ITRON INC /WA/
Form 10-Q
November 03, 2009

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, 2009

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 ¨ 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 October 30, 2009 there were 40,124,156 shares outstanding of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Itron, Inc.

Table of Contents

	Page
PART I: FINANCIAL INFORMATION	
Item 1: Financial Statements (Unaudited)	
Consolidated Statements of Operations	1
Consolidated Balance Sheets	2
Consolidated Statements of Cash Flows	3
Notes to Condensed Consolidated Financial Statements	4
Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations	35
Item 3: Quantitative and Qualitative Disclosures About Market Risk	45
Item 4: Controls and Procedures	46
PART II: OTHER INFORMATION	
Item 1: Legal Proceedings	47
Item 1A: Risk Factors	47
Item 4: Submission of Matters to a Vote of Security Holders	47
Item 5: Other Information	47
Item 6: Exhibits	47
SIGNATURE	48

Table of Content

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,	
	2009	2008	2009	2008
	(in thousands, except per share data)			
Revenues	$ 408,358	$ 484,818	$ 1,210,624	$ 1,477,225
Cost of revenues	278,879	321,858	818,452	975,496
Gross profit	129,479	162,960	392,172	501,729
Operating expenses				
Sales and marketing	37,669	41,363	112,569	127,534
Product development	31,077	31,781	93,044	92,283
General and administrative	26,606	34,088	84,097	100,000
Amortization of intangible assets	25,121	30,395	72,788	93,114
Total operating expenses	120,473	137,627	362,498	412,931
Operating income	9,006	25,333	29,674	88,798
Other income (expense)				
Interest income	(45)	1,962	971	4,846
Interest expense	(20,075)	(21,037)	(53,319)	(75,362)
Loss on extinguishment of debt, net	(2,460)	-	(12,800)	-
Other income (expense), net	(4,534)	(281)	(9,445)	(1,938)
Total other income (expense)	(27,114)	(19,356)	(74,593)	(72,454)
Income (loss) before income taxes	(18,108)	5,977	(44,919)	16,344
Income tax benefit (provision)	15,146	(377)	37,517	1,298
Net income (loss)	$ (2,962)	$ 5,600	$ (7,402)	$ 17,642
Earnings (loss) per common share				
Basic	$ (0.07)	$ 0.16	$ (0.19)	$ 0.54
Diluted	$ (0.07)	$ 0.15	$ (0.19)	$ 0.50
Weighted average common shares outstanding				
Basic	40,039	34,385	38,003	32,632
Diluted	40,039	36,872	38,003	34,991

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

1

Table of Content

ITRON, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2009 (unaudited)	December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 124,721	$ 144,390
Accounts receivable, net	325,119	321,278
Inventories	177,766	164,210
Deferred income taxes, net	28,993	31,807
Other	69,583	56,032
Total current assets	726,182	717,717
Property, plant, and equipment, net	315,967	307,717
Prepaid debt fees	10,450	12,943
Deferred income taxes, net	68,934	30,917
Other	18,831	19,315
Intangible assets, net	419,136	481,886
Goodwill	1,323,932	1,285,853
Total assets	$ 2,883,432	$ 2,856,348
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 193,867	$ 200,725
Other current liabilities	59,687	66,365
Wages and benefits payable	70,559	78,336
Taxes payable	34,309	18,595
Current portion of long-term debt	10,953	10,769
Current portion of warranty	20,751	23,375
Unearned revenue	34,731	24,329
Deferred income taxes, net	1,927	1,927
Total current liabilities	426,784	424,421
Long-term debt	812,991	1,140,998
Warranty	12,764	14,880
Pension plan benefits	59,026	55,810
Deferred income taxes, net	83,745	102,720
Other obligations	77,280	58,743
Total liabilities	1,472,590	1,797,572
Commitments and contingencies		
Shareholders' equity		
Preferred stock	-	-
Common stock	1,294,425	992,184
Accumulated other comprehensive income, net	91,320	34,093

Retained earnings		25,097		50,291	
Cumulative effect of change in accounting principle (Note 1)		-		(17,792	)
Total shareholders' equity		1,410,842		1,058,776	
Total liabilities and shareholders' equity	$	2,883,432	$	2,856,348	

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

2

Table of Content

ITRON, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2009	2008
	(in thousands)	
Operating activities		
Net income (loss)	$ (7,402)	$ 17,642
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	113,812	133,295
Stock-based compensation	13,467	12,560
Amortization of prepaid debt fees	6,384	7,665
Amortization of convertible debt discount	7,262	9,995
Loss on extinguishment of debt, net	9,960	-
Deferred income taxes, net	(51,341)	(31,357)
Other, net	1,768	236
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	11,608	1,834
Inventories	(4,211)	(19,100)
Accounts payables, other current liabilities, and taxes payable	(2,473)	15,373
Wages and benefits payable	(10,404)	15,549
Unearned revenue	9,272	5,339
Warranty	(5,735)	103
Other, net	(4,880)	(12,910)
Net cash provided by operating activities	87,087	156,224
Investing activities		
Acquisitions of property, plant, and equipment	(38,023)	(41,422)
Business acquisitions & contingent consideration, net of cash equivalents acquired	(1,317)	(95)
Other, net	4,101	1,380
Net cash used in investing activities	(35,239)	(40,137)
Financing activities		
Payments on debt	(236,495)	(384,426)
Issuance of common stock	165,235	323,424
Prepaid debt fees	(3,936)	(207)
Other, net	(1,309)	(44)
Net cash used in financing activities	(76,505)	(61,253)
Effect of foreign exchange rate changes on cash and cash equivalents	4,988	569
Increase (decrease) in cash and cash equivalents	(19,669)	55,403
Cash and cash equivalents at beginning of period	144,390	91,988

Cash and cash equivalents at end of period	$	124,721	$	147,391
Non-cash transactions:				
Fixed assets purchased but not yet paid	$	5,492	$	5,282
Exchange of debt for common stock (see Note 6)		120,984		-
Contingent consideration payable for previous acquisitions		2,000		-
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes	$	19,308	$	16,699
Interest, net of amounts capitalized		43,207		58,195

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

Table of Content

ITRON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(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, 2009 and 2008, the Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2008 audited financial statements and notes included in our Annual Report on Form 10-K, as filed with the SEC on February 26, 2009. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

The Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC), which became effective on July 1, 2009, is now the single source of authoritative GAAP, along with additional guidance issued by the SEC. All other accounting literature is now considered non-authoritative. For new accounting pronouncements issued by the FASB prior to the effective date of the ASC, we will continue to use the pre-ASC reference, e.g., FSP 14-1 or SFAS 167, for clarity, as the guidance in these recently released pronouncements is typically located in multiple subtopics and sections within the ASC. All other GAAP references in this Quarterly Report on Form 10-Q are from the ASC.

