	------	------------	------	------------

Supplemental disclosure of cash flow information:

Cash paid during the period for:					
Income taxes	\$ 667	\$ -	\$ 16,780	\$ -	\$ 17,447
Interest, net of amounts capitalized	31,386	-	280	-	31,666

Table of Contents**Consolidating Statement of Cash Flows****Nine Months Ended September 30, 2009**

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Operating activities					
Net loss	\$ (7,402)	\$ (2,775)	\$ (48,013)	\$ 50,788	\$ (7,402)
Adjustments to reconcile net loss to net cash provided by operating activities:					
Depreciation and amortization	35,253	-	78,559	-	113,812
Stock-based compensation	13,467	-	-	-	13,467
Amortization of prepaid debt fees	6,384	-	-	-	6,384
Amortization of convertible debt discount	7,262	-	-	-	7,262
Loss on extinguishment of debt, net	9,960	-	-	-	9,960
Deferred taxes, net	(37,015)	-	(14,326)	-	(51,341)
Equity in losses of guarantor and non-guarantor subsidiaries, net	45,322	5,466	-	(50,788)	-
Other adjustments, net	1,552	-	216	-	1,768
Changes in operating assets and liabilities, net of acquisitions:					
Accounts receivable	15,280	(839)	(2,833)	-	11,608
Inventories	(1,130)	-	(3,081)	-	(4,211)
Accounts payables, other current liabilities, and taxes payable	(3,376)	153	750	-	(2,473)
Wages and benefits payable	(7,973)	(78)	(2,353)	-	(10,404)
Unearned revenue	10,773	338	(1,839)	-	9,272
Warranty	(2,852)	-	(2,883)	-	(5,735)
Intercompany transactions, net	1,005	1,219	(2,224)	-	-
Other operating, net	(9,010)	63	4,067	-	(4,880)
Net cash provided by operating activities	77,500	3,547	6,040	-	87,087
Investing activities					
Acquisitions of property, plant, and equipment	(16,946)	(346)	(20,731)	-	(38,023)
Business acquisitions & contingent consideration, net of cash equivalents acquired	(1,317)	-	-	-	(1,317)
Current intercompany notes, net	(20,661)	-	1,217	19,444	-
Long-term intercompany notes receivable, net	3,660	(3,850)	1,135	(945)	-
Other investing, net	706	974	2,421	-	4,101
Net cash used in investing activities	(34,558)	(3,222)	(15,958)	18,499	(35,239)
Financing activities					
Payments on debt	(236,495)	-	-	-	(236,495)
Issuance of common stock	165,235	-	-	-	165,235
Current intercompany notes, net	(1,254)	-	20,698	(19,444)	-
	(785)	-	(160)	945	-

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Long-term intercompany notes payable, net					
Prepaid debt fees	(3,936)	-	-	-	(3,936)
Other financing, net	-	-	(1,309)	-	(1,309)
Net cash provided by (used in) financing activities	(77,235)	-	19,229	(18,499)	(76,505)
Effect of foreign exchange rate changes on cash and cash equivalents	-	-	4,988	-	4,988
Cash transferred from guarantor to parent	2,940	(2,940)	-	-	-
Increase (decrease) in cash and cash equivalents	(31,353)	(2,615)	14,299	-	(19,669)
Cash and cash equivalents at beginning of period	67,404	3,180	73,806	-	144,390
Cash and cash equivalents at end of period	\$ 36,051	\$ 565	\$ 88,105	\$ -	\$ 124,721
<i>Non-cash transactions:</i>					
Property, plant, and equipment purchased but not yet paid, net	\$ 1,265	\$ 346	\$ 3,881	\$ -	\$ 5,492
Exchange of debt (face value) for common stock	120,984	-	-	-	120,984
Contingent consideration payable for previous acquisitions	2,000	-	-	-	2,000
<i>Supplemental disclosure of cash flow information:</i>					
Cash paid during the period for:					
Income taxes	\$ 539	\$ -	\$ 18,769	\$ -	\$ 19,308
Interest, net of amounts capitalized	43,199	115	(107)	-	43,207

Table of Contents

ITEM 2: Management 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 nine months ended September 30, 2010 increased 41% and 36%, compared with the same periods in 2009, primarily due to deployment of our OpenWay® projects in Itron North America. Total backlog was \$1.7 billion and twelve-month backlog was \$958 million at September 30, 2010.

