

ITRON INC /WA/
Form 10-Q
November 05, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended September 30, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____
Commission file number 000-22418

ITRON, INC.

(Exact name of registrant as specified in its charter)

Washington

(State of Incorporation)

2111 N Molter Road, Liberty Lake, Washington 99019

(509) 924-9900

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

91-1011792

(I.R.S. Employer Identification Number)

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

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

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

Large accelerated filer

Accelerated filer

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

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

As of October 31, 2015 there were outstanding 37,897,742 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

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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,	
	2015	2014	2015	2014
	(in thousands, except per share data)			
Revenues	\$469,092	\$496,454	\$1,387,442	\$1,460,602
Cost of revenues	322,126	345,692	983,706	992,264
Gross profit	146,966	150,762	403,736	468,338
Operating expenses				
Sales and marketing	39,217	44,484	123,302	138,212
Product development	41,559	42,303	126,399	130,711
General and administrative	31,118	36,542	103,195	114,629
Amortization of intangible assets	7,869	10,917	23,730	33,096
Restructuring	(5	) 58	(9,686	) (2,211
Goodwill impairment	—	—	—	977
Total operating expenses	119,758	134,304	366,940	415,414
Operating income	27,208	16,458	36,796	52,924
Other income (expense)				
Interest income	180	163	440	313
Interest expense	(2,799	) (3,015	) (9,336	) (8,837
Other income (expense), net	(1,120	) (1,569	) (3,003	) (5,442
Total other income (expense)	(3,739	) (4,421	) (11,899	) (13,966
Income before income taxes	23,469	12,037	24,897	38,958
Income tax provision	(10,144	) (4,484	) (19,673	) (11,679
Net income	13,325	7,553	5,224	27,279
Net income attributable to noncontrolling interests	630	245	1,817	966
Net income attributable to Itron, Inc.	\$12,695	\$7,308	\$3,407	\$26,313
Earnings per common share - Basic	\$0.33	\$0.19	\$0.09	\$0.67
Earnings per common share - Diluted	\$0.33	\$0.19	\$0.09	\$0.67
Weighted average common shares outstanding - Basic	38,114	39,213	38,329	39,268
Weighted average common shares outstanding - Diluted	38,358	39,493	38,591	39,516

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

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ITRON, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Net income	\$13,325	\$7,553	\$5,224	\$27,279
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(16,700	) (49,391	) (63,934	) (60,760
Foreign currency translation adjustment reclassified into net income on disposal	962	—	962	—
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	(182	) 134	(681	) (344
Net hedging loss reclassified into net income	253	266	761	788
Pension plan benefit liability adjustment	866	98	1,863	313
Total other comprehensive income (loss), net of tax	(14,801	) (48,893	) (61,029	) (60,003
Total comprehensive income (loss), net of tax	(1,476	) (41,340	) (55,805	) (32,724
Comprehensive income attributable to noncontrolling interests, net of tax	630	245	1,817	966
Comprehensive income (loss) attributable to Itron, Inc.	\$(2,106	) \$(41,585	) \$(57,622	) \$(33,690

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

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ITRON, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets		
Cash and cash equivalents	\$ 109,458	\$ 112,371
Accounts receivable, net	340,423	348,389
Inventories	214,237	154,504
Deferred tax assets current, net	35,975	39,115
Other current assets	106,059	104,307
Total current assets	806,152	758,686
Property, plant, and equipment, net		
Deferred tax assets noncurrent, net	190,295	207,789
Other long-term assets	59,830	74,598
Intangible assets, net	27,192	28,503
Goodwill	111,767	139,909
Total assets	474,965	500,820
	\$ 1,670,201	\$ 1,710,305
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	\$ 201,450	\$ 184,132
Other current liabilities	68,140	100,945
Wages and benefits payable	93,206	95,248
Taxes payable	13,210	21,951
Current portion of debt	11,250	30,000
Current portion of warranty	40,060	21,063
Unearned revenue	44,639	43,436
Total current liabilities	471,955	496,775
Long-term debt		
Long-term warranty	369,457	293,969
Pension plan benefit liability	14,684	15,403
Deferred tax liabilities noncurrent, net	94,100	101,432
Other long-term obligations	3,569	3,808
Total liabilities	81,628	84,437
	1,035,393	995,824
Commitments and contingencies		
Equity		
Preferred stock	—	—
Common stock	1,246,177	1,270,045
Accumulated other comprehensive loss, net	(197,543)	(136,514)
Accumulated deficit	(433,184)	(436,591)
Total Itron, Inc. shareholders' equity	615,450	696,940
Noncontrolling interests	19,358	17,541
Total equity	634,808	714,481