Basis of Consolidation
We consolidate all entities in which we have a greater than 50% ownership interest. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. At September 30, 2009, investments in variable interest entities and noncontrolling interests were not material. Intercompany transactions and balances have been eliminated upon consolidation,

Change in Accounting Principle
On January 1, 2009, we adopted FASB Staff Position (FSP) APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP 14-1). FSP 14-1 requires the

convertible debt to be separated into its liability and equity components in a manner that reflects our non-convertible debt borrowing rate and must be applied retrospectively to all periods during which our convertible debt was outstanding. Our senior subordinated convertible notes (convertible notes) were issued in August 2006. Refer to Note 6 for further disclosure of the terms of the convertible notes and the adoption of FSP 14-1. (The guidance in FSP 14-1 is now embedded within ASC 470).

Table of Content

The impact of the adoption of FSP 14-1 on our results of operations, our financial position, and our cash flows is as follows:

	Three Months Ended September 30, 2008			Nine Months Ended September 30, 2008		
	As Previously Reported	Impact of FSP 14-1	Upon Adoption of FSP 14-1	As Previously Reported	Impact of FSP 14-1	Upon Adoption of FSP 14-1
	(in thousands, except per share data)					
Consolidated Statements of Operations						
Interest expense	$(17,644)	$(3,393)	$(21,037)	$(65,367)	$(9,995)	$(75,362)
Income tax (provision) benefit	(1,695)	1,318	(377)	(2,586)	3,884	1,298
Net income	7,675	(2,075)	5,600	23,753	(6,111)	17,642
Earnings per common share						
Basic	$0.22	$(0.06)	$0.16	$0.73	$(0.19)	$0.54
Diluted	$0.21	$(0.06)	$0.15	$0.68	$(0.18)	$0.50

	At December 31, 2008		
	As Previously Reported	Impact of FSP 14-1	Upon Adoption of FSP 14-1
	(in thousands)		
Consolidated Balance Sheet			
Deferred income taxes, net (long-term asset)	$45,783	$(14,866)	$30,917
Long-term debt	1,179,249	(38,251)	1,140,998
Common stock	951,007	41,177	992,184
Cumulative effect of change in accounting principle	-	(17,792)	(17,792)

	Nine Months Ended September 30, 2008		
	As Previously Reported	Impact of FSP 14-1	Upon Adoption of FSP 14-1
	(in thousands)		
Consolidated Statement of Cash Flows			
Net income	$23,753	$(6,111)	$17,642
Amortization of convertible debt discount	-	9,995	9,995
Deferred income taxes, net	(27,473)	(3,884)	(31,357)

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	As Reported	Impact of FSP 14-1	Excluding Impact of FSP 14-1	As Reported	Impact of FSP 14-1	Excluding Impact of FSP 14-1
	(in thousands, except per share data)					
Consolidated Statements of Operations						

Interest expense	$(20,075)	$2,367	$(17,708)	$(53,319)	$7,262	$(46,057)
Income tax benefit (provision)	15,146	(904)	14,242	37,517	(2,783)	34,734
Net loss	(2,962)	1,463	(1,499)	(7,402)	4,479	(2,923)
Earnings (loss) per common share						
Basic	$(0.07)	$0.03	$(0.04)	$(0.19)	$0.11	$(0.08)
Diluted	$(0.07)	$0.03	$(0.04)	$(0.19)	$0.11	$(0.08)

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.

Table of Content

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

Derivatives are not used for trading or speculative purposes. Most of our derivatives are with one counterparty, which is a major international financial institution, with whom we have a master netting agreement; 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 other comprehensive income (loss).

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 three to five years for equipment, computers, 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. 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 have no assets held for sale.

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree results of operations are also included as of the date of acquisition in the

consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and development (IPR&D), are measured and recorded at fair value. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recorded at fair value. If not practicable, such assets and liabilities are measured and recorded when it is probable that a gain or loss has occurred and the amount can be reasonably estimated. We will capitalize any future IPR&D as an intangible asset and amortize the balance over its estimated useful life (prior to January 1, 2009, we expensed acquired IPR&D in accordance with U.S. GAAP in effect at that time). The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs will be expensed as incurred. Restructuring costs are generally expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period are recognized as a component of provision for income taxes.

Goodwill and Intangible Assets

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

Table of Content

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 incremental 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 the 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 gross profit. The long-term warranty balance includes estimated warranty claims beyond one year. Warranty expense is classified within cost of revenues.

Contingencies

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

Bonus and Profit Sharing

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

Defined Benefit Pension Plans

We sponsor both funded and unfunded non-U.S. defined benefit pension plans. We recognize a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. We also recognize the funded status of our defined benefit pension plans on our Consolidated Balance Sheets and recognize as a component of other comprehensive income, 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.

Revenue Recognition

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

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, there is vendor-specific objective evidence (VSOE) of fair value of both the delivered and undelivered item(s), 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) collectibility 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 software arrangements with multiple elements, revenue recognition is also dependent upon the availability of VSOE of 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. 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. 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 in our Consolidated Statements of Operations.

Table of Content

Unearned revenue is recorded when a customer pays for products or services where the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of $39.7 million and $29.4 million at September 30, 2009 and December 31, 2008 related 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 for which 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. Deferred costs were $17.5 million and $11.0 million at September 30, 2009 and December 31, 2008.

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 issued pursuant to our Employee Stock Purchase Plan (ESPP), and the issuance of restricted and unrestricted stock awards and units based on estimated fair values. The fair values of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected life. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the vesting requirement. A substantial portion of our stock-based compensation cannot be expensed for tax purposes. 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. Included in the net carrying amount is any unamortized premium or discount from the original issuance of the debt. Due to the particular characteristics of our convertible notes, upon conversion or derecognition of our convertible notes, we recognize a gain or loss for the difference between the fair value of the consideration transferred to the holder that is allocated to the liability component, which is equal to the fair value of the liability component immediately prior to extinguishment, and the net carrying amount of the liability component (including any unamortized discount and debt issuance costs). In the case of an induced conversion, a loss is recognized for the amount of the fair value of the securities or other consideration transferred to the holder in excess of fair value of the consideration issuable in accordance with the original conversion terms of the debt.