Itron North America meter volumes increased 136% and 108%, primarily driven by the OpenWay contracts, while Itron International meter volumes increased 5% and decreased 4% for the three and nine months ended September 30, 2010, compared with the same periods in 2009.

Diluted earnings per share were \$0.71 and \$2.02 for the three and nine months ended September 30, 2010, compared with diluted loss per share of \$0.07 and \$0.19 for the same periods last year.

Term debt repayments during the nine months ended September 30, 2010 were \$106.5 million, bringing the total debt outstanding to \$663.0 million at September 30, 2010.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	% Change	2010	2009	% Change
	(in millions)			(in millions)		
Revenues	\$ 576.0	\$ 408.4	41%	\$ 1,644.7	\$ 1,210.6	36%
Gross Profit	\$ 184.2	\$ 129.5	42%	\$ 519.4	\$ 392.2	32%
Gross Margin	32.0%	31.7%		31.6%	32.4%	

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Revenues by region				
United States and Canada	\$ 312.8	\$ 132.1	\$ 854.9	\$ 402.8
Europe	174.0	203.9	562.3	610.9
Other	89.2	72.4	227.5	196.9
Total revenues	\$ 576.0	\$ 408.4	\$ 1,644.7	\$ 1,210.6

Revenues

Revenues increased \$167.6 million and \$434.1 million, or 41% and 36%, for the three and nine months ended September 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 accounted for a 3% decrease in revenues in the third quarter and was minor for the nine months ended September 30, 2010, compared with the same period last year. 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 nine 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 37% and 33% of total revenues for the three and nine months ended September 30, 2010, compared with 16% and 12% for the three and nine months ended September 30, 2009, respectively.

Gross Margins

Gross margin was 32.0% and 31.6% for the three and nine months ended September 30, 2010, compared with 31.7% and 32.4% during the same periods in 2009. For the three months ended September 30, 2010, Itron North America gross margin increased 4.5 percentage points, while Itron International gross margin decreased 4.3 percentage points, resulting in a minimal overall change. The lower gross margin for the nine months ended September 30, 2010 was due to Itron International. A more detailed analysis of these fluctuations is provided in *Operating Segment Results*.

Table of Contents*Meter and Module Summary*

Meters are sold with and without advanced functionality. In addition, smart meter modules (automatic meter reading (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 September 30, 2010		Nine Months Ended September 30, 2009	
	2010	2009	2010	2009
	(units in thousands)			
Total meters (with and without AMR/AMI)				
Itron North America				
Electricity	1,800	740	4,990	2,340
Gas	160	90	420	260
Itron International				
Electricity	2,020	1,890	5,590	5,670
Gas	940	1,160	2,940	3,880
Water	2,290	1,960	6,960	6,540
Total meters	7,210	5,840	20,900	18,690
Additional meter information (Total Company)				
Meters with AMR	1,110	670	2,830	2,200
Meters with AMI	1,130	120	2,990	220
Standalone AMR/AMI modules	1,620	850	4,410	2,860
Meters with AMR/AMI and modules	3,860	1,640	10,230	5,280
Meters with other vendors' AMR/AMI	130	160	390	470

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 September 30, 2010			Nine Months Ended September 30, 2009		
	2010	2009	% Change	2010	2009	% Change
	(in millions)			(in millions)		
Itron North America	\$ 315.4	\$ 137.4	130%	\$ 861.6	\$ 419.7	105%
Itron International	260.6	271.0	(4%)	783.1	790.9	(1%)
Total revenues	\$ 576.0	\$ 408.4	41%	\$ 1,644.7	\$ 1,210.6	36%

<i>Segment Gross Profit and Margin</i>	Three Months Ended September 30, 2010				Nine Months Ended September 30, 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)	

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Itron North America	\$ 111.9	35.5%	\$ 42.5	31.0%	\$ 294.9	34.2%	\$ 144.7	34.5%
Itron International	72.3	27.8%	87.0	32.1%	224.5	28.7%	247.5	31.3%
Total gross profit and margin	\$ 184.2	32.0%	\$ 129.5	31.7%	\$ 519.4	31.6%	\$ 392.2	32.4%