Total liabilities and equity	\$ 1,670,201	\$ 1,710,305
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2015	2014
	(in thousands)	
Operating activities		
Net income	\$5,224	\$27,279
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	58,514	75,233
Stock-based compensation	10,879	12,703
Amortization of prepaid debt fees	1,851	1,212
Deferred taxes, net	14,926	(9,787)
Goodwill impairment	—	977
Restructuring, non-cash	1,395	—
Other adjustments, net	1,877	120
Changes in operating assets and liabilities:		
Accounts receivable	(12,401)	(1,576)
Inventories	(73,212)	(23,986)
Other current assets	(4,696)	(5,298)
Other long-term assets	605	(1,396)
Accounts payable, other current liabilities, and taxes payable	(11,666)	19,669
Wages and benefits payable	4,110	6,717
Unearned revenue	4,128	11,800
Warranty	20,280	(3,544)
Other operating, net	(1,660)	6,415
Net cash provided by operating activities	20,154	116,538
Investing activities		
Acquisitions of property, plant, and equipment	(33,324)	(32,060)
Business acquisitions, net of cash and cash equivalents acquired	(5,754)	—
Other investing, net	545	(193)
Net cash used in investing activities	(38,533)	(32,253)
Financing activities		
Proceeds from borrowings	89,709	—
Payments on debt	(30,186)	(68,750)
Issuance of common stock	2,229	2,324
Repurchase of common stock	(35,278)	(15,324)
Other financing, net	1,881	2,395
Net cash provided by (used in) financing activities	28,355	(79,355)
Effect of foreign exchange rate changes on cash and cash equivalents	(12,889)	(7,260)
Decrease in cash and cash equivalents	(2,913)	(2,330)
Cash and cash equivalents at beginning of period	112,371	124,805
Cash and cash equivalents at end of period	\$109,458	\$122,475

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Non-cash transactions:

Property, plant, and equipment purchased but not yet paid	\$690	\$832
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Supplemental disclosure of cash flow information:

Cash paid during the period for:

Income taxes, net	\$22,578	\$8,528
Interest, net of amounts capitalized	7,549	7,536

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

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ITRON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

(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 are a technology company, offering end-to-end smart metering solutions to electric, natural gas, and water utilities around 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 and the Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2015 and 2014, the Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2014 audited financial statements and notes included in our Annual Report on Form 10-K filed with the SEC on February 20, 2015. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation

We consolidate all entities in which we have a greater than 50% ownership interest or in which we exercise control over the operations. We use the equity method of accounting for entities in which we have a 50% or less ownership interest and exercise significant influence. Entities in which we have less than a 20% ownership interest and where we do not exercise significant influence are accounted for under the cost method. Intercompany transactions and balances are eliminated upon consolidation.

Noncontrolling Interests

In several of our consolidated international subsidiaries, we have joint venture partners, who are minority shareholders. Although these entities are not wholly-owned by Itron, we consolidate them because we have a greater than 50% ownership interest or because we exercise control over the operations. The noncontrolling interest balance is adjusted each period to reflect the allocation of net income and other comprehensive income attributable to the noncontrolling interests, as shown in our Consolidated Statements of Operations and our Consolidated Statements of Comprehensive Income (Loss) as well as contributions from and distributions to the owners. The noncontrolling interest balance in our Consolidated Balance Sheets represents the proportional share of the equity of the joint venture entities, which is attributable to the minority shareholders.