Income Taxes

The two primary objectives related to accounting for income taxes are to 1) recognize the amount of taxes payable or refundable for the current year and 2) recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our financial statements or tax returns. Deferred income taxes are recorded for the temporary differences between the financial reporting basis and tax basis of our assets and liabilities in each of the tax jurisdictions in which we operate. These deferred income taxes are measured using the tax rates expected to be in effect when the temporary differences reverse. We establish a valuation allowance related to a deferred income tax asset when we believe it is more likely than not that a portion of such asset will not be realized. Deferred income tax liabilities have not been recorded 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.

We recognize and measure tax positions taken, or expected to be taken, in a tax return that affect amounts in our financial statements. 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. We classify interest expense and penalties related to uncertain tax positions and interest income on tax overpayments as part of income tax expense.

Table of Content

Foreign Exchange

Our condensed consolidated financial statements are reported in U.S. dollars. Assets and liabilities of international subsidiaries with a non-U.S. dollar functional currency are translated to U.S. dollars at the exchange rates in effect on the balance sheet date, or the last business day of the period, if applicable. Gains and losses that arise from exchange rate fluctuations for asset and liability balances that are not denominated in an entity's functional currency are included in the Consolidated Statements of Operations. Currency gains and losses of intercompany balances deemed to be long-term in nature or designated as a hedge of the net investment in international subsidiaries are included, net of tax, in accumulated other comprehensive income in shareholders' equity. 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 accumulated other comprehensive income in shareholders' equity.

Fair Value Measurements

The 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). For fair value measurements using Level 3 inputs, a reconciliation of the beginning and ending balances is required. The effective date for applying the fair value measurement criteria in accordance with FASB ASC 820-10-20, Fair Value Measurements, was January 1, 2009 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

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.

Reclassifications

See Change in Accounting Principle for the impact of the adoption of FSP 14-1.

New Accounting Pronouncements

In December 2008, the FASB issued FSP FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets, which amends Statement of Financial Accounting Standards (SFAS) 132(R), Employer's Disclosures about Pensions and Other Postretirement Benefits, to require additional fair value disclosures about assets held in an employer's defined benefit pension or other postretirement plan. This FSP is effective for our December 31, 2009 Annual Report on Form 10-K. (The guidance in FSP FAS 132(R)-1 is now embedded within ASC 715.)

In June 2009, the FASB issued SFAS 167, Amendments to FASB Interpretation No. 46(R). This Statement requires an enterprise to perform additional analyses to assess variable interest entities (VIE's) and the enterprise's involvement with these entities, as well provide additional disclosures. SFAS 167 will be effective for Itron on January 1, 2010. We do not expect SFAS 167 to have a material impact to our consolidated financial statements. (The guidance in SFAS 167 is now embedded within ASC 810.)

The FASB issued Accounting Standards Update (ASU) 2009-5, Measuring Liabilities at Fair Value (ASU 2009-5), in August 2009. ASU 2009-5 reaffirms that fair value measurement of a liability assumes the transfer of a liability to a market participant as of the measurement date and is therefore presumed to continue and is not settled with the

counterparty. This ASU also states that the fair value measurement of a liability includes nonperformance risk and that such risk does not change after transfer of the liability. ASU 2009-5 will be effective for us on October 1, 2009, and we do not expect it to have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Tax Force) (ASU 2009-13). The objective of ASU 2009-13 is to address the accounting for multiple-deliverable arrangements (previously known as EITF 00-21) to enable vendors to account for more products or services separately rather than as a combined unit. The hierarchy for establishing a selling price has been increased and consists of the following: (1) vendor specific objective evidence (VSOE), if available, (2) third party evidence (TPE), if VSOE is not available, and (3) estimated selling price, if VSOE and TPE are not available. The amendments in ASU 2009-13 will also (1) replace the term fair value with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a market-place participant; and (2) eliminate the residual value method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. ASU 2009-13 also requires additional disclosures about an entity's multiple-deliverable contracts. ASU 2009-13 is effective for us on January 1, 2011, with early adoption permitted. We are currently considering an early adoption of this guidance on January 1, 2010, to be applied on a prospective basis. We do not expect ASU 2009-13 to have a material impact on our consolidated financial statements.

Concurrent with the issuance of ASU 2009-13, the FASB issued 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). ASU 2009-14 affects revenue arrangements that include both tangible products and software elements, and it provides a scope exception from software revenue recognition guidance in ASC 985-605 (previously known as SOP 97-2) for tangible products containing software and non-software components that function together to deliver the tangible product's essential functionality. Revenue arrangements that are affected by this guidance will still be subject to the disclosure requirements of ASU 2009-13, as applicable. ASU 2009-14 is effective for us on January 1, 2011, with early adoption permitted. We are currently considering an early adoption of this guidance on January 1, 2010, to be applied on a prospective basis. ASU 2009-14 may impact the timing of revenue for our tangible hardware products sold under new arrangements in the future.

Table of Content

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,	
	2009	2008	2009	2008
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	$ (2,962)	$ 5,600	$ (7,402)	$ 17,642
Weighted average common shares outstanding - Basic	40,039	34,385	38,003	32,632
Dilutive effect of stock-based awards	-	760	-	762
Dilutive effect of convertible notes	-	1,727	-	1,597
Weighted average common shares outstanding - Diluted	40,039	36,872	38,003	34,991
Basic earnings (loss) per common share	$ (0.07)	$ 0.16	$ (0.19)	$ 0.54
Diluted earnings (loss) per common share	$ (0.07)	$ 0.15	$ (0.19)	$ 0.50

Common Stock

During the first quarter of 2009, we completed exchanges with certain holders of our convertible notes in which we issued, in the aggregate, approximately 2.3 million shares of common stock valued at $132.9 million, in exchange for, in the aggregate, $121.0 million principal amount of the convertible notes. See Note 6 for a further discussion.

On June 3, 2009, we completed a public offering of approximately 3.2 million shares of common stock for net proceeds of $160.4 million.

