ITRON INC /WA/
Form 10-Q
November 02, 2010
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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	**91-1011792**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

2111 N Molter Road, Liberty Lake, Washington 99019

(509) 924-9900

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

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

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 x 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	x	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 x

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.

Itron, Inc.

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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.

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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

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.

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ITRON, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 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

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.

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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 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

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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.

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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.

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Revenue Recognition

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

On January 1, 2010, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605)   Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Tax Force)* and ASU 2009-14, *Software (Topic 985), Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)* on a prospective basis for new arrangements and arrangements that are materially modified. This new guidance did not have a material impact on our financial statements for the three and 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.

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

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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.

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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.

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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.

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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,		Nine 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

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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			At December 31, 2009		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated 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

		(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

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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

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.

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.