Business Acquisition

On August 26, 2015, we completed our acquisition of 100% of Temetra Limited (Temetra) in a stock purchase. Temetra is a technology company focused on meter data management and meter data collection in the water industry with a software-as-a-service business model. The acquisition strengthens Itron's data analytics capabilities and provides water utility customers with additional cloud-based technology options. The acquisition consisted of cash

and contingent consideration. This acquisition is not considered significant to our financial position, results of operations, and cash flows. See Business Combinations policy below.

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.

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. We record an allowance for doubtful accounts representing our estimate of the probable losses in accounts receivable at the date of the balance sheet based on our historical experience of bad debts and our specific review

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of outstanding receivables. 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.

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 are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP. The net fair value of our derivative instruments may switch between a net asset and a net liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position.

For any derivative 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. For any derivative designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) (OCI) and are recognized in earnings when the hedged item affects earnings. Ineffective portions of cash flow hedges are recognized in other income (expense), net in the Consolidated Statements of Operations. For a hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Upon termination of a net investment hedge, the net derivative gain/loss will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated operations. 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), net in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

Derivatives are not used for trading or speculative purposes. Our derivative contract counterparties are credit-worthy multinational commercial banks, with whom we have master netting agreements; however, our derivative positions are not recorded on a net basis in the Consolidated Balance Sheets. There are no credit-risk-related contingent features within our derivative instruments. Refer to Note 7 and Note 13 for further disclosures of our derivative instruments and their impact on OCI.

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 30 years for buildings and improvements and three to ten years for machinery and equipment, computers and software, and furniture. Leasehold improvements are capitalized and depreciated over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Construction in process represents capital expenditures incurred for assets not yet placed in service. Costs related to internally developed software and software purchased for internal uses are capitalized and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset group may not be recoverable. 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. Gains and losses from asset disposals and impairment losses are classified within the Consolidated Statements of Operations according to the use of the asset, except those gains and losses recognized in conjunction with our restructuring activities, which are classified within restructuring.

Prepaid Debt Fees

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

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree's results of operations are also included as of the date of acquisition in our 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, and amortized over the estimated useful life. IPR&D is not

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amortized until such time as the associated development projects are completed or terminated. If a development project is completed, the IPR&D is reclassified as a core technology intangible asset and amortized over its estimated useful life. If the development project is terminated, the recorded value of the associated IPR&D is immediately expensed. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recorded at fair value. If not practicable, such assets and liabilities are measured and recorded when it is probable that a gain or loss has occurred and the amount can be reasonably estimated. The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs are expensed as incurred. Restructuring costs associated with an acquisition are generally expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties, including penalties and interest, after the measurement period are recognized as a component of the provision for income taxes. Our acquisitions may include contingent consideration, which require us to recognize the fair value of the estimated liability at the time of the acquisition. Subsequent changes in the estimate of the amount to be paid under the contingent consideration arrangement are recognized in the Consolidated Statements of Operations. Cash payments for contingent or deferred consideration are classified within cash flows from investing activities within the Consolidated Statements of Cash Flows.

Goodwill and Intangible Assets

Goodwill and intangible assets may result from our business acquisitions. Intangible assets may also result from the purchase of assets and intellectual property in a transaction that does not qualify as a business combination. We use estimates, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations, in determining the value assigned to goodwill and intangible assets. Our finite-lived intangible assets are amortized over their estimated useful lives based on estimated discounted cash flows. IPR&D is considered an indefinite-lived intangible asset and is not subject to amortization until the associated projects are completed or terminated. Finite-lived intangible assets are tested for impairment at the asset group level when events or changes in circumstances indicate the carrying value may not be recoverable. Indefinite-lived intangible assets are tested for impairment annually, when events or changes in circumstances indicate the asset may be impaired, or at the time when their useful lives are determined to be no longer indefinite.

Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the forecasted discounted cash flows associated with each reporting unit. Each reporting unit corresponds with its respective operating segment, effective in the fourth quarter of 2013.