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. As a result of our net loss for the nine months ended September 30, 2009, there was no dilutive effect to the weighted average common shares outstanding. Approximately 1.0 million and 268,000 stock-based awards were excluded from the calculation of diluted EPS for the three months ended September 30, 2009 and 2008, and approximately 1.0 million and 170,000 stock-based awards were excluded from the calculation of diluted EPS for the nine months ended September 30, 2009 and 2008 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Convertible Notes

We are required, pursuant to the indenture for the convertible notes, to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares, or a combination. We include 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, 2009 and 2008 were used as the basis for determining the dilutive effect on EPS. The average price of our common stock for 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 EPS. The average price of our common stock for the three and nine months ended September 30, 2008 exceeded the conversion price of $65.16 and, therefore, approximately 1.7 million and 1.6 million shares, respectively, were included as dilutive shares in the calculation of diluted EPS.

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, rates, and subject to such adjustments as set by the Board of Directors. There was no preferred stock sold or outstanding at September 30, 2009 and December 31, 2008.

Table of Content

Note 3: Certain Balance Sheet Components

Accounts receivable, net	At September 30, 2009	At December 31, 2008
	(in thousands)	
Trade receivables (net of allowance of $6,904 and $5,954)	$ 304,443	$ 306,593
Unbilled revenue	20,676	14,685
Total accounts receivable, net	$ 325,119	$ 321,278

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

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(in thousands)			
Beginning balance	$ 7,271	$ 6,408	$ 5,954	$ 6,391
Actaris acquisition opening balance/adjustments	-	-	-	(471)
Provision for (release of) doubtful accounts, net	(378)	314	1,512	1,057
Accounts written off	(112)	(105)	(748)	(661)
Effects of change in exchange rates	123	(313)	186	(12)
Ending balance, September 30	$ 6,904	$ 6,304	$ 6,904	$ 6,304

Inventories	At September 30, 2009	At December 31, 2008
	(in thousands)	
Materials	$ 90,836	$ 85,153
Work in process	18,186	14,556
Finished goods	68,744	64,501
Total inventories	$ 177,766	$ 164,210

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 $13.6 million and $19.1 million at September 30, 2009 and December 31, 2008, respectively.

Property, plant, and equipment, net	At September 30, 2009	At December 31, 2008
	(in thousands)	
Machinery and equipment	$ 232,778	$ 195,677
Computers and purchased software	65,131	58,505
Buildings, furniture, and improvements	142,915	132,195
Land	37,522	33,702
Construction in progress, including purchased equipment	20,139	30,632
Total cost	498,485	450,711
Accumulated depreciation	(182,518)	(142,994)
Property, plant, and equipment, net	$ 315,967	$ 307,717

Depreciation expense was $14.3 million and $13.5 million for the three months ended September 30, 2009 and 2008, and $41.0 million and $40.2 million for each of the nine months ended September 30, 2009 and 2008, respectively.

Table of Content

Note 4: Intangible Assets

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

	At September 30, 2009			At December 31, 2008		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$ 401,827	$ (232,546)	$ 169,281	$ 394,912	$ (188,953)	$ 205,959
Customer contracts and relationships	310,356	(84,726)	225,630	299,928	(56,966)	242,962
Trademarks and trade names	78,250	(55,552)	22,698	76,766	(45,851)	30,915
Other	24,799	(23,272)	1,527	24,630	(22,580)	2,050
Total intangible assets	$ 815,232	$ (396,096)	$ 419,136	$ 796,236	$ (314,350)	$ 481,886

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Beginning balance, intangible assets, gross	$ 792,551	$ 864,049	$ 796,236	$ 895,979
Adjustment of previous acquisitions	-	-	-	(70,048)
Effect of change in exchange rates	22,681	(49,053)	18,996	(10,935)
Ending balance, intangible assets, gross	$ 815,232	$ 814,996	$ 815,232	$ 814,996

During the first quarter of 2008, intangible assets were adjusted by $70.0 million based on our completion of the fair value assessment associated with the Actaris Metering Systems SA (Actaris) acquisition in 2007.

Intangible assets are recorded in the functional currency of our international subsidiaries; therefore, the carrying amount of intangible assets increase or decrease, with a corresponding change in accumulated other comprehensive income, due to changes in foreign currency exchange rates. Intangible asset amortization expense was $25.1 million and $30.4 million for the three months ended September 30, 2009 and 2008, and $72.8 million and $93.1 million for the nine months ended September 30, 2009 and 2008, respectively.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)
2009 (amount remaining at September 30, 2009)	$ 25,609
2010	74,253
2011	63,550
2012	49,201
2013	39,901

Beyond 2013		166,622
Total intangible assets, net	$	419,136

12

Table of Content

Note 5: Goodwill

The following table reflects goodwill allocated to each reporting segment at September 30, 2009 and 2008:

	Itron North America	Itron International	Total Company
		(in thousands)	
Goodwill balance at January 1, 2008	$ 185,869	$ 1,080,264	$ 1,266,133
Adjustment of previous acquisitions	-	55,370	55,370
Effect of change in exchange rates	(663)	(3,936)	(4,599)
Goodwill balance at September 30, 2008	$ 185,206	$ 1,131,698	$ 1,316,904
Goodwill balance at January 1, 2009	$ 184,535	$ 1,101,318	$ 1,285,853
Adjustment of previous acquisitions	2,100	-	2,100
Effect of change in exchange rates	1,232	34,747	35,979
Goodwill balance at September 30, 2009	$ 187,867	$ 1,136,065	$ 1,323,932

In 2009, we made refinements to our management reporting and geographic reporting structure between our International and North America operations. Itron North America now includes sales of gas and water meters in North America, which were previously part of Itron International. The allocation of goodwill to our reporting units is based on our current segment reporting structure; therefore we have reallocated $57.5 million between the operating segments. Historical segment information has been restated from the segment information previously provided to conform to our current segment reporting structure after the refinement.

In 2009, $2.1 million of contingent consideration became payable associated with two acquisitions in 2006, which is reflected as adjustment of previous acquisitions.

In 2008, the adjustment of previous acquisitions represents an adjustment to goodwill associated with the 2007 Actaris acquisition based on our final determination of fair values of certain assets acquired and liabilities assumed.

