ITRON INC /WA/
Form 10-Q
November 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 000-22418
ITRON, INC.
(Exact name of registrant as specified in its charter)

Washington	91-1011792
(State of Incorporation)	(I.R.S. Employer Identification Number)

2111 N Molter Road, Liberty Lake, Washington 99019
(509) 924-9900
(Address and telephone number of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	o (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 31, 2012 there were outstanding 39,206,165 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,	
	2012	2011	2012	2011
	(in thousands, except per share data)			
Revenues	$504,063	$615,555	$1,654,843	$1,791,647
Cost of revenues	332,266	438,559	1,103,196	1,237,722
Gross profit	171,797	176,996	551,647	553,925
Operating expenses				
Sales and marketing	44,913	44,870	145,616	138,019
Product development	43,299	38,377	134,295	119,147
General and administrative	30,743	33,492	100,763	104,627
Amortization of intangible assets	11,929	16,013	35,867	47,807
Restructuring expense	(5,054)	1,096	3,455	3,003
Goodwill impairment	—	540,400	—	540,400
Total operating expenses	125,830	674,248	419,996	953,003
Operating income (loss)	45,967	(497,252)	131,651	(399,078)
Other income (expense)				
Interest income	297	155	667	631
Interest expense	(2,551)	(10,796)	(7,594)	(34,330)
Other income (expense), net	(1,269)	(1,402)	(4,224)	(4,342)
Total other income (expense)	(3,523)	(12,043)	(11,151)	(38,041)
Income (loss) before income taxes	42,444	(509,295)	120,500	(437,119)
Income tax provision	(6,547)	(6,042)	(26,740)	(15,529)
Net income (loss)	35,897	(515,337)	93,760	(452,648)
Net income attributable to noncontrolling interests	550	1,745	1,445	2,878
Net income (loss) attributable to Itron, Inc.	$35,347	$(517,082)	$92,315	$(455,526)
Earnings per common share - Basic	$0.90	$(12.70)	$2.32	$(11.21)
Earnings per common share - Diluted	$0.89	$(12.70)	$2.31	$(11.21)
Weighted average common shares outstanding - Basic	39,472	40,725	39,756	40,648
Weighted average common shares outstanding - Diluted	39,791	40,725	40,042	40,648

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,	
	2012	2011	2012	2011
	(in thousands)			
Net income (loss)	$35,897	$(515,337)	$93,760	$(452,648)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	24,596	(80,625)	806	43,432
Unrealized gains (losses) on hedging instruments:				
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	(828)	2,086	(1,677)	1,922
Net unrealized gain (loss) on nonderivative hedging instruments	—	408	—	(8,854)
Net hedging loss (gain) reclassified into net income	—	(176)	—	2,598
Pension plan benefit liability adjustment	(5)	22	40	(506)
Total other comprehensive income (loss), net of tax	23,763	(78,285)	(831)	38,592
Total comprehensive income (loss), net of tax	59,660	(593,622)	92,929	(414,056)
Comprehensive income (loss) attributable to noncontrolling interest, net of tax:				
Net income attributable to noncontrolling interest	550	1,745	1,445	2,878
Foreign currency translation adjustments	69	(442)	109	71
Amounts attributable to noncontrolling interest	619	1,303	1,554	2,949
Comprehensive income (loss) attributable to Itron, Inc.	$59,041	$(594,925)	$91,375	$(417,005)

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

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ITRON, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$91,474	$133,086
Accounts receivable, net	363,111	371,641
Inventories	201,775	195,837
Deferred tax assets current, net	58,866	58,172
Other current assets	102,195	81,618
Total current assets	817,421	840,354
Property, plant, and equipment, net	251,703	262,670
Deferred tax assets noncurrent, net	13,268	22,144
Other long-term assets	29,875	62,704
Intangible assets, net	247,636	239,500
Goodwill	687,432	636,910
Total assets	$2,047,335	$2,064,282
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	$219,945	$246,775
Other current liabilities	62,250	53,734
Wages and benefits payable	82,405	93,730
Taxes payable	8,754	11,526
Current portion of debt	16,875	15,000
Current portion of warranty	32,834	52,588
Unearned revenue	41,255	37,369
Total current liabilities	464,318	510,722
Long-term debt	404,375	437,502
Long-term warranty	22,853	26,948
Pension plan benefit liability	63,041	62,449
Deferred tax liabilities noncurrent, net	21,307	31,699
Other long-term obligations	81,199	73,417
Total liabilities	1,057,093	1,142,737
Commitments and contingencies		
Equity		
Preferred stock	—	—
Common stock	1,294,990	1,319,222
Accumulated other comprehensive loss, net	(38,100)	(37,160)
Accumulated deficit	(282,822)	(375,137)
Total Itron, Inc. shareholders' equity	974,068	906,925

Noncontrolling interests	16,174	14,620
Total equity	990,242	921,545
Total liabilities and equity	$2,047,335	$2,064,282

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

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

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Operating activities		
Net income (loss)	$93,760	$(452,648)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	81,856	96,919
Stock-based compensation	14,319	12,401
Amortization of prepaid debt fees	1,176	5,365
Amortization of convertible debt discount	—	5,336
Deferred taxes, net	1,505	(1,410)
Goodwill impairment	—	540,400
Restructuring expense, non-cash	(4,841)	—
Other adjustments, net	(119)	(917)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	46,493	(21,940)
Inventories	(4,619)	(32,750)
Other current assets	(21,525)	(8,672)
Other long-term assets	1,624	(17,499)
Accounts payables, other current liabilities, and taxes payable	(39,368)	12,347
Wages and benefits payable	(16,869)	(28,018)
Unearned revenue	9,201	22,862
Warranty	(23,610)	28,028
Other operating, net	(1,980)	(6,003)
Net cash provided by operating activities	137,003	153,801
Investing activities		
Acquisitions of property, plant, and equipment	(34,278)	(45,799)
Business acquisitions, net of cash and cash equivalents acquired	(79,874)	(14,635)
Other investing, net	4,005	634
Net cash used in investing activities	(110,147)	(59,800)
Financing activities		
Proceeds from borrowings	70,000	670,000
Payments on debt	(101,252)	(804,304)
Issuance of common stock	3,778	3,512
Repurchase of common stock	(40,700)	—
Other financing, net	(342)	(5,319)
Net cash used in financing activities	(68,516)	(136,111)
Effect of foreign exchange rate changes on cash and cash equivalents	48	2,147
Decrease in cash and cash equivalents	(41,612)	(39,963)
Cash and cash equivalents at beginning of period	133,086	169,477

Cash and cash equivalents at end of period	$91,474	$129,514
Non-cash transactions:		
Property, plant, and equipment purchased but not yet paid, net	$(1,533)	$(3,130)
Fair value of contingent and deferred consideration payable for business acquisition	—	5,108
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net	$33,368	$12,904
Interest, net of amounts capitalized	6,386	25,964

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, 2012
(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 and the Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2012 and 2011, the Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 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 2011 audited financial statements and notes included in our Current Report on Form 8-K filed with the SEC on May 24, 2012. The results of operations for the three and nine months ended September 30, 2012 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 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. Intercompany transactions and balances have been 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 (loss) and other comprehensive income (loss) attributable to the noncontrolling interests, as shown in our Consolidated Statements of Operations and our Consolidated Statements of Comprehensive Income (Loss). 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.

Reclassifications
Certain 2011 amounts have been reclassified to conform to the current classifications in the Consolidated Statements of Operations. These reclassifications relate to certain administrative expenses in the former Itron North America segment that were in prior periods allocated to cost of revenues and sales and marketing and product development operating expenses but have been reclassified to general and administrative operating expenses to conform to our

worldwide presentation across our new segment structure. These reclassifications did not have a material impact to gross profit and had no impact on income before income taxes, net income attributable to Itron, Inc., earnings per share, or total equity.