<i>Segment Operating Income (Loss) and Operating Margin</i>	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010		2009		2010		2009	
	<i>Operating Income (Loss)</i>	<i>Operating Margin</i>	<i>Operating Income (Loss)</i>	<i>Operating Margin</i>	<i>Operating Income (Loss)</i>	<i>Operating Margin</i>	<i>Operating Income (Loss)</i>	<i>Operating Margin</i>
	(in millions)		(in millions)		(in millions)		(in millions)	
Itron North America	\$ 64.6	20%	\$ (1.2)	(1%)	\$ 155.9	18%	\$ 12.5	3%
Itron International	7.6	3%	17.3	6%	23.3	3%	40.0	5%
Corporate unallocated	(10.8)		(7.1)		(32.1)		(22.8)	
Total Company	\$ 61.4	11%	\$ 9.0	2%	\$ 147.1	9%	\$ 29.7	2%

Table of Contents

Itron North America: Revenues increased \$178.0 million and \$441.9 million, or 130% and 105%, during the three and nine months ended September 30, 2010, compared with the same periods last year. The increase in revenues was primarily due to the deployment on our OpenWay projects in 2010. Our OpenWay contracts accounted for 50% and 48% of operating segment revenues for the three and nine months ended September 30, 2010, compared with 15% and 8% in the same periods last year. OpenWay meter and module volumes were 1.3 million and 3.4 million in the third quarter and nine months ended September 30, 2010. Non-OpenWay revenues increased 35% and 17% for the three and nine months ended September 30, 2010, compared with the same periods last year.

Gross margin increased to 35.5% in the three months ended September 30, 2010, compared with gross margin of 31.0% in the same period in 2009, due to manufacturing efficiency improvements driven by higher volumes and cost reduction efforts. Gross margin for the nine months ended September 30, 2010 was 34.2%, compared with 34.5% in the same period in 2009, due to increased compensation costs resulting from the reinstatement of our annual incentive plans in 2010, substantially offset by manufacturing efficiency improvements due to higher volumes and cost reduction efforts.

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

Itron North America operating expenses increased \$3.6 million and \$6.7 million, or 8% and 5%, for the three and nine months ended September 30, 2010, compared with the same periods in 2009, primarily due to increased compensation expense. These higher costs were partially offset by a scheduled decrease in amortization of intangible assets. As a result of higher revenues, operating expenses as a percentage of revenues were 15% and 16% for the three and nine months ended September 30, 2010, compared with 32% for the same periods in 2009.

Itron International: Revenues decreased \$10.4 million, or 4%, for the three months ended September 30, 2010, and decreased \$7.8 million, or 1%, for the nine months ended September 30, 2010, compared with the same periods in 2009. Excluding the translation effect to the U.S. dollar, revenues increased 1% in the third quarter of 2010, compared with the same period last year. There was minimal translation impact on revenues for the nine months ended September 30, 2010, compared with the same period last year. Meter volumes were 5% higher for the third quarter of 2010 and 4% lower for the nine months ended September 30, 2010, compared with the same periods last year. Itron International experiences variability in revenues as a result of the diverse economies in which it operates and sells its products.

Gross margin decreased 4.3 percentage points and 2.6 percentage points in the three and nine months ended September 30, 2010, compared with the same periods in 2009, due primarily to increased warranty expense of \$4.2 million and \$13.8 million recorded in those respective periods for the arbitration claims in Sweden, as discussed in Item 1: Financial Statements Note 11: Commitments and Contingencies. Gross margins in 2010 were also lower due to facility movement and consolidation expenses, an increase in material costs, and foreign currency translation.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Electricity	40%	42%	39%	40%
Water	30%	28%	32%	31%
Gas	30%	30%	29%	29%

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

Table of Contents

Operating expenses for Itron International were \$64.7 million and \$69.7 million for the three months ended September 30, 2010 and 2009, or 25% and 26% of revenues for the respective periods. Operating expenses for the nine months ended September 30, 2010 and 2009 were \$201.2 million and \$207.5 million or 26% of revenues for the respective periods. Operating expenses, excluding amortization expense and before the impact of foreign currency exchange rate changes, increased 10% and 7% for the three and nine months ended September 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 \$3.7 million and \$9.3 million in the three and nine months ended September 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 and/or contractual 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
September 30, 2010	\$ 528	\$ 1,657	\$ 958
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

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 and/or contractual conditions are satisfied. In the second quarter of 2010, contract approvals were received for our OpenWay contract with Detroit Edison. As a result, bookings and backlog included \$339 million related to that contract for the quarter ended June 30, 2010.