Note 6: Debt

The components of our borrowings are as follows:

	At September 30, 2009	At December 31, 2008
	(in thousands)	
Term loans		
USD denominated term loan	$ 301,205	$ 375,744
EUR denominated term loan	316,981	360,494
Convertible senior subordinated notes	205,758	306,337
Senior subordinated notes	-	109,192
	823,944	1,151,767
Current portion of long-term debt	(10,953)	(10,769)
Total long-term debt	$ 812,991	$ 1,140,998

Table of Content

Credit Facility

The Actaris acquisition in 2007 was financed in part by a $1.2 billion credit facility. The credit facility, dated April 18, 2007, was composed of a $605.1 million first lien U.S. dollar denominated term loan; a €335 million first lien euro denominated term loan; a £50 million first lien pound sterling denominated term loan (collectively the term loans); and a $115 million multicurrency revolving line-of-credit (revolver). Our loan balances denominated in currencies other than the U.S. dollar fluctuate due to currency exchange rates. The principal balance of our euro denominated term loan at September 30, 2009 and December 31, 2008 was €216.6 million and €254.1 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 3.75% at September 30, 2009 and 1.75% at December 31, 2008. Our interest rates were 4.02% for the U.S. dollar denominated and 4.87% for the euro denominated term loans at September 30, 2009. Scheduled amortization of principal payments is 1% per year (0.25% quarterly) with an excess cash flow provision for additional annual principal repayment requirements. Maturities of the term loans and multicurrency revolver are seven years and six years from the date of issuance, respectively. The credit facility is secured by substantially all of the assets of Itron, Inc., our operating subsidiaries, except our international 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. On April 24, 2009, we amended our credit facility to adjust the maximum total leverage ratio and the minimum interest coverage ratio thresholds to increase operational flexibility. The amendment also allows us to seek a $75 million increase to the $115 million multicurrency revolving line-of-credit without further amendment. The current lending participants may then choose to increase their level of participation or approve the participation of additional lenders. (The amendment was filed with the SEC on April 27, 2009 as Exhibit 4.1 to our Current Report on Form 8-K.) Prepaid debt fees of approximately $3.7 million were capitalized for the amendment and legal and advisory fees of $1.5 million were expensed as the amendment did not substantially modify the original terms of the loan. At September 30, 2009, we were in compliance with the debt covenants under this credit facility.

At September 30, 2009, there were no borrowings outstanding under the revolver and $48.4 million was utilized by outstanding standby letters of credit resulting in $66.6 million being available for additional borrowings.

We repaid $57.0 million and $127.2 million of the term loans during the three and nine months end September 30, 2009, respectively. Repayments of $24.6 million and $369.0 million were made during the three and nine months ended September 30, 2008, respectively.

Senior Subordinated Notes

In May 2004, we issued $125 million of 7.75% senior subordinated notes (subordinated notes), which were discounted to a price of 99.265 to yield 7.875%. On July 17, 2009, we paid $113.2 million, including accrued interest of $1.5 million, to redeem all of our subordinated notes. The subordinated notes had a remaining principal value of $109.6 million and were due May 2012. We redeemed the notes at 101.938% of the principal amount, 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.

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 and events are met, 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 (filed with the SEC on November 6, 2006 as Exhibit 4.16 to our Quarterly Report on Form 10-Q):

- 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;
- between July 1, 2011 and August 1, 2011, and any time after August 1, 2024;
- 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 conversion value of the convertible notes;
- if the convertible notes are called for redemption;
- if a fundamental change occurs; or
- upon the occurrence of defined corporate events.

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, 2009 was $64.14.

Table of Content

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

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

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

The convertible notes are unsecured, subordinated to our credit facility (senior secured borrowings), and are guaranteed by all of our operating subsidiaries, except for our international subsidiaries. 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, 2009.

As our stock price is subject to fluctuation, the contingent conversion threshold may be triggered during any quarter, prior to July 2011, and the notes become convertible. At September 30, 2009 and December 31, 2008, the contingent conversion threshold was not exceeded and, therefore, the aggregate principal amount of the convertible notes is included in long-term debt.

On January 1, 2009, we adopted FSP 14-1, which requires the convertible debt to be separated between its liability and equity components, in a manner that reflects our non-convertible debt borrowing rate and must be applied retroactively to all periods presented. Our non-convertible debt borrowing rate at the time of the issuance of our convertible notes was determined to be 7.38%, which also reflects the effective interest rate on the liability component. See Note 1 for disclosure about the financial statement impact of our adoption of FSP 14-1.

The carrying amounts of the debt and equity components are as follows:

	At September 30, 2009	At December 31, 2008
	(in thousands)	
Face value of convertible debt	$ 223,604	$ 344,588
Unamortized discount	(17,846)	(38,251)
Net carrying amount of debt component	$ 205,758	$ 306,337
Carrying amount of equity component	$ 31,831	$ 41,177

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, 2009	2008	Nine Months Ended September 30, 2009	2008
	(in thousands)			
Contractual interest coupon	$ 1,398	$ 2,156	$ 4,442	$ 6,469
Amortization of the discount on the liability component	2,367	3,393	7,262	9,995

Total interest expense	$ 3,765	$ 5,549	$ 11,704	$ 16,464

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 21 months.

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

Table of Content

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, 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 sold under the exchange agreement and the value of the shares 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). As required by FSP 14-1, upon derecognition of the convertible notes, we remeasured the fair value of the liability and equity components using a borrowing rate for similar non-convertible debt that would be applicable to us at the date of the exchange agreements. Because borrowing rates increased, the remeasurement of the components of the convertible notes resulted in a gain on extinguishment of $13.4 million (the revaluation gain). As a result, we recognized a net loss on extinguishment of debt of $10.3 million, calculated as the inducement loss, plus an allocation of advisory fees less the revaluation gain.

Prepaid Debt Fees & Accrued Interest Expense

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 using the effective interest method. When debt is repaid early, or first becomes convertible as in the case of our convertible notes, the related portion of unamortized prepaid debt fees is written-off and included in interest expense. Total unamortized prepaid debt fees were $10.4 million and $12.9 million at September 30, 2009 and December 31, 2008, respectively. Accrued interest expense was $900,000 and $4.5 million at September 30, 2009 and December 31, 2008, respectively.