We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. As part of the impairment test, we may elect to perform an assessment of qualitative factors. If this qualitative assessment indicates that it is more likely than not that the fair value of a reporting unit, including goodwill, is less than its carrying amount, or if we elect to bypass the qualitative assessment, we would then proceed with the two-step impairment test. The impairment test involves comparing the fair values of the reporting units to their carrying amounts. If the carrying amount of a reporting unit exceeds its fair value, a second step is required to measure the goodwill impairment loss amount. This second step determines the current fair values of all assets and liabilities of the reporting unit and then compares the implied fair value of the reporting unit's goodwill to the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

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. These combined fair values are then reconciled to the aggregate market value of our common stock on the date of valuation, while considering a reasonable control premium.

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. Loss contingencies that we determine to be reasonably possible, but not probable, are disclosed but not recorded. Changes in these factors and related estimates could materially affect our financial position and results of operations. Legal costs to defend against contingent liabilities are expensed as incurred.

Bonus and Profit Sharing

We have various employee bonus and profit sharing plans, which provide award amounts for the achievement of annual financial and nonfinancial targets. If management determines it is probable that the targets will be achieved, and the amounts can be reasonably estimated, a compensation accrual is recorded based on the proportional achievement of the financial and nonfinancial targets. Although we monitor and accrue expenses quarterly based on our progress toward the achievement of the annual targets,

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the actual results at the end of the year may result in awards that are significantly greater or less than the estimates made in earlier quarters.

Warranty

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

Restructuring

We record a liability for costs associated with an exit or disposal activity under a restructuring project at its fair value in the period in which the liability is incurred. Employee termination benefits considered postemployment benefits are accrued when the obligation is probable and estimable, such as benefits stipulated by human resource policies and practices or statutory requirements. One-time termination benefits are expensed at the date the employee is notified. If the employee must provide future service greater than 60 days, such benefits are expensed ratably over the future service period. For contract termination costs, we record a liability upon the termination of a contract in accordance with the contract terms or the cessation of the use of the rights conveyed by the contract, whichever occurs later.

Asset impairments associated with a restructuring project are determined at the asset group level. An impairment may be recorded for assets that are to be abandoned, are to be sold for less than net book value, or are held for sale in which the estimated proceeds less costs to sell are less than the net book value. We may also recognize impairment on an asset group, which is held and used, when the carrying value is not recoverable and exceeds the asset group's fair value. If an asset group is considered a business, a portion of our goodwill balance is allocated to it based on relative fair value. If the sale of an asset group under a restructuring project results in proceeds that exceed the net book value of the asset group, the resulting gain is recorded within restructuring in the Consolidated Statements of Operations.

Defined Benefit Pension Plans

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

Share Repurchase Plan

From time to time, we may repurchase shares of common stock under programs authorized by our Board of Directors. Share repurchases are made in the open market or in privately negotiated transactions and in accordance with

applicable securities laws. Under applicable Washington State law, shares repurchased are retired and not reported separately as treasury stock on the financial statements; the value of the repurchased shares is deducted from common stock.

Revenue Recognition

Revenues consist primarily of hardware sales, software license fees, software implementation, project management services, installation, consulting, and post-sale maintenance support. Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured.

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The majority of our revenue arrangements involve multiple deliverables, which combine two or more of the following: hardware, meter reading system software, installation, and/or project management services. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) has value to the customer on a standalone basis and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative selling prices and the applicable revenue recognition criteria considered for each 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 for each deliverable are then recognized based on the type of deliverable, such as: 1) when the products are shipped, 2) services are delivered, 3) percentage-of-completion when implementation services are essential to other deliverables in the arrangement, 4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. The majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

Hardware revenues are recognized at the time of shipment, receipt by the customer, or, if applicable, upon completion of customer acceptance provisions.

Generally, network software revenue is recognized when shipped if all other revenue recognition criteria are met and services are not essential to the functionality of the software. If implementation services are essential to the functionality of the network software, software and implementation revenues are recognized using the percentage-of-completion methodology of contract accounting when project costs are reliably estimated.

If the data collection system does not use standard Internet protocols and network design services are deemed complex and extensive, revenue from network software and services is recognized using the units-of-delivery method of contract accounting, as network design services and network software are essential to the functionality of the related hardware (network). This methodology results in the deferral of costs and revenues as professional services and software implementation commence prior to deployment of hardware.