Business Acquisitions

On May 1, 2012, we completed the acquisition of SmartSynch, Inc. (SmartSynch). The acquisition was financed through borrowings on our multicurrency revolving line of credit and cash on hand. SmartSynch was a provider of smart grid solutions that utilize cellular networks for communications. We have included supplemental pro forma financial information related to the acquisition in Note 16 Business Combinations.

In January 2011, we completed the acquisition of Asais S.A.S. and Asais Conseil S.A.S. (collectively Asais), an energy information management software and consulting services provider, located in France. The acquisition consisted of cash and contingent consideration. Additional acquisitions were completed in 2011, which were immaterial to our financial position, results of

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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. The cash and cash equivalents balance in our Consolidated Balance Sheets includes amounts that reside in our joint venture entities. As a result, the minority shareholders of these entities control their proportional share of the cash and cash equivalents balance, and there may be limitations on Itron's ability to repatriate cash to the U.S. from these entities.

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 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. 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) in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

Derivatives are not used for trading or speculative purposes. Our derivatives are with credit worthy multinational commercial banks, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments. Refer to Note 7 and Note 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 purchased software, and furniture. Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Construction in process represents capital expenditures incurred for assets not yet placed in service. Costs related to internally developed software and software purchased for internal uses are capitalized and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. 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 Statement of Operations according to the use

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of the asset, except those gains and losses recognized in conjunction with our restructuring activities, which are classified as restructuring expense.

Prepaid Debt Fees

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

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree'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 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 acquisitions. We use estimates, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations, in determining the value assigned to goodwill and intangible assets. Our intangible assets have finite lives and are amortized over their estimated useful lives based on estimated discounted cash flows. 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.

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. Prior to 2012, we had four reporting units: Itron North America (INA), Itron International (INL) Electricity, INL Gas, and INL Water. Effective January 1, 2012, our three new reporting units are Electricity, Gas, and Water. Our new Energy operating segment consists of the Electricity and Gas reporting units, while our new Water operating segment consists of the Water reporting unit. In the first quarter of 2012, we reallocated the goodwill from our former INA reporting unit to the three new reporting units based on the relative fair values of the electricity, gas, and water product lines within INA on January 1, 2012. We also reassigned the goodwill from our former INL Electricity, INL Gas, and INL Water reporting units to the new reporting units, Electricity, Gas, and Water, respectively.

We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. The impairment test involves comparing the fair value 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 for a goodwill impairment loss. This second step revalues all assets and liabilities of the reporting unit to their current fair values 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.

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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, 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.

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. Continuing quality control efforts during manufacturing reduce our exposure to warranty claims. When our quality control efforts fail to detect a fault in one of our products, we experience an increase in warranty claims. We track warranty claims to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. When new products are introduced, our process relies on historical averages of similar products until sufficient data is available. As actual experience becomes available, it is used to modify the original estimate to ensure the expected warranty costs are within a range of likely outcomes. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The warranty allowances may fluctuate due to higher than anticipated 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 and Asset Impairments

We record a liability for costs associated with an exit or disposal activity at its fair value in the period in which the liability is incurred. Employee termination benefits considered postemployement 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 later of when we terminate a contract in accordance with the contract terms or when we cease using the rights conveyed by the contract.

Asset impairments, net, 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 are less than the net book value less costs to sell. 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, the asset group may consist of property, plant, equipment, intangible assets, and goodwill.

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

We may repurchase shares of Itron common stock under a twelve-month program, which was authorized by our Board of Directors on October 24, 2011. 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 displayed separately as treasury stock on the financial statements. Instead, the value of the repurchased shares is deducted from common stock. On September 13, 2012, the Board approved the extension of the expiration date of the stock repurchase program until February 15,

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2013, or until the aggregate limit of $100 million of outstanding common stock has been repurchased, whichever occurs first.

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.

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 fair values 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.

We primarily enter into two types of multiple deliverable arrangements, which include a combination of hardware and associated software and services:

- Arrangements that do not include the deployment of our smart metering systems and technology are recognized as follows:

Hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.
If implementation services are essential to the functionality of the associated software, software and implementation revenues are recognized using either the percentage-of-completion methodology of contract accounting if project costs can be reliably estimated or the completed contract methodology if project costs cannot be reliably estimated.

- Arrangements to deploy our smart metering systems and technology are recognized as follows:

Hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.
Revenue from associated software and services is recognized using the units-of-delivery method of contract accounting, as the software is essential to the functionality of the related hardware and the implementation services are essential to the functionality of the associated software. This methodology results in the deferral of costs and revenues as professional services and software implementation commence prior to deployment of hardware.

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 which 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). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP).

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

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If we are unable to establish selling price using VSOE or TPE, we use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were 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 arrangement. Specifically, we consider the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, our ongoing pricing strategy and policies (as evident in the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable, and the characteristics of the varying markets in which the deliverable is sold. We analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices are analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

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 $71.9 million and $61.0 million at September 30, 2012 and December 31, 2011 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 $15.4 million and $11.7 million at September 30, 2012 and December 31, 2011 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 due to the immaterial nature of these costs as a result of 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, stock sold pursuant to our Employee Stock Purchase Plan (ESPP), 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 life. For ESPP awards, the fair value is the difference between the market close price of our common stock on the date of purchase and the discounted purchase price. For restricted stock units and unrestricted stock awards, the fair value is the market close price of our common stock on the date of grant. 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 both performance and service conditions, if 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. 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.

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 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.

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 not more likely than not that such assets will 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 fifty percent likelihood of being realized upon ultimate settlement are then measured to determine amounts to be recognized in the financial statements. This measurement incorporates information about potential settlements with taxing authorities. A previously recognized tax position is derecognized in the first period in which the position no longer meets the more-likely-than-not recognition threshold 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.

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Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	$35,347	$(517,082)	$92,315	$(455,526)
Weighted average common shares outstanding - Basic	39,472	40,725	39,756	40,648
Dilutive effect of stock-based awards	319	—	286	—
Weighted average common shares outstanding - Diluted	39,791	40,725	40,042	40,648
Earnings per common share - Basic	$0.90	$(12.70)	$2.32	$(11.21)
Earnings per common share - Diluted	$0.89	$(12.70)	$2.31	$(11.21)

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 881,000 and 1.2 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2012, and approximately 1.4 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, 2011, respectively, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, and rates as defined in the Rights Agreement, which may be adjusted by the Board of Directors. There was no preferred stock sold or outstanding at September 30, 2012 and December 31, 2011.

Stock Repurchase Plan

On October 24, 2011, our Board of Directors authorized a twelve-month repurchase program of up to $100 million of our common stock with an expiration date of October 23, 2012. On September 13, 2012, the Board approved the extension of the expiration date of the stock repurchase program until February 15, 2013, or until the aggregate limit of $100 million of outstanding common stock has been repurchased, whichever occurs first. Repurchases are made in the open market or in privately negotiated transactions, and in accordance with applicable securities laws. As of September 30, 2012, we have repurchased $70.1 million of our common stock, with $29.9 million remaining under the repurchase program.

Note 3: Certain Balance Sheet Components

Accounts receivable, net	September 30, 2012	December 31, 2011
	(in thousands)	
Trade receivables (net of allowance of $5,355 and $6,049)	$307,062	$328,845
Unbilled receivables	56,049	42,796
Total accounts receivable, net	$363,111	$371,641

At September 30, 2012 and December 31, 2011, $19.2 million and $2.5 million were recorded within trade receivables as billed but not yet paid by customers in accordance with contract retainage provisions. At September 30, 2012 and December 31, 2011, contract retainage amounts that were unbilled and classified as unbilled receivables were $10.6 million and $7.4 million. These contract retainage amounts within trade receivables and unbilled receivables are expected to be collected within the following 12 months.