Note 7: Derivative Financial Instruments and Hedging Activities

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

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as “Level 2”), as defined by 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, 2009 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, 2009. 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. We have considered our own nonperformance risk by discounting our derivative liabilities to reflect the potential credit risk to our counterparty by 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, 2009 and December 31, 2008 are as follows:

	Balance Sheet Location	Fair Value	
		At September 30, 2009	At December 31, 2008
Asset Derivatives		(in thousands)	
Derivatives not designated as hedging instruments under ASC 815-20			

Foreign exchange forward contracts	Other current assets	$	292	$	-
Liability Derivatives					
Derivatives designated as hedging instruments under ASC 815-20					
Interest rate swap contracts	Other current liabilities	$	(13,141)	$	(8,772)
Interest rate swap contracts	Long-term other obligations		(4,997)		(8,723)
Euro denominated term loan *	Current portion of long-term debt		(4,902)		(4,752)
Euro denominated term loan *	Long-term debt		(312,079)		(355,742)
Total derivatives designated as hedging instruments under Subtopic 815-20		$	(335,119)	$	(377,989)
Derivatives not designated as hedging instruments under ASC 815-20					
Foreign exchange forward contracts	Other current liabilities	$	(1,096)	$	(67)
Total liability derivatives		$	(336,215)	$	(378,056)

* 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 the carrying value in the Consolidated Balance Sheets and not recorded at fair value.

Table of Content

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

	2009	2008
	(in thousands)	
Net unrealized loss on hedging instruments at January 1,	$(29,734)	$(26,503)
Unrealized gain (loss) on derivative instruments	(5,906)	1,520
Unrealized loss on a nonderivative hedging instrument	(5,676)	(8)
Realized (gains) losses reclassified into net income (loss)	6,025	(294)
Net unrealized loss on hedging instruments at September 30,	$(35,291)	$(25,285)

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 borrowing rates on our floating rate 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 interest rate to a fixed interest rate, as follows:

Transaction Date	Effective Date of Swap	Notional amount (in thousands)	Fixed Interest Rate
June 26, 2008	June 30, 2008 - June 30, 2009	$ 200,000	3.01%
October 27, 2008	June 30, 2009 - June 30, 2010	$ 200,000	2.68%
July 1, 2009	June 30, 2010 - June 30, 2011	$ 100,000	2.15%
July 1, 2009	June 30, 2010 - June 30, 2011	$ 100,000	2.11%

At September 30, 2009, our U.S. dollar term loan had a balance of $301.2 million. 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 $4.0 million, which was based on the Bloomberg U.S. dollar swap yield curve as of September 30, 2009.

In 2007, we entered into a pay-fixed 6.59% receive three-month Euro Interbank Offered Rate (EURIBOR) amortizing interest rate swap to convert a significant portion of our euro denominated variable-rate term loan to fixed-rate debt. 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 $280.4 million (€191.6 million) at September 30, 2009. The amount of net losses expected to be reclassified into earnings in the next 12 months is approximately $9.1 million (€6.2 million), which was based on the Bloomberg U.S. dollar swap yield curve as of September 30, 2009.

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

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

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)		
			Location	Amount		Location	Amount	
	2009	2008		2009	2008		2009	2008
	(in thousands)			(in thousands)			(in thousands)	
Three months ended September 30								
Interest rate swap contracts	$ (3,588)	$ (4,257)	Interest expense	$ (3,808)	$ 111	Interest expense	$ (88)	$ -
Nine months ended September 30								
Interest rate swap contracts	$ (9,753)	$ 2,459	Interest expense	$ (9,970)	$ 479	Interest expense	$ (272)	$ -

17

Table of Content

Net Investment Hedges

We are exposed to foreign exchange risk through our international subsidiaries. As a result of our acquisition of an international company, 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 is reduced each quarter as a result of repayments and was $317.0 million (€216.6 million) at September 30, 2009. 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 is as follows:

Nonderivative Financial Instruments in ASC 815-20 Net Investment Hedging Relationships	Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Gain (loss) recognized in OCI on derivative (Effective Portion)		(in thousands)		
Before tax	$ (13,770)	$ 32,043	$ (9,157)	$ (366)
Net of tax	$ (8,533)	$ 19,934	$ (5,686)	$ (8)

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk through our intercompany financing transactions. At each period end, foreign currency monetary assets and liabilities, including intercompany balances, are revalued with the change recorded to other income and expense. In the second quarter of 2008, we began entering into monthly foreign exchange forward contracts, not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain foreign currency balances of intercompany financing transactions. During the nine months ended September 30, 2009, we entered into approximately 50 foreign currency option and forward transactions. The notional amounts of the contracts ranged from less than $1 million to $44 million, offsetting our exposures primarily from the euro, British pound, Czech koruna, and Hungarian forint.

During 2007, we entered into a cross currency interest rate swap for the purpose of converting our £50 million pound sterling denominated term loan and the pound sterling LIBOR variable interest rate to a U.S. dollar denominated term loan and a U.S. LIBOR interest rate (plus an additional margin of 210 basis points), which was not designated as an accounting hedge. The cross currency interest rate swap had terms similar to the pound sterling denominated term loan, including expected prepayments. This instrument was intended to reduce the impact of volatility between the pound sterling and the U.S. dollar. Therefore, gains and losses were recorded in other income and expense as an offset to the gains (losses) on the underlying term loan revaluation to the U.S. dollar. The amounts paid or received on the interest rate swap were recognized as adjustments to interest expense. In the second quarter of 2008, we repaid the £50 million pound sterling denominated loan.

The effect of our foreign exchange forward and cross currency swap derivative instruments on the Consolidated Statements of Operations for the three and nine months ended September 30 is as follows:

Derivatives Not Designated as Hedging Instrument under ASC 815-20	Gain (Loss) Recognized on Derivatives in Other Income (Expense)
	Nine Months Ended September 30,

	Three Months Ended September 30,			
	2009	2008	2009	2008
	(in thousands)			
Foreign exchange forward contracts	$ (1,976)	$ 1,712	$ (2,503)	$ 1,253
Cross currency interest rate swap	-	-	-	(1,709)
	$ (1,976)	$ 1,712	$ (2,503)	$ (456)

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded non-U.S. defined benefit pension plans offering death and disability, retirement, and special termination benefits to employees in Germany, France, Spain, Italy, Belgium, Chile, Portugal, Hungary, and Indonesia. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2008.