In the unusual instances when we are unable to reliably estimate the cost to complete a contract at its inception, we use the completed contract method of contract accounting. Revenues and costs are recognized upon substantial completion when remaining costs are insignificant and potential risks are minimal.

Under contract accounting, if we estimate that the completion of a contract component (unit of accounting) will result in a loss, the loss is recognized in the period in which the loss becomes evident. We reevaluate the estimated loss through the completion of the contract component and adjust the estimated loss for changes in facts and circumstances.

Many of our customer arrangements contain clauses for liquidated damages, related to the timing of delivery or milestone accomplishments, that could become material in an event of failure to meet the contractual deadlines. At the inception of the arrangement and on an ongoing basis, we evaluate if the liquidating damages represent contingent revenue and, if so, we reduce the amount of consideration allocated to the delivered products and services and record it as a reduction in revenue in the period of default. If the arrangement is subject to contract accounting, liquidated damages resulting from anticipated events of default are estimated and are accounted for as job costs in the period in which the liquidated damages are deemed probable of occurrence and are reasonably estimable.

We also enter into multiple deliverable software arrangements that do not include hardware. For this type of arrangement, revenue recognition is dependent upon the availability of vendor specific objective evidence (VSOE) of fair value for each of the deliverables. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for multiple deliverable software arrangements.

Certain of our revenue arrangements include an extended or noncustomary warranty provision that covers all or a portion of a customer's replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, a portion of the arrangement's total consideration is allocated to this extended warranty deliverable. This revenue is deferred and recognized over the extended warranty coverage period. Extended or noncustomary warranties do not represent a significant portion of our revenue.

We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using VSOE, if it exists, otherwise we use third party evidence (TPE). We define VSOE as a median price of recent standalone transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP) to determine the price at which we would transact if the product or service were regularly sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the

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arrangement. The factors considered include the cost to produce the deliverable, the anticipated margin on that deliverable, our ongoing pricing strategy and policies, and the characteristics of the varying markets in which the deliverable is sold.

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

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of \$78.2 million and \$76.6 million at September 30, 2015 and December 31, 2014 related primarily to professional services and software associated with our smart metering contracts, extended or noncustomary warranty, and prepaid post-contract support. Deferred costs are recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were \$11.7 million and \$24.9 million at September 30, 2015 and December 31, 2014 and are recorded within other assets in the Consolidated Balance Sheets.

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.

Product and Software Development Costs

Product and software development costs primarily include employee compensation and third party contracting fees. We do not capitalize product development costs, and we do not generally capitalize software development expenses as the costs incurred are immaterial for the relatively short period of time between technological feasibility and the completion of software development.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including stock options and the issuance of restricted stock units and unrestricted stock awards, based on estimated fair values. The fair value of stock options is 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 term. For performance-based restricted stock units and unrestricted stock awards with no market conditions, the fair value is the market close price of our common stock on the date of grant. For restricted stock units with market conditions, the fair value is estimated at the date of award using a Monte Carlo simulation model, which includes assumptions for dividend yield and expected volatility for our common stock and the common stock for companies within the Russell 3000 index, as well as the risk-free interest rate and expected term of the awards. We expense stock-based compensation at the date of grant for unrestricted stock awards. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with performance and service conditions, if vesting is probable, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. For awards with a market condition, we expense the fair value over the requisite service period. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Certain of our employees are eligible to participate in our Employee Stock Purchase Plan (ESPP). The discount provided for ESPP purchases is 5% from the fair market value of the stock at the end of each fiscal quarter and is not

considered compensatory.

Income Taxes

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 calculating the estimated annual ETR, we analyze various factors, including the forecast mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and uncertain tax positions, among other items. 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.

Deferred tax assets and liabilities are recognized based upon anticipated future tax consequences, in each of the jurisdictions in which we operate, attributable to: (1) the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases; and (2) operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of our tax liabilities involves applying complex tax regulations in different jurisdictions to our tax positions. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period

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that includes the enactment date. A valuation allowance is recorded to reduce the carrying amount of deferred tax assets if it is more likely than not that such assets will not be realized. We do not record tax liabilities on undistributed earnings of international subsidiaries that are permanently reinvested.