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We had no long-term unbilled receivables or long-term retainage contracts at September 30, 2012 as we expect to bill and collect all contract retainage receivables within the following 12 months. At December 31, 2011, long-term unbilled receivables and long-term retainage contracts totaled $31.5 million.

Allowance for doubtful account activity	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$5,381	$8,980	$6,049	$9,045
Provision (release) of doubtful accounts, net	(124)	175	(414)	128
Accounts written-off	(53)	(1,127)	(314)	(1,680)
Effects of change in exchange rates	151	(576)	34	(41)
Ending balance	$5,355	$7,452	$5,355	$7,452

Inventories	September 30, 2012	December 31, 2011
	(in thousands)	
Materials	$104,404	$112,470
Work in process	14,720	16,306
Finished goods	82,651	67,061
Total inventories	$201,775	$195,837

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

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 $6.8 million and $7.4 million at September 30, 2012 and December 31, 2011, respectively.

Property, plant, and equipment, net	September 30, 2012	December 31, 2011
	(in thousands)	
Machinery and equipment	$278,615	$269,611
Computers and purchased software	82,760	74,885
Buildings, furniture, and improvements	143,486	140,064
Land	27,460	26,126
Construction in progress, including purchased equipment	23,391	20,687
Total cost	555,712	531,373
Accumulated depreciation	(304,009)	(268,703)
Property, plant, and equipment, net	$251,703	$262,670

Depreciation expense	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Depreciation expense	$15,656	$16,607	$45,989	$49,112

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Note 4: Intangible Assets

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

	September 30, 2012			December 31, 2011		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$402,897	$(323,629)	$79,268	$387,606	$(305,285)	$82,321
Customer contracts and relationships	288,429	(147,614)	140,815	278,581	(131,418)	147,163
Trademarks and trade names	71,992	(63,922)	8,070	71,854	(62,206)	9,648
Other	11,096	(11,013)	83	11,153	(10,785)	368
Total intangible assets subject to amortization	774,414	(546,178)	228,236	749,194	(509,694)	239,500
In-process research and development	19,400		19,400	—		—
Total intangible assets	$793,814	$(546,178)	$247,636	$749,194	$(509,694)	$239,500

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

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Beginning balance, intangible assets, gross	$749,194	$759,152
Intangible assets acquired	43,400	10,297
Assets no longer in use written-off	—	(8,450)
Effect of change in exchange rates	1,220	12,263
Ending balance, intangible assets, gross	$793,814	$773,262

Intangible assets acquired in 2012 are based on the preliminary purchase price allocation relating to our acquisition of SmartSynch on May 1, 2012. SmartSynch's intangible assets include IPR&D, which is not amortized until such time as the associated development projects are completed. These projects are expected to be completed in the next 12 months. Refer to Note 16 for additional information regarding this acquisition. Intangible assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts of intangible assets increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)
2012 (amount remaining at September 30, 2012)	$12,015
2013	41,917
2014	37,595
2015	30,700

2016	24,275
Beyond 2016	81,734
Total intangible assets subject to amortization, net	$228,236

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Note 5: Goodwill

Effective January 1, 2012, our reporting segments were changed from two geographic operating segments, Itron North America and Itron International, to two product operating segments, Energy and Water. As a result, we reallocated the goodwill balance as of January 1, 2012 to the Electricity, Gas, and Water reporting units within these two operating segments.

The following table reflects the goodwill balance as of September 30, 2012:

	Total Company	Energy	Water
	(in thousands)		
Balance at January 1, 2012			
Goodwill before impairment	$1,221,757	$808,601	$413,156
Accumulated impairment losses	(584,847)	(254,735)	(330,112)
Goodwill, net	636,910	553,866	83,044
Goodwill acquired	46,881	46,881	—
Other	4,767	3,994	773
Effect of change in exchange rates	(1,126)	(6,348)	5,222
Balance at September 30, 2012			
Goodwill before impairment	1,242,159	840,009	402,150
Accumulated impairment losses	(554,727)	(241,616)	(313,111)
Goodwill, net	$687,432	$598,393	$89,039

Goodwill acquired in 2012 is based on the preliminary purchase price allocation relating to the SmartSynch acquisition on May 1, 2012. Refer to Note 16 for additional information regarding this acquisition.

In the preceding table, "Other" includes activity associated with our restructuring announced in the fourth quarter of 2011. During the third quarter of 2012, we identified an error in our consolidated financial statements for the year ended December 31, 2011, which resulted in an overstatement of restructuring expense related to the expected sale of a non-core business. The identified assets to be disposed originally included $6.7 million of goodwill, which was impaired and charged to restructuring expense as a result of the expected sale proceeds being less than the carrying value of the identified assets. During the third quarter of 2012, we determined the amount of goodwill that should have been allocated to the asset disposal group was $1.3 million. In accordance with the relevant guidance, management evaluated the materiality of the error from a qualitative and quantitative perspective. Based on such evaluation, we concluded that correcting the goodwill allocated to this business asset group is not material, quantitatively or qualitatively, to our results of operations for the three months ended September 30, 2012 or our expected full year results of operations for 2012 and would not have had a material impact on our results for the year ended December 31, 2011. Accordingly, we recorded a non-cash adjustment during the third quarter of 2012 to reduce restructuring expense and increase goodwill by $5.4 million. Refer to Note 12 for additional disclosure on Itron's restructuring costs. Additionally, during the three months ended September 30, 2012, we sold a non-core business in Europe to which we allocated $675,000 of goodwill and recognized as restructuring expense.

As a result of a significant decline in the price of our shares of common stock at the end of September 2011, our aggregate market value was significantly lower than the aggregate carrying value of our net assets. As a result, we performed an impairment test of our goodwill as of September 30, 2011, and recorded total goodwill impairment charges of $584.8 million in the year ended December 31, 2011, of which $540.4 million was recorded during the

three months ended September 30, 2011. These goodwill impairment charges were associated with our previous reporting units of Itron International Electricity and Itron International Water. The accumulated impairment losses were reallocated to our new operating segments, Energy and Water, effective January 1, 2012.

Goodwill and accumulated impairment losses associated with our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts of these balances increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates.

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Note 6: Debt

The components of our borrowings are as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
2011 credit facility:		
USD denominated term loan	$281,250	$292,502
Multicurrency revolving line of credit	140,000	160,000
Total debt	421,250	452,502
Less: Current portion of debt	16,875	15,000
Long-term debt	$404,375	$437,502

Credit Facilities

In August 2011, we entered into a senior secured credit facility (2011 credit facility), which replaced the senior secured credit facility we entered into in 2007 (2007 credit facility). The 2011 credit facility consists of a $300 million U.S. dollar term loan (the term loan) and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $660 million, which was increased from $500 million in April 2012. Both the term loan and the revolver mature on August 8, 2016, and amounts borrowed under the revolver are classified as long-term. Amounts borrowed under the revolver during the credit facility term may be repaid and reborrowed until the revolver's maturity, at which time the revolver will terminate, and all outstanding loans, together with all accrued and unpaid interest, must be repaid. Amounts not borrowed under the revolver are subject to a commitment fee, which is paid in arrears on the last day of each fiscal quarter, ranging from 0.20% to 0.40% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter. Amounts repaid on the term loan may not be reborrowed. The 2011 credit facility permits us and certain of our foreign subsidiaries to borrow in U.S. dollars, euros, British pounds, or, with lender approval, other currencies readily convertible into U.S. dollars. All obligations under the 2011 credit facility are guaranteed by Itron, Inc. and material U.S. domestic subsidiaries and are secured by a pledge of substantially all of the assets of Itron, Inc. and material U.S. domestic subsidiaries, including a pledge of 100% of the capital stock of material U.S. domestic subsidiaries and up to 66% of the voting stock (100% of the non-voting stock) of their first-tier foreign subsidiaries. In addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the 2011 credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents. The 2011 credit facility includes debt covenants, which contain certain financial ratios and place certain restrictions on the incurrence of debt, investments, and the issuance of dividends. We were in compliance with the debt covenants under the 2011 credit facility at September 30, 2012.