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. Our expected contribution assumes that actual plan asset returns are consistent with our expected rate of return and that interest rates remain constant. For 2009, we expect to contribute a total of $500,000 to our defined pension benefit plans with the majority payable in the fourth quarter. For the three and nine months ended September 30, 2009, we contributed approximately $49,000 and $101,000, respectively, to the defined benefit pension plans. For the three and nine months ended September 30, 2008, we contributed approximately $33,000 and $126,000, respectively, to the defined benefit pension plans.

Table of Content

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Service cost	$ 457	$ 438	$ 1,325	$ 1,616
Interest cost	933	955	2,673	2,825
Expected return on plan assets	(74)	(78)	(215)	(230)
Amortization of actuarial net gain	(106)	(44)	(288)	(119)
Amortization of unrecognized prior service costs	7	13	20	44
Net periodic benefit cost	$ 1,217	$ 1,284	$ 3,515	$ 4,136

Note 9: Stock-Based Compensation

We record stock-based compensation expense for awards of stock options, stock issued 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 months ended September 30, 2009 and 2008, stock-based compensation expense was $4.2 million and $4.5 million and the related tax benefit was $1.0 million and $1.1 million, respectively. For the nine months ended September 30, 2009 and 2008, stock-based compensation expense was $13.4 million and $12.5 million and the related tax benefit was $3.5 million and $2.9 million, respectively. We have not capitalized any stock-based compensation expense. 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 (1) Nine Months Ended September 30,	
	2009	2008
Dividend yield	-	-
Expected volatility	50.2 %	44.8 %
Risk-free interest rate	1.8 %	3.0 %
Expected life (years)	4.91	4.49

	ESPP			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Dividend yield	-	-	-	-
Expected volatility	51.9 %	36.8 %	75.8 %	52.6 %
Risk-free interest rate	0.2 %	1.9 %	0.4 %	2.2 %
Expected life (years)	0.25	0.25	0.25	0.25

(1) There were no Employee Stock Options granted during the three months ended September 30, 2009 and 2008.

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 include historical experience of similar awards, with consideration to the 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 Content

Subject to stock splits, dividends, and other similar events, 5,875,000 shares of common stock are reserved and authorized for issuance under our Amended and Restated 2000 Stock Incentive Plan. Of the authorized shares under the plan, no more than 1.0 million shares can be issued as non-stock options (awards). Awards consist of restricted stock units, restricted stock awards, and unrestricted stock awards. At September 30, 2009, shares available for issuance under the plan as either options or awards were 450,638.

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.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. No stock options were granted during the three months ended September 30, 2009 and 2008. The weighted average grant date fair values of the stock options granted during the nine months ended September 30, 2009 and 2008 were $57.96 and $39.07 per share, respectively. Compensation expense related to stock options for the three months ended September 30, 2009 and 2008 was $1.6 million and $2.2 million, and for the nine months ended September 30, 2009 and 2008 was $6.2 million and $6.8 million, respectively. 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, 2009 and 2008 is as follows:

	Shares (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2008	1,561	$ 37.81	6.98	$ 90,769
Granted	247	95.79		
Exercised	(399)	26.37		
Forfeited	(19)	46.71		
Outstanding, September 30, 2008	1,390	51.26	7.25	$ 53,578
Exercisable and expected to vest, September 30, 2008	1,324	$ 49.90	7.16	$ 52,683
Exercisable, September 30, 2008	804	$ 34.88	6.12	$ 43,182
Outstanding, January 1, 2009	1,374	$ 51.53	6.99	$ 25,809
Granted	50	57.96		
Exercised	(134)	20.20		
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

The aggregate intrinsic value in the table above 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, 2009, total unrecognized stock-based compensation expense related to nonvested stock options was approximately $7.2 million, which is expected to be recognized over a weighted average period of approximately 18 months. During the three months ended September 30, 2009 and 2008, the total intrinsic value of stock options exercised was $4.2 million and $12.9 million, respectively. During the nine months ended September 30, 2009 and 2008, the total intrinsic value of stock options exercised was $4.6 million and $28.2 million, respectively.

Table of Content

Restricted Stock Units
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.

Upon 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 employee upon vesting of the restricted awards. Total compensation expense recognized for restricted awards was $2.3 million and $2.0 million for the three months ended September 30, 2009 and 2008, and $6.6 million and $5.1 million for the nine months ended September 30, 2009 and 2008. At September 30, 2009, unrecognized compensation expense was $12.0 million, which is expected to be recognized over a weighted average period of approximately 18 months. The total fair value of awards that vested was $298,000 and $1.5 million during the three and nine months ended September 30, 2009, respectively. No awards vested during the three and nine months ended September 30, 2008.

The following table summarizes restricted award activity for the nine months ended September 30, 2009 and 2008:

	Number of Restricted Awards (in thousands)		Weighted-Average Grant Date Fair Value	
Nonvested, January 1, 2008	111		$	66.92
Granted	213			84.53
Forfeited	(12	)		74.08
Nonvested, September 30, 2008	312		$	78.70
Nonvested, January 1, 2009	313		$	78.55
Granted	59			69.44
Vested	(23	)		64.80
Forfeited	(6	)		77.95
Nonvested, September 30, 2009	343		$	73.72

Unrestricted Stock Awards
We issue unrestricted stock awards to our Board of Directors as part of their compensation. Awards are fully vested at issuance and are expensed when issued. The fair value of unrestricted stock awards is the market close price of our common stock on the date of grant. During the three months ended September 30, 2009 and 2008, we issued 2,168 and 1,184 shares of unrestricted stock with a weighted average grant date fair value of $55.27 and $100.74 per share, respectively. During the nine months ended September 30, 2009 and 2008, we issued 4,284 and 2,744 shares of unrestricted stock with a weighted average grant date fair value of $59.40 and $97.94 per share, respectively. The expense related to these awards was $120,000 and $119,000 for the three months ended September 30, 2009 and 2008, and $254,000 and $269,000 for the nine months ended September 30, 2009 and 2008, respectively.

Employee Stock Purchase Plan
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. Under the ESPP, we sold 16,663 and 8,672 shares to employees during the three months ended September 30, 2009 and 2008, and 49,413 and 24,647 shares during the nine months ended September 30, 2009 and 2008, respectively. The fair value of ESPP awards is estimated using the Black-Scholes option-pricing model. The fair value

of the ESPP awards was $9.62 and $16.20 per share for the awards associated with the grant in each of the three month offering periods ended September 30, 2009 and 2008, respectively. The weighted average fair value of the ESPP awards associated with the offering periods during the nine months ended September 30, 2009 and 2008 was $8.13 and $15.94 per share, respectively. The expense related to the ESPP was $115,000 and $138,000 for the three months ended September 30, 2009 and 2008, and $394,000 and $406,000 for the nine months ended September 30, 2009 and 2008, respectively. At September 30, 2009, all compensation cost associated with the ESPP had been recognized. There were approximately 259,000 shares of common stock available for future issuance under the ESPP at September 30, 2009.