We utilize a two step approach to account for uncertain tax positions. A tax position is first evaluated for recognition based on its technical merits. Tax positions that have a greater than 50% likelihood of being realized upon ultimate settlement are then measured to determine amounts to be recognized in the financial statements. This measurement incorporates information about potential settlements with taxing authorities. A previously recognized tax position is derecognized in the first period in which the position no longer meets the recognition threshold or upon expiration of the statute of limitations. We classify interest expense and penalties related to uncertain tax positions and interest income on tax overpayments as part of income tax expense.

Foreign Exchange

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

Fair Value Measurements

For assets and liabilities measured at fair value, the GAAP fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means. Inputs may include yield curves, volatility, credit risks, and default rates.

Use of Estimates

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

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 is effective for us on January 1, 2018 using either the retrospective or modified-retrospective transition method. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements.

On April 7, 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03), which will require debt issuance costs to be presented in the

balance sheet as a direct deduction from the associated debt liability. ASU 2015-03 is effective for us on January 1, 2016 using the retrospective or transition method, and we plan to adopt on that date. We do not anticipate that ASU 2015-03 will have a material impact to our balance sheet.

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05), which provides guidance about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 is effective for us on January 1, 2016. We are currently evaluating the impact of adopting this guidance.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330) - Simplifying the Measurement of Inventory (ASU 2015-11). The amendments in ASU 2015-11 apply to inventory measured using first-in, first-out (FIFO) or average cost and will require

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entities to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the normal course of business, minus the cost of completion, disposal and transportation. Replacement cost and net realizable value less a normal profit margin will no longer be considered. ASU 2015-11 is effective for us on January 1, 2017. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805) - Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period with a corresponding adjustment to goodwill in the reporting period in which the adjustment amounts are determined. The effect on earnings of changes in depreciation, amortization or other income effects, if any, as a result of the change to the provisional amounts will be recorded in the same period's financial statements, calculated as if the accounting had been completed at the acquisition date. This ASU is effective for fiscal years beginning after December 15, 2015, and early adoption is permitted. The amendments in this update should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update with earlier application permitted for financial statements that have not been issued. We adopted this ASU on October 1, 2015, and we do not anticipate a material impact from adoption.

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Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2014	2014	2014
	(in thousands, except per share data)			
Net income available to common shareholders	\$12,695	\$7,308	\$3,407	\$26,313
Weighted average common shares outstanding - Basic	38,114	39,213	38,329	39,268
Dilutive effect of stock-based awards	244	280	262	248
Weighted average common shares outstanding - Diluted	38,358	39,493	38,591	39,516
Earnings per common share - Basic	\$0.33	\$0.19	\$0.09	\$0.67
Earnings per common share - Diluted	\$0.33	\$0.19	\$0.09	\$0.67

Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 1.1 million and 1.2 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2015, and 2014 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Note 3: Certain Balance Sheet Components

Accounts receivable, net	September 30, 2015 (in thousands)	December 31, 2014
Trade receivables (net of allowance of \$4,959 and \$6,195)	\$298,895	\$312,302
Unbilled receivables	41,528	36,087
Total accounts receivable, net	\$340,423	\$348,389

At September 30, 2015 and December 31, 2014, \$4.5 million and \$4.7 million, respectively, were recorded within trade receivables as billed but not yet paid by customers, in accordance with contract retainage provisions. At September 30, 2015 and December 31, 2014, contract retainage amounts that were unbilled and classified as unbilled receivables were \$4.7 million and \$4.0 million, respectively. These contract retainage amounts within trade receivables and unbilled receivables are expected to be collected within the following 12 months.

At September 30, 2015 and December 31, 2014, long-term unbilled receivables totaled \$3.8 million and \$4.3 million, respectively. These long-term unbilled receivables are classified within other long-term assets, as collection is not anticipated within the following 12 months. We had no long-term billed contract retainage receivables at September 30, 2015 and December 31, 2014.