Scheduled principal repayments for the term loan are due quarterly in the amounts of $3.8 million through June 2013, $5.6 million from September 2013 through June 2014, $7.5 million from September 2014 through June 2016, and the remainder due at maturity on August 8, 2016. The term loan may be repaid early in whole or in part, subject to certain minimum thresholds, without penalty.

Under the 2011 credit facility, we elect applicable market interest rates for both the term loan and any outstanding revolving loans. We also pay an applicable margin, which is based on our total leverage ratio (as defined in the credit agreement). The applicable rates per annum may be based on either: (1) the LIBOR rate, plus an applicable margin, or (2) the Alternate Base Rate, plus an applicable margin. The Alternate Base Rate election is equal to the greatest of three rates: (i) the prime rate, (ii) the Federal Reserve effective rate plus 1/2 of 1%, or (iii) one month LIBOR plus 1%. At September 30, 2012, the interest rate for both the term loan and the revolver was 1.47% (the LIBOR rate plus a margin of 1.25%).

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Total credit facility repayments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
2011 credit facility term loan	$3,750	$3,750	$11,252	$3,750
2011 credit facility multicurrency revolving line of credit	30,000	—	90,000	—
2007 credit facility term loans	—	351,320	—	406,950
2007 credit facility multicurrency revolving line of credit	—	170,000	—	170,000
Total credit facility repayments	$33,750	$525,070	$101,252	$580,700

At September 30, 2012, $140.0 million was outstanding under the 2011 credit facility revolver, and $49.4 million was utilized by outstanding standby letters of credit, resulting in $470.6 million available for additional borrowings.

Upon repayment of the 2007 credit facility in August 2011, unamortized prepaid debt fees of $2.4 million were written-off to interest expense. Prepaid debt fees of approximately $6.6 million were capitalized in the third quarter of 2011 associated with the 2011 credit facility, and $897,000 were capitalized in the second quarter of 2012 associated with the increase in the revolver in April 2012. Unamortized prepaid debt fees were as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
Unamortized prepaid debt fees	$5,763	$6,027

Convertible Senior Subordinated Notes

On August 1, 2011, in accordance with the terms of the convertible senior subordinated notes (convertible notes), we repurchased $184.8 million of the convertible notes at their principal amount plus accrued and unpaid interest. On September 30, 2011, we redeemed the remaining $38.8 million of the convertible notes, plus accrued and unpaid interest.

The convertible notes were separated between the liability and equity components using our estimated non-convertible debt borrowing rate at the time the convertible notes were issued, which was determined to be 7.38%. This rate also reflected the effective interest rate on the liability component for all periods during which the convertible notes were outstanding. The carrying amount of the equity component of $31.8 million is retained as a permanent component of our shareholders' equity, and no gain or loss was recognized upon derecognition of the convertible notes as the fair value of the consideration transferred to the holders equaled the fair value of the liability component.

The discount on the liability component was fully amortized by the end of the second quarter of 2011. The interest expense relating to both the contractual interest coupon and amortization of the discount on the liability component was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Contractual interest coupon	$—	$625	$—	$3,420
Amortization of the discount on the liability component	—	—	—	5,336
Total interest expense on convertible notes	$—	$625	$—	$8,756

Note 7: Derivative Financial Instruments

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to Note 1, Note 13, and Note 14 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”). 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, 2012 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

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for these inputs at September 30, 2012. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

The fair values of our derivative instruments at September 30, 2012 and December 31, 2011 were as follows:

	Balance Sheet Location	Fair Value September 30, 2012 (in thousands)	December 31, 2011
Asset Derivatives			
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current assets	$57	$241
Liability Derivatives			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other current liabilities	$256	$—
Interest rate swap contracts	Other long-term obligations	2,441	—
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	103	222
Total liability derivatives		$2,800	$222

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

	2012 (in thousands)	2011
Net unrealized loss on hedging instruments at January 1,	$(14,380)	$(10,034)
Unrealized gain (loss) on derivative instruments	(1,677)	1,922
Unrealized gain (loss) on a nonderivative net investment hedging instrument	—	(8,854)
Realized (gains) losses reclassified into net income (loss)	—	2,598
Net unrealized loss on hedging instruments at September 30,	$(16,057)	$(14,368)

Following the termination of our net investment hedge in August 2011, the net derivative loss of $14.4 million will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

Cash Flow Hedges

As a result of our floating rate debt, we are exposed to variability in our cash flows from changes in the applicable interest rate index. 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 reduce the variability of cash flows from increases in the LIBOR base borrowing rates on our floating rate credit facility. The swaps do not protect us from changes to the applicable margin under our credit facility.

In May 2012, we entered into six forward starting pay-fixed receive one-month LIBOR interest rate swaps. The interest rate swaps convert $200 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.00% (excluding the applicable margin on the debt) and are effective July 31, 2013 to August 8, 2016.

The cash flow hedges 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 swaps are recorded as a component of OCI and will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedges will be recognized as adjustments to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is $256,000. At September 30, 2012, our LIBOR based debt balance was $421.3 million.

In 2007, we entered into a pay fixed 6.59% receive three-month Euro Interbank Offered Rate (EURIBOR), plus 2%, amortizing interest rate swap to convert a significant portion of our euro denominated variable-rate term loan to fixed-rate debt, plus or minus

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the variance in the applicable margin from 2%, through December 31, 2012. The objective of this swap was to protect us from increases in the EURIBOR base borrowing rates. The swaps did not protect us from changes to the applicable margin under our credit agreement. Throughout the duration of the hedging relationship, this cash flow hedge was expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk. Consequently, effective changes in the fair value of the interest rate swap were recorded as a component of OCI and were recognized in earnings when the hedged item affected earnings. The amounts paid or received on the hedge were recognized as adjustments to interest expense. In August 2011, we repaid our 2007 credit facility, which included the euro-denominated term loan. In conjunction with the debt repayment, we paid $2.9 million to terminate the related interest rate swap, and the accumulated loss in OCI was reclassified to interest expense.

In 2010, we entered into two interest rate swaps with one-year terms, which each converted $100 million of our U.S. dollar term loan from a floating LIBOR interest rate to fixed interest rates of 2.11% and 2.15%, respectively. These swaps expired on June 30, 2011 and did not include the additional interest rate margin applicable to our term debt.

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 are as follows:

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)		
			Location	Amount		Location	Amount	
	2012	2011		2012	2011		2012	2011
	(in thousands)			(in thousands)			(in thousands)	
Three Months Ended September 30,								
Interest rate swap contracts	$ (1,332)	$ 277	Interest expense	$ —	$ (3,083)	Interest expense	$—	$(121)
Nine Months Ended September 30,								
Interest rate swap contracts	$ (2,697)	$ (4,200)	Interest expense	$ —	$ (7,254)	Interest expense	$—	$(201)

Net Investment Hedge

We are exposed to foreign exchange risk through our international subsidiaries. As a result of our acquisition of an international company in 2007, we entered into a euro denominated term loan, which exposed us to fluctuations in the euro foreign exchange rate. Therefore, we designated this foreign currency denominated term loan as a hedge of our net investment in international operations. The non-functional currency term loan was revalued into U.S. dollars at each balance sheet date, and the changes in value associated with currency fluctuations were recorded as adjustments to long-term debt with offsetting gains and losses recorded in OCI. The loan was repaid in full in August 2011 as part of our repayment of the 2007 credit facility. The net derivative loss will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

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

Nonderivative Financial Instruments in ASC 815-20 Net Investment Hedging Relationships	Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Gain (loss) recognized in OCI on derivative (Effective Portion)				
Before tax	$—	$645	$—	$(14,278)
Net of tax	$—	$408	$—	$(8,854)

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts (a total of 429 contracts were entered into during the nine months ended September 30, 2012), which are not designated for hedge accounting, with the intent to reduce

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earnings volatility associated with certain of these balances. The notional amounts of the contracts ranged from $120,000 to $51 million, offsetting our exposures from the euro, British pound, Canadian dollar, Australian dollar, Brazilian real, and various other currencies.