Table of Content

Note 10: Income Taxes

Our tax provision (benefit) 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 the forecasted mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits (including research and development and foreign tax), state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items.

Our tax benefits in 2009 and 2008 reflect the benefit of certain interest expense deductions and the election under U.S. Internal Revenue Code Section 338 with respect to the Actaris acquisition in 2007, as well as the forecasted mix of earnings in different tax jurisdictions.

Our tax provision (benefit) as a percentage of income (loss) before tax was (84%) for the three and nine months ended September 30, 2009, compared with 6% and (8%) for the same periods in 2008. We had a tax benefit of $15.1 million in the third quarter of 2009 compared with tax expense of $377,000 in the same quarter of 2008. The benefit in the third quarter of 2009 is due primarily to tax elections regarding the repatriation of foreign earnings and the associated foreign tax credits for years 2007, 2008, and 2009, which were finalized during the quarter. In addition, a decrease in projected pretax income in high tax jurisdictions for the year, net decrease in certain reserves for uncertain tax positions in foreign jurisdictions, and a refund of taxes previously paid in foreign tax audits also contributed to the benefit.

Unrecognized tax benefits related to uncertain tax positions were $45.8 million and $37.6 million at September 30, 2009 and December 31, 2008, respectively. We classify interest expense and penalties related to uncertain tax positions and interest income on tax overpayments as components of income tax expense. We recognized an expense of $558,000 and a benefit of $305,000 during the three months ended September 30, 2009 and 2008, and expenses of $1.9 million and $725,000 during the nine months ended September 30, 2009 and 2008, respectively, in interest and penalties. At September 30, 2009 and December 31, 2008, accrued interest was $4.0 million and $3.2 million, and accrued penalties were $4.0 million and $2.9 million, respectively. Unrecognized tax benefits that would affect our tax provision at September 30, 2009 and December 31, 2008 were $38.6 million and $37.0 million, respectively. At September 30, 2009, we expect to pay $104,000 in income taxes, interest, or penalties related to uncertain tax positions over the next twelve months.

We believe it is reasonably possible that our unrecognized tax benefits may decrease by approximately $10.0 million within the next twelve months due to a change in method of depreciation for certain foreign subsidiaries and a cash payment associated with an international tax audit.

Note 11: Commitments and Contingencies

Guarantees and Indemnifications

We are often required to obtain letters of credit or bonds in support of our obligations for customer contracts. These letters of credit 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. At September 30, 2009, in addition to the outstanding standby letters of credit of $48.4 million issued under our credit facility's $115 million multicurrency revolver, our Itron International operating segment has a total of $31.6 million of unsecured multicurrency revolving lines of credit with various financial institutions with total outstanding standby letters of credit of $7.4 million. At December 31, 2008, Itron International had a total of $28.8 million of unsecured multicurrency revolving lines of credit with various financial institutions with total outstanding standby letters of credit of $6.7 million. Unsecured surety bonds in force were $69.5 million and $33.1 million at September 30, 2009 and December 31, 2008, respectively. In the event any such bonds or letters of credit are called, we would be

obligated to reimburse the issuer of the letter of credit or bond; however, we do not believe that any currently outstanding bonds or letters of credit 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, 2009 were not material to our financial condition or results of operations.

Table of Content

On August 28, 2009, Itron and PT Berca completed a settlement agreement in which litigation against several Itron International subsidiaries and the successor in interest to another company previously owned by Schlumberger Limited (Schlumberger) was dismissed. PT Berca had claimed that it had preemptive rights in the PT Mecoindo joint venture and had sought to nullify the transaction in 2001 whereby Schlumberger transferred its ownership interest in PT Mecoindo to an Itron International subsidiary. The plaintiff also sought to collect damages for the earnings it otherwise would have earned had its alleged preemptive rights been observed. In connection with the settlement, certain portions of the debt of PT Mecoindo were converted to equity and PT Mecoindo was restructured so that Itron and PT Berca became approximately 51:49 owners of PT Mecoindo as of August 28, 2009 and ownership will become equal as of August 28, 2010. This settlement did not, and is not expected to, have a material impact on our financial condition or results of operations.

Health Benefits

We are self insured for a substantial portion of the cost of 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 were approximately $5.4 million and $4.8 million for the three months ended September 30, 2009 and 2008, and approximately $15.4 million and $14.3 million for the nine months ended September 30, 2009 and 2008, respectively. The IBNR accrual, which is included in wages and benefits payable, was $3.4 million and $3.0 million at September 30, 2009 and December 31, 2008, respectively. Our IBNR accrual and expenses may fluctuate due to the number of plan participants, claims activity, and deductible limits. 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.

Warranty

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Beginning balance	$ 34,065	$ 42,184	$ 38,255	$ 32,841
Adjustment of previous acquisition	-	713	-	7,655
New product warranties	2,223	1,856	5,345	5,789
Other changes/adjustments to warranties	1,641	1,318	4,750	5,405
Claims activity	(5,067)	(3,908)	(15,788)	(11,424)
Effect of change in exchange rates	653	(1,563)	953	334
Ending balance, September 30	33,515	40,600	33,515	40,600
Current portion of warranty	(20,751)	(25,911)	(20,751)	(25,911)
Long-term warranty	$ 12,764	$ 14,689	$ 12,764	$ 14,689

Total warranty expense, which consists of new product warranties issued and other changes and adjustments to warranties, totaled approximately $3.9 million and $3.2 million for the three months ended September 30, 2009 and 2008, and approximately $10.1 million and $11.2 million for the nine months ended September 30, 2009 and 2008, respectively.

Note 12: Other Comprehensive Income (Loss)

Other comprehensive income (loss) 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,	
	2009	2008	2009	2008
	(in thousands)			
Net income (loss)	$ (2,962)	$ 5,600	$ (7,402)	$ 17,642
Foreign currency translation adjustment, net	65,895			