Table of Contents**Operating Expenses**

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010 (in millions)	% of Revenues	2009 (in millions)	% of Revenues	2010 (in millions)	% of Revenue	2009 (in millions)	% of Revenue
Sales and marketing	\$ 41.2	7%	\$ 37.7	9%	\$ 123.7	8%	\$ 112.6	9%
Product development	34.0	6%	31.1	8%	100.1	6%	93.0	8%
General and administrative	30.7	5%	26.6	7%	97.0	6%	84.1	7%
Amortization of intangible assets	16.9	3%	25.1	6%	51.5	3%	72.8	6%
Total operating expenses	\$ 122.8	21%	\$ 120.5	30%	\$ 372.3	23%	\$ 362.5	30%

Operating expenses increased 2% and 3% for the three and nine months ended September 30, 2010, compared with the same periods in 2009, respectively. The translation of foreign currencies to the U.S. dollar represented a decrease of \$4.8 million and \$1.1 million for the three and nine months ended September 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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Interest income	\$ 166	\$ (45)	\$ 444	\$ 971
Interest expense	(11,872)	(15,963)	(37,997)	(46,935)
Amortization of prepaid debt fees	(1,456)	(4,112)	(4,219)	(6,384)
Loss on extinguishment of debt, net	-	(2,460)	-	(12,800)
Other income (expense), net	(4,423)	(4,534)	(5,440)	(9,445)
Total other income (expense)	\$ (17,585)	\$ (27,114)	\$ (47,212)	\$ (74,593)

Interest income: Interest income decreased in 2010, compared with 2009, primarily due to lower interest rates in 2010. Average cash and cash equivalent balances increased 7% and 2% in the three and nine months ended September 30, 2010, compared with the same periods in 2009.

Interest expense: Interest expense decreased 26% and 19% for the three and nine months ended September 30, 2010, compared with the same periods in 2009, primarily due to the decline in the principal balance of our debt outstanding. At September 30, 2010, inclusive of our interest rate swaps, 89% 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 decrease in amortization of prepaid debt fees for the three and nine months ended September 30, 2010 was primarily the result of lower debt repayments. Repayments on our borrowings were \$32.6 million and \$106.5 million for the three and nine months ended September 30, 2010, compared with \$166.3 million and \$236.5 million for the three and nine months ended September 30, 2009. When debt is repaid early, the related portion of unamortized prepaid debt fees is written off and included in interest expense.

Edgar Filing: ITRON INC /WA/ - Form 10-Q

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 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 . During the third quarter of 2009, we repaid the outstanding balance on our senior subordinated notes and recognized a loss on extinguishment of \$2.5 million.

Table of Contents

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. During the nine months ended September 30, 2009, other expense also included \$1.5 million in consulting and legal fees associated with the amendment to our credit facility.

Table of Contents**Financial Condition***Cash Flow Information:*

	Nine Months Ended September 30,	
	2010	2009
	(in millions)	
Operating activities	\$ 167.1	\$ 87.1
Investing activities	(40.1)	(35.2)
Financing activities	(100.9)	(76.5)
Effect of exchange rates on cash and cash equivalents	0.1	4.9
Increase (decrease) in cash and cash equivalents	\$ 26.2	\$ (19.7)

Cash and cash equivalents was \$148.1 million at September 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 higher net cash outflows from financing activities.

Operating activities

Cash provided by operating activities during the nine months ended September 30, 2010 was \$80.0 million higher, compared with the same period in 2009, primarily due to increased revenues.

Investing activities

Investing activities consist primarily of capital expenditures for machinery and equipment associated with the expansion of our manufacturing facilities for increased operating capacity.

Financing activities

During the nine months ended September 30, 2010, we repaid \$106.5 million in borrowings, compared with \$236.5 million during the same period in 2009. Cash generated from the exercise of stock-based awards was \$7.9 million for the nine months ended September 30, 2010, compared with \$5.0 million during the same period in 2009. During the nine months ended September 30, 2009, we completed an underwritten public offering of approximately 3.2 million shares of common stock for net cash proceeds of \$160.4 million, which the proceeds were used to repay debt.

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 nine months ended September 30, 2010 was an increase of \$123,000, compared with an increase of \$4.9 million for the same period in 2009.