The effect of our foreign exchange forward 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)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Foreign exchange forward contracts	$(245)	$2,464	$(666)	$(877)

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our international employees, primarily in Germany, France, Italy, Indonesia, and Spain, offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2011.

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

	September 30, 2012	December 31, 2011
	(in thousands)	
Plan assets in other long-term assets	$(473)	$(449)
Current portion of pension plan liability in wages and benefits payable	2,763	2,621
Long-term portion of pension plan liability	63,041	62,449
Net pension plan benefit liability	$65,331	$64,621

Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan. We contributed $33,000 and $388,000 to the defined benefit pension plans for the three and nine months ended September 30, 2012, and $40,000 and $431,000 for the three and nine months ended September 30, 2011, respectively. The timing of when contributions are made can vary by plan and from year to year. For 2012, assuming that actual plan asset returns are consistent with our expected rate of return, and that interest rates remain constant, we expect to contribute approximately $474,000 to our defined benefit pension plans. We contributed $520,000 to the defined benefit pension plans for the year ended December 31, 2011.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Service cost	$655	$637	$2,069	$1,855
Interest cost	887	947	2,722	2,833
Expected return on plan assets	(80)	(80)	(247)	(243)
Settlements and termination benefits	97	—	97	—

Amortization of actuarial net loss (gain)	1	14	5	42
Amortization of unrecognized prior service costs	16	18	50	55
Net periodic benefit cost	$1,576	$1,536	$4,696	$4,542

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Note 9: Stock-Based Compensation

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Stock options	$333	$(320)	$942	$1,224
Restricted stock units	4,390	2,916	12,281	10,320
Unrestricted stock awards	179	140	589	330
ESPP	161	147	507	527
Total stock-based compensation	$5,063	$2,883	$14,319	$12,401
Related tax benefit	$1,358	$700	$3,922	$3,359

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

Subject to stock splits, dividends, and other similar events, 3,500,000 shares of common stock are reserved and authorized for issuance under our 2010 Stock Incentive Plan (Stock Incentive Plan). Awards consist of stock options, restricted stock units, and unrestricted stock awards. At September 30, 2012, 1,338,142 shares were available for grant under the Stock Incentive Plan.

Stock Options

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

The fair values of stock options granted were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012[1]	2011	2012	2011
Dividend yield	—	—	—	—
Expected volatility	—	45.8%	42.7%	46.4%
Risk-free interest rate	—	0.9%	0.9%	1.7%
Expected life (years)	—	4.91	5.14	4.86

[1] There were no employee stock options granted for the three months ended September 30, 2012.

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 estimated date the award will be fully exercised. Factors considered in estimating the expected life include historical experience of similar awards, contractual terms, vesting schedules, and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

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

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value [1]	Weighted Average Grant Date Fair Value
	(in thousands)		(years)	(in thousands)	
Outstanding, January 1, 2011	1,102	$ 55.21	5.58	$ 10,883	
Granted	103	52.13			$ 21.81
Exercised	(29)	19.53		$ 1,050	
Forfeited	(63)	58.50			
Expired	(1)	7.00			
Outstanding, September 30, 2011	1,112	$ 55.72	4.68	$ 1,518	
Exercisable, September 30, 2011	1,027	$ 55.94	4.30	$ 1,518	
Expected to vest, September 30, 2011	80	$ 53.19	9.28	$ —	
Outstanding, January 1, 2012	1,109	$ 55.97	4.51	$ 2,323	
Granted	54	48.23			$ 18.64
Exercised	(50)	22.12		$ 972	
Expired	(83)	60.06			
Outstanding, September 30, 2012	1,030	$ 56.87	4.35	$ 3,127	
Exercisable, September 30, 2012	904	$ 58.04	3.72	$ 2,969	
Expected to vest, September 30, 2012	119	$ 48.50	8.89	$ 149	

(1) The aggregate intrinsic value of outstanding stock options represents amounts that would have been received by the optionees had all in- the-money options been exercised on that date. Specifically, it is the amount by which the market value of Itron's stock exceeded the exercise price of the outstanding in-the-money options before applicable income taxes, based on our closing stock price on the last business day of the period. The aggregate intrinsic value of stock options exercised during the period is calculated based on our stock price at the date of exercise.

As of September 30, 2012, total unrecognized stock-based compensation expense related to nonvested stock options was approximately $1.5 million, which is expected to be recognized over a weighted average period of approximately 1.7 years.

Restricted Stock Units

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

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

The restricted stock units issued under the Long Term Performance Restricted Stock Unit Award Agreement (Performance Award Agreement) are determined based on the attainment of annual performance goals after the end of the calendar year performance period. During the year, if management determines that it is probable that the targets will be achieved, compensation expense, net of forfeitures, is recognized on a straight-line basis over the annual performance and subsequent vesting period for each separately vesting portion of the award. Performance awards typically vest and are released in three equal installments at the end of each year following attainment of the performance goals. For U.S. participants who retire during the performance period, a pro-rated number of restricted stock units (based on the number of days of employment during the performance period) immediately vest based on the attainment of the performance goals as assessed after the end of the performance period. During the vesting period, unvested restricted stock units immediately vest at the date of retirement for U.S. participants who retire during that period. For U.S. participants who are or will become retirement eligible during either the annual performance or vesting period, compensation expense is accelerated and recognized over the greater of the performance period (one year) or through the participant’s retirement eligible date. For performance awards granted in 2012, the maximum restricted stock units that may become eligible for vesting is 208,000 with a grant date fair value of $44.07.

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The following table summarizes restricted stock unit activity for the nine months ended September 30:

	Number of Restricted Stock Units	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value[1]
	(in thousands)		(in thousands)
Outstanding, January 1, 2011	588		
Granted[2]	286	$54.82	
Released	(201)		$15,739
Forfeited	(37)		
Outstanding, September 30, 2011	636		
Outstanding, January 1, 2012	625		
Granted[2]	452	$47.29	
Released	(207)		$12,835
Forfeited	(34)		
Outstanding, September 30, 2012	836		
Vested, September 30, 2012	48		$2,049
Expected to vest, September 30, 2012	763		$32,904

(1) The aggregate intrinsic value is the market value of the stock, before applicable income taxes, based on the closing price on the stock release dates or at the end of the period for restricted stock units expected to vest.

(2) These restricted stock units do not include the respective 2011 and 2012 awards under the Performance Award Agreement, which are not eligible for vesting as of September 30 of each respective year.

At September 30, 2012, unrecognized compensation expense on restricted stock units was $25.8 million, which is expected to be recognized over a weighted average period of approximately 2.0 years.

Unrestricted Stock Awards

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Shares of unrestricted stock granted	4,342	2,864	14,321	6,317
Weighted average grant date fair value per share	$41.41	$48.84	$41.16	$52.19

Employee Stock Purchase Plan

Under the terms of the ESPP, employees can deduct up to 10% of their regular cash compensation to purchase our common stock at a 15% discount from the fair market value of the stock at the end of each fiscal quarter, subject to other limitations under the plan. The sale of the stock to the employees occurs at the beginning of the subsequent quarter.