Allowance for doubtful accounts activity Three Months Ended September 30, Nine Months Ended September 30,

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	2015	2014	2015	2014
	(in thousands)			
Beginning balance	\$5,422	\$7,355	\$6,195	\$8,368
Provision (release) for doubtful accounts, net	(141) (356) (111) (545
Accounts written-off	(162	) (233	) (503	) (1,023
Effect of change in exchange rates	(160) (242) (622) (276
Ending balance	\$4,959	\$6,524	\$4,959	\$6,524

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Inventories	September 30, 2015 (in thousands)	December 31, 2014
Materials	\$123,730	\$90,557
Work in process	10,193	8,991
Finished goods	80,314	54,956
Total inventories	\$214,237	\$154,504

Our inventory levels may vary from period to period as a result of our factory scheduling and the timing of contract fulfillments, which may include the buildup of materials in preparation for customer orders or finished goods for shipment.

Consigned inventory is held at third party locations; however, we retain title to the inventory until it is purchased by the third party. Consigned inventory, consisting of raw materials and finished goods, was \$3.0 million and \$2.5 million at September 30, 2015 and December 31, 2014, respectively.

Property, plant, and equipment, net	September 30, 2015 (in thousands)	December 31, 2014
Machinery and equipment	\$278,609	\$287,448
Computers and software	107,328	100,212
Buildings, furniture, and improvements	130,009	134,461
Land	20,758	21,186
Construction in progress, including purchased equipment	24,784	21,007
Total cost	561,488	564,314
Accumulated depreciation	(371,193)	(356,525)
Property, plant, and equipment, net	\$190,295	\$207,789

Assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts of these assets increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates. In addition, depreciation expense is impacted by the fluctuations in foreign exchange rates.

Depreciation expense	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Depreciation expense	\$11,885	\$13,691	\$34,784	\$42,118

Note 4: Intangible Assets

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

	September 30, 2015			December 31, 2014		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	\$392,667	\$(357,007)	\$35,660	\$405,434	\$(359,500)	\$45,934
Customer contracts and relationships	242,627	(168,552)	74,075	262,930	(172,755)	90,175
Trademarks and trade names	64,808	(62,884)	1,924	68,205	(64,905)	3,300

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Other	11,131	(11,023) 108	11,579	(11,079) 500
Total intangible assets	\$711,233	\$(599,466) \$111,767	\$748,148	\$(608,239) \$139,909

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A summary of intangible asset activity is as follows:

	Nine Months Ended September 30,	
	2015	2014
	(in thousands)	
Beginning balance, intangible assets, gross	\$748,148	\$804,281
Intangible assets acquired	4,827	1,453
Intangible assets impaired	(497) —
Effect of change in exchange rates	(41,245	) (35,742
Ending balance, intangible assets, gross	\$711,233	\$769,992

Intangible assets impaired includes purchased software licenses to be sold to others. This amount was expensed as part of cost of revenues in the Consolidated Statement of Operations.

Intangible assets acquired in 2015 are based on the preliminary purchase price allocation relating to our acquisition of Temetra. Refer to Note 5 for additional information regarding this acquisition. The following table reflects our preliminary allocation of purchase price for intangible assets acquired on August 26, 2015:

	Fair Value	Weighted Average
	(in thousands)	Useful Life
		(in years)
Identified intangible assets		
Core-developed technology	\$4,378	7.0
Customer contracts and relationships	337	7.0
Trademarks and trade names	56	3.0
Other	56	2.0
Total identified intangible assets subject to amortization	\$4,827	6.9

Intangible assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts and accumulated amortization of intangible assets increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates. Amortization expense is scheduled to decrease in future periods.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)
2015 (amount remaining at September 30, 2015)	\$8,189
2016	25,566
2017	19,005
2018	13,271
2019	10,448
Beyond 2019	35,288
Total intangible assets subject to amortization	\$111,767

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Note 5: Goodwill

The following table reflects goodwill allocated to each reporting segment as of September 30, 2015:

Electricity	Gas	Water	Total Company
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