Non-cash transactions

During the nine months ended September 30, 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

Edgar Filing: ITRON INC /WA/ - Form 10-Q

We have no off-balance sheet financing agreements or guarantees as defined by Item 303 of Regulation S-K at September 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 the sale 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.

Table of Contents

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. Our yearly debt repayments have historically exceeded the annual excess cash flow provision repayment requirement and, therefore, no additional payments have been required in the following fiscal year.

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.

On July 1, 2010, we classified our 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 nine 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 September 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, unrealized losses from 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 \$1.7 million in U.S. federal and state taxes and approximately \$26 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 \$148.6 million at September 30, 2010, compared with \$282.5 million at December 31, 2009. The decrease is due to the classification of our convertible senior subordinated notes as current during the third quarter of 2010 due to the combination of put, call, and conversion options commencing on July 1, 2011.

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 .

Table of Contents

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 Task 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 nine months ended September 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 analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices are 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 if an item were 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

Table of Contents

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 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 September 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. Our effective tax rate requires significant judgment and is 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. Changes in tax laws and unanticipated tax liabilities could significantly impact our tax rate.

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.

Table of Contents*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.

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 Carrying Value
	(in millions)	
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 and the economies in which we operate across local markets, 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

Table of Contents

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 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. At September 30, 2010, we classified the convertible notes as current due to the combination of put, call, and conversion options commencing on July 1, 2011.

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 comprise 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% at December 31, 2009. The weighted average discount rate used to measure the projected benefit obligation for all of the plans at 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

Table of Contents

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 nine months ended September 30, 2010, we accrued \$12.1 million and \$36.8 million for such awards, compared with \$6.6 million and \$8.7 million in the same periods in 2009. Awards are typically distributed 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 required vesting period. 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.

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 September 30, 2010. Including the effect of our interest rate swaps at September 30, 2010, 89% 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 September 30, 2010, our estimated leverage ratio, which determines our additional interest rate margin, and a static foreign exchange rate at September 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	\$ 1.5	\$ 6.1	\$ 6.1	\$ 6.1	\$ 200.4	\$ 220.2
Average interest rate	3.78%	4.12%	4.09%	4.36%	4.68%	
Principal: Euro term loan	\$ 1.1	\$ 4.1	\$ 4.1	\$ 4.1	\$ 213.7	\$ 227.1
Average interest rate	4.38%	4.79%	4.99%	5.15%	5.30%	
<i>Interest rate swaps on U.S. dollar term loan ⁽²⁾</i>						
Average interest rate (Pay)	2.13%	2.13%				
Average interest rate (Receive)	0.28%	0.62%				
Net/Spread	(1.85%)	(1.51%)				
<i>Interest rate swap on euro term loan ⁽³⁾</i>						
Average interest rate (Pay)	6.59%	6.59%	6.59%			
Average interest rate (Receive)	2.88%	3.29%	3.49%			
Net/Spread	(3.71%)	(3.30%)	(3.10%)			

⁽¹⁾ The face value of our convertible notes is \$223.6 million, while the carrying value is \$215.7 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 \$7.9 million discount on the liability component of the convertible notes to interest expense over the next nine 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 \$220.2 million U.S. dollar denominated variable rate term loan from a floating London Interbank Offered Rate 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).

Edgar Filing: ITRON INC /WA/ - Form 10-Q

- ⁽³⁾ The amortizing euro denominated interest rate swap is used to convert \$173.1 million (128.3 million) of our \$227.1 million (168.3 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).

Table of Contents

Based on a sensitivity analysis as of September 30, 2010, we estimate that if market interest rates average one percentage point higher in 2010 than in the table above, our earnings in 2010 would not be materially impacted due to our interest rate swaps in place at September 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 functional currencies other than the U.S. dollar were 48% and 50% of total revenues for the three and nine months ended September 30, 2010, compared with 69% and 68% for the same periods in 2009.

In conjunction with our acquisition of Actaris Metering Systems SA, 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 (loss). 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 (170 during the nine months ended September 30, 2010), not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. The notional amounts of the contracts ranged from less than \$1 million to \$50 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 September 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 September 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 third quarter of 2010.

Item 1A: Risk Factors

There were no material changes to risk factors during the third 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 third 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.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

* Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. Users of this data are advised that,

Edgar Filing: ITRON INC /WA/ - Form 10-Q

pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

Table of Contents

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.

November 2, 2010
Date

By:

ITRON, INC.

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