The following table summarizes ESPP activity for the three and nine months ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Shares of stock sold to employees[(1)]	22,739	22,518	76,415	65,143
Weighted average fair value per ESPP award[(2)]	$6.47	$4.43	$6.52	$5.56

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

(2) Relating to awards associated with the offering period during the three and nine months ended September 30.

At September 30, 2012, all compensation cost associated with the ESPP had been recognized. There were 625,000 shares of common stock available for future issuance under the ESPP at September 30, 2012.

Note 10: Income Taxes

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

For the three and nine months ended September 30, 2012, we had tax provisions of 15.4% and 22.2%, based on a percentage of income (loss) before tax, as compared with tax provisions of 1.2% and 3.6% for the same periods in 2011.

Our tax provision in 2012 differs from the federal statutory rate due to projected earnings in tax jurisdictions with rates lower than 35%, the benefit of certain interest expense deductions, and an election under U.S. Internal Revenue Code Section 338 with respect to a foreign acquisition in 2007.

Our tax provision in 2011 differs from the federal statutory rate due to the impact of the goodwill impairment, which is not deductible, projected earnings in tax jurisdictions with rates lower than 35%, the benefit of certain interest expense deductions, a benefit related to the settlement of a foreign tax litigation, and an election under U.S. Internal Revenue Code Sections 338 with respect to a foreign acquisition in 2007.

We classify interest expense and penalties related to unrecognized tax liabilities and interest income on tax overpayments as components of income tax expense. The net interest and penalties expense recognized is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Net interest and penalties expense	$378	$476	$643	$584

Accrued interest and penalties recorded are as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
Accrued interest	$4,225	$3,781
Accrued penalties	2,847	2,766

Unrecognized tax benefits related to uncertain tax positions and the amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate are as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	

Unrecognized tax benefits related to uncertain tax positions	$26,163	$24,737
The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate	25,667	24,451

We believe it is reasonably possible that our unrecognized tax benefits may decrease by approximately $5.0 million within the

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next twelve months due to the expiration of the statute of limitations and the completion of examinations by taxing authorities. At September 30, 2012, we are not able to reasonably estimate the timing of future cash flows relating to our uncertain tax positions.

Note 11: Commitments and Contingencies

Guarantees and Indemnifications

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

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

	September 30, 2012	December 31, 2011
	(in thousands)	
Credit facilities[1]		
Multicurrency revolving line of credit	$660,000	$500,000
Long-term borrowings	(140,000)	(160,000)
Standby LOC's issued and outstanding	(49,410)	(44,549)
Net available for additional borrowings and LOC's	$470,590	$295,451
Unsecured multicurrency revolving lines of credit with various financial institutions		
Multicurrency revolving lines of credit	$63,500	$67,968
Standby LOC's issued and outstanding	(29,571)	(28,733)
Short-term borrowings[2]	(834)	—
Net available for additional borrowings and LOC's	$33,095	$39,235
Unsecured surety bonds in force	$154,047	$139,954

[1] See Note 6 for details regarding our secured credit facilities.

[2] Short-term borrowings are included in "Other current liabilities" on the Consolidated Balance Sheets.

In the event any such standby LOC or bond is called, we would be obligated to reimburse the issuer of the standby LOC or bond; however, we do not believe that any outstanding LOC or bond 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 may 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, 2012 were not material to our financial condition or results of operations.

In 2010 and 2011, Transdata Incorporated (Transdata) filed lawsuits against three of our customers, CenterPoint Energy (CenterPoint), TriCounty Electric Cooperative, Inc. (Tri-County), and San Diego Gas & Electric Company (San Diego), a customer of recently acquired SmartSynch, and several other utilities, alleging infringement of three patents owned by Transdata related to the use of an antenna in a meter. Pursuant to our contractual obligations with our customers, we agreed to indemnify and defend them in these lawsuits. The complaints seek unspecified damages as well as injunctive relief. CenterPoint, Tri-County, and San Diego have denied all of the substantive allegations and filed counterclaims seeking a declaratory judgment that the patents are

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invalid and not infringed. In December 2011, the Judicial Panel on Multi-District Litigation consolidated all of these cases in the Western District of Oklahoma for pretrial proceedings. On April 17, 2011, the Oklahoma court stayed the litigation pending the resolution of re-examination proceedings in the United States Patent and Trademark Office (U.S. PTO). The U.S. PTO has issued re-examination certificates confirming the patentability of the original claims and allowing certain new claims added by TransData. The stay of the litigation has been lifted by the district court. We do not believe this matter will have a material adverse effect on our business or financial condition, although an unfavorable outcome could have a material adverse effect on our results of operations for the period in which such a loss is recognized.

On February 23, 2011, a purported class action lawsuit was filed in U.S. District Court for the Eastern District of Washington alleging violations of federal securities laws relating to a restatement of our financial results for the quarters ended March 31, June 30, and September 30, 2010. These revisions were made primarily to defer revenue that had been incorrectly recognized on one contract due to a misinterpretation of an extended warranty obligation. The effect of the restatement was to reduce revenue and earnings in each of the first three quarters of 2010. As a result of the restatement, total revenue for the first nine months of 2010 was reduced by $6.1 million and diluted EPS was reduced by $0.11. On August 22, 2011, the lead plaintiff in the federal securities lawsuit filed a consolidated complaint, which defendants moved to dismiss. On September 11, 2012, the U.S. District Court for the Eastern District of Washington granted defendants' motion to dismiss in its entirety and dismissed all claims against all defendants asserted in the consolidated complaint. On October 30, 2012, the lead plaintiff dismissed its complaint with prejudice, and the Court subsequently approved Plaintiffs' voluntary dismissal with prejudice.

In March 2011, a lawsuit was filed in the Superior Court of the State of Washington in and for Spokane County against certain current or former officers and directors seeking unspecified damages on behalf of Itron, Inc. The complaint alleges that the defendants breached their fiduciary obligations to Itron with respect to the restatement of Itron's financial results for the quarters ended March 31, June 30, and September 30, 2010. This lawsuit is a shareholder derivative action that purports to assert claims on behalf of Itron, Inc. This purported derivative action had been stayed pending the outcome of the motion to dismiss in the federal securities lawsuit referred to above, but, as a result of the September 11, 2012 dismissal order, the stay has been lifted. Defendants intend to seek dismissal of this purported derivative action, and the Superior Court has set a schedule for briefing and hearing the motion to dismiss. Briefing on the motion to dismiss will be completed in April 2013, and the Superior Court has scheduled a hearing on the motion to dismiss for May 2013. Defendants believe they have valid defenses to this derivative action and intend to defend themselves vigorously.

In June 2011, a lawsuit was filed in the United States District Court for the Eastern District of Texas alleging infringement of three patents owned by EON Corp. IP Holdings, LLC (EON), related to two-way communication networks, network components, and related software platforms. The complaint seeks unspecified damages as well as injunctive relief. On July 16, 2012, Itron filed a Motion to Sever and Transfer Venue to the Eastern District of Washington. The decision on this motion is pending. We believe these claims are without merit and we intend to vigorously defend our interests. We do not believe this matter will have a material adverse effect on our business or financial condition, although an unfavorable outcome could have a material adverse effect on our results of operations for the period in which the claim is resolved.

Warranty

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$66,368	$62,838	$79,536	$51,283

New product warranties	1,996	1,512	7,632	5,591
Other changes/adjustments to warranties	(1,552)	26,263	509	40,906
Claims activity	(12,050)	(9,207)	(31,625)	(18,422)
Effect of change in exchange rates	925	(2,374)	(365)	(326)
Ending balance, September 30	55,687	79,032	55,687	79,032
Less: current portion of warranty	32,834	50,798	32,834	50,798
Long-term warranty	$22,853	$28,234	$22,853	$28,234

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Total warranty expense is classified within cost of revenues and consists of new product warranties issued and other changes and adjustments to warranties. Warranty expense for the three and nine months ended September 30 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Total warranty expense	$444	$27,775	$8,141	$37,939

Warranty expense for the nine months ended September 30, 2012 reflects a $5.0 million adjustment, which reduced a warranty accrual, originally recorded in 2011, as a result of lower than estimated replacements. Warranty expense for the three and nine month ended September 30, 2011 reflects a warranty charge of $12.6 million associated with a vendor supplied component in North America. Warranty expense for the nine months ended September 30, 2011 also reflects the benefit of an $8.6 million insurance recovery associated with the settlement of product claims in Sweden in 2010, and a warranty charge of $7.7 million related to certain products in Brazil.

Extended Warranty

A summary of changes to unearned revenue for extended warranty contracts is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$29,011	$19,109	$24,448	$14,637
Unearned revenue for new extended warranties	2,080	3,138	7,269	8,286
Unearned revenue recognized	(351)	(283)	(982)	(959)
Effect of change in exchange rates	95	—	100	—
Ending balance, September 30	30,835	21,964	30,835	21,964
Less: current portion of unearned revenue for extended warranty	1,800	1,162	1,800	1,162
Long-term unearned revenue for extended warranty within Other long-term obligations	$29,035	$20,802	$29,035	$20,802

Health Benefits

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

Plan costs are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Plan costs	$7,441	$5,653	$20,319	$18,324

IBNR accrual, which is included in wages and benefits payable, is as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
IBNR accrual	$3,050	$2,460

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.

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Note 12: Restructuring

During the fourth quarter of 2011, we announced the approval of projects to restructure our manufacturing operations to increase efficiency and lower our cost of manufacturing. We began implementing these projects in the fourth quarter of 2011, and we expect to substantially complete these projects by the end of 2013.

Certain projects are subject to a variety of labor and employment laws, rules, and regulations, which could result in a delay in implementing projects at some locations. Real estate market conditions may impact the timing of our ability to sell some of the manufacturing facilities we have designated for closure and disposal. This may delay the completion of the restructuring projects beyond 2013.

The total expected restructuring costs as of September 30, 2012 were $81.1 million, which is a decrease of approximately $7.9 million from the total expected costs at June 30, 2012. This decrease was primarily the result of gains on the dispositions of fixed assets and a correction to the amount of goodwill allocated to one of our non-core businesses sold as part of the restructuring process. In addition, expected severance costs were reduced as the result of certain employees in positions that were eliminated under the restructuring plan filling vacant positions within the Company.

The total expected restructuring costs, the costs recognized in prior periods, the restructuring costs recognized during the nine months ended September 30, 2012, and the remaining expected restructuring costs as of September 30, 2012 are as follows:

	Total Expected Costs at September 30, 2012	Costs Recognized in Prior Periods	Costs Recognized During the Nine Months Ended September 30, 2012	Remaining Costs to be Recognized at September 30, 2012
	(in thousands)			
Employee severance costs	$51,395	$42,530	$3,668	$5,197
Asset impairments	21,356	25,144	(4,841)	1,053
Other restructuring costs	8,368	408	4,628	3,332
Total	$81,119	$68,082	$3,455	$9,582
Segments:				
Energy	$59,312	$51,873	$3,536	$3,903
Water	16,210	15,321	(871)	1,760
Corporate unallocated	5,597	888	790	3,919
Total	$81,119	$68,082	$3,455	$9,582

Other restructuring costs includes expenses to exit the facilities once the operations in those facilities have ceased. Costs associated with restructuring activities are generally presented as restructuring expense in the Consolidated Statements of Operations, except for certain costs associated with inventory write-downs, which are classified within cost of revenues, and accelerated depreciation expense, which is recognized according to the use of the asset.

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The following table summarizes the activity within the restructuring related balance sheet accounts during the nine months ended September 30, 2012:

	Accrued Employee Severance	Asset Impairments & Net Loss (Gain) on Sale or Disposal	Other Accrued Costs	Total
	(in thousands)			
Beginning balance, January 1, 2012	$28,168	$—	$399	$28,567
Costs incurred and charged to expense	3,668	(4,841)	4,628	3,455
Cash payments	(13,518)	—	(1,737)	(15,255)
Non-cash items	—	4,841	—	4,841
Effect of change in exchange rates	197	—	(44)	153
Ending balance, September 30, 2012	$18,515	$—	$3,246	$21,761

Asset impairments are determined at the asset group level. During the nine months ended September 30, 2012, we adjusted the estimated impairment of certain assets and recognized gains on the sale of various asset groups. As part of the sale of a non-core business in Europe, $675,000 of goodwill was allocated to the business and charged to asset impairment restructuring expense during the three months ended September 30, 2012. In addition, during the third quarter of 2012, we corrected an overstatement of $5.4 million in restructuring expense, originally recognized during the year ended December 31, 2011, for the goodwill allocated to a non-core business in North America that was sold in May 2012. See Note 5 for additional information related to the goodwill impairment correction.

The current and long-term portions of the restructuring related liability balance as of September 30, 2012 were $19.2 million and $2.6 million, which are classified within other current liabilities and other long-term liabilities, respectively, on the Consolidated Balance Sheets.

There were no significant long-lived assets that were recorded at fair value at September 30, 2012 and 2011, respectively.

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Note 13: Other Comprehensive Income (Loss)

OCI is reflected as a net increase (decrease) to shareholders' equity and is not reflected in our results of operations. The before-tax amount, income tax (provision) benefit, and net-of-tax amount related to each component of other comprehensive income (loss) during the reporting periods were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Before-tax amount				
Foreign currency translation adjustment	$25,085	$(80,794)	$940	$43,162
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	(1,332)	3,360	(2,697)	3,054
Net unrealized gain (loss) on a nonderivative net investment hedging instrument	—	645	—	(14,278)
Net hedging (gain) loss reclassified into net income	—	(277)	—	4,200
Pension plan benefits liability adjustment	(4)	32	34	(713)
Total other comprehensive income (loss), before tax	23,749	(77,034)	(1,723)	35,425
Tax (provision) benefit				
Foreign currency translation adjustment	(558)	611	(243)	199
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	504	(1,274)	1,020	(1,132)
Net unrealized gain (loss) on a nonderivative net investment hedging instrument	—	(237)	—	5,424
Net hedging (gain) loss reclassified into net income	—	101	—	(1,602)
Pension plan benefits liability adjustment	(1)	(10)	6	207
Total other comprehensive income (loss) tax (provision) benefit	(55)	(809)	783	3,096
Net-of-tax amount				
Foreign currency translation adjustment	24,527	(80,183)	697	43,361
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	(828)	2,086	(1,677)	1,922
Net unrealized gain (loss) on a nonderivative net investment hedging instrument	—	408	—	(8,854)
Net hedging (gain) loss reclassified into net income	—	(176)	—	2,598
Pension plan benefits liability adjustment	(5)	22	40	(506)
Total other comprehensive income (loss), net of tax	$23,694	$(77,843)	$(940)	$38,521

Accumulated other comprehensive loss, net of tax, was $38.1 million at September 30, 2012 and $37.2 million at December 31, 2011. These amounts include adjustments for foreign currency translation, the unrealized gain (loss) on our hedging instruments, the hedging gain (loss), and the pension liability adjustment as indicated above.

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Note 14: Fair Values of Financial Instruments

The fair values at September 30, 2012 and December 31, 2011 do not reflect subsequent changes in the economy, interest rates, and other variables that may affect the determination of fair value.

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
		(in thousands)		
Assets				
Cash and cash equivalents	$91,474	$91,474	$133,086	$133,086
Foreign exchange forwards	57	57	241	241
Liabilities				
2011 credit facility				
USD denominated term loan	$281,250	$278,963	$292,502	$296,856
Multicurrency revolving line of credit	140,000	138,676	160,000	163,269
Foreign exchange forwards	103	103	222	222
Interest rate swaps	2,697	2,697	—	—

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

Cash and cash equivalents: Due to the liquid nature of these instruments, the carrying value approximates fair value (Level 1).

2011 Credit Facility - term loan and multicurrency revolving line of credit: The term loan and revolver are not traded publicly.The fair values, which are valued based upon a hypothetical market participant, are calculated using a discounted cash flow model with Level 2 inputs, including estimates of incremental borrowing rates for debt with similar terms, maturities, and credit profiles. Refer to Note 6 for a further discussion of our debt.

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

Note 15: Segment Information

As part of the global reorganization we announced in the first quarter of 2011, Itron is now managed and reports under two operating segments, Energy and Water. A transition to the new organizational structure, including changes to operations and financial and operational management systems, was completed in the first quarter of 2012. Therefore, financial reporting as of and for the three and nine months ended September 30, 2012 is based on the new operating segments, Energy and Water. Prior period segment information has been recast to reflect our new operating segments.

The Energy operating segment includes our global electricity and gas businesses, while the Water operating segment includes our global water and heat businesses.

We have three measures of segment performance: revenue, gross profit (margin), and operating income (margin). Our operating segments have distinct products, and therefore intersegment revenues are minimal. Corporate operating expenses, interest income, interest expense, other income (expense), and income tax provision (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss. In addition, we allocate only certain production assets and intangible assets to our operating segments. We do not manage the performance of the segments

on a balance sheet basis.

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Segment	Products
Energy	Standard electricity (electromechanical and electronic) and gas meters; advanced electricity and gas meters and communication modules; smart electricity meters; smart electricity and gas communication modules; prepayment systems, including smart key, keypad, and smart card communication technologies; advanced systems including handheld, mobile, and fixed network collection technologies; smart network technologies; meter data management software; knowledge application solutions; and professional services including implementation, installation, consulting, and analysis.
Water	Standard water and heat meters; advanced and smart water meters and communication modules; advanced systems including handheld, mobile, and fixed network collection technologies; meter data management software; knowledge application solutions; and professional services including implementation, installation, consulting, analysis, and system management.

Revenues, gross profit, and operating income associated with our segments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Revenues				
Energy	$377,489	$483,748	$1,259,834	$1,389,979
Water	126,574	131,807	395,009	401,668
Total Company	$504,063	$615,555	$1,654,843	$1,791,647
Gross profit				
Energy	$125,503	$144,120	$409,057	$426,457
Water	46,294	32,876	142,590	127,468
Total Company	$171,797	$176,996	$551,647	$553,925
Operating income (loss)				
Energy	$30,978	$(166,197)	$116,211	$(77,566)
Water	22,293	(321,191)	49,896	(290,582)
Corporate unallocated	(7,304)	(9,864)	(34,456)	(30,930)
Total Company	45,967	(497,252)	131,651	(399,078)
Total other income (expense)	(3,523)	(12,043)	(11,151)	(38,041)
Income (loss) before income taxes	$42,444	$(509,295)	$120,500	$(437,119)

One customer represented 10% of total Company revenues for the nine months ended September 30, 2012, while no customer represented more than 10% of total Company revenues during the three months ended September 30, 2012 and during the three and nine months ended September 30, 2011. One customer represented 11% and 13% of the Energy operating segment revenues in the three and nine months ended September 30, 2012, respectively, and one customer represented 10% and 11% of the Energy operating segment revenues in the three and nine months ended September 30, 2011, respectively. No single customer represented more than 10% of the Water operating segment revenues for the three and nine months ended September 30, 2012 and 2011.

Revenues by region were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
United States and Canada	$224,956	$292,322	$802,542	$852,715
Europe, Middle East, and Africa	211,195	227,884	648,050	702,296
Other	67,912	95,349	204,251	236,636
Total revenues	$504,063	$615,555	$1,654,843	$1,791,647

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Depreciation and amortization expense associated with our segments was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Energy	$20,452	$24,246	$61,596	$72,169
Water	7,116	8,368	20,211	24,742
Corporate Unallocated	17	6	49	8
Total Company	$27,585	$32,620	$81,856	$96,919

Note 16: Business Combinations

SmartSynch

On May 1, 2012, we completed our acquisition of 100% of SmartSynch. The acquisition was financed through borrowings on our multicurrency revolving line of credit and cash on hand. SmartSynch is a provider of smart grid solutions that utilize cellular networks for communications. The acquisition strengthens our cellular communications offerings, and we believe the acquisition brings greater choice to utility customers across the spectrum of smart metering deployments.

The preliminary purchase price for SmartSynch was $77.7 million in cash (net of $6.8 million of cash and cash equivalents acquired). The purchase price is subject to a working capital adjustment, which is expected to be finalized in the fourth quarter of 2012. The announced purchase price of $100 million included employee retention payments and change in control fees. Although these payments were settled at closing, in accordance with GAAP they are considered assumed liabilities.

We have made a preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on estimated fair value assessments. We are continuing to collect information to determine the fair values of certain accrued liabilities associated with specific contracts and income taxes, which would affect goodwill. As a result, the fair values of these assets and liabilities are provisional until we are able to complete our assessment. The following reflects our preliminary allocation of purchase price as of the acquisition date, May 1, 2012:

	Fair Value (in thousands)
Current assets[1]	$12,412
Property, plant, and equipment	1,653
Intangible assets	43,400
Goodwill	46,881
Total assets acquired	104,346
Current liabilities	26,143
Long-term liabilities	465
Total liabilities assumed	26,608
Total net assets acquired	$77,738

(1) Current assets include the fair value of accounts receivable of $6.1 million, which equals its contractual balance as it is considered fully collectible.

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Intangible assets acquired were as follows:

	Fair Value	Weighted Average Useful Life
	(in thousands)	(in years)
Core-developed technology	$15,100	7
Customer contracts and relationships	8,900	11
Total identified intangible assets subject to amortization	24,000	8
In-process research and development	19,400	
Total identified intangible assets	$43,400	

The fair values for the identified intangible assets were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The intangible assets will be amortized using the estimated discounted cash flows assumed in the valuation models. Existing technology represents the fair values of SmartSynch products that have reached technological feasibility and were part of SmartSynch's product offerings at the date of the acquisition. Customer contracts and relationships represent the fair value SmartSynch developed with its customers, including backlog.

IPR&D assets acquired represent the fair value of SmartSynch research and development projects that had not yet reached technological feasibility and consist primarily of projects to upgrade the hardware components of cellular communication modules to be compatible with 3G cellular network standards. These projects are expected to be completed in the next 12 months. Incremental costs to be incurred for these projects, currently estimated at $2.3 million, will be expensed as incurred in product development operating expenses. Once the projects are completed, they will be amortized over the expected life of the technology, which is expected to be seven years.

Goodwill of $46.9 million arising from the acquisition consists largely of the synergies expected from combining the operations of Itron and SmartSynch, as well as certain intangible assets that do not qualify for separate recognition. Based on synergies expected to be realized by the Electricity and Gas reporting units within the Energy operating segment, $37.3 million was assigned to the Electricity reporting unit and $9.6 million was assigned to the Gas reporting unit. The entire goodwill balance is expected to be deductible for income tax purposes.

Itron's acquisition related expenses of $44,000 and $3.0 million were recognized during the three and nine months ended September 30, 2012 and are included in general and administrative expenses.

The following table presents the revenues and net income (loss) from SmartSynch's operations that are included in our consolidated statements of operations:

	July 1, 2012 - September 30, 2012	May 1, 2012 - September 30, 2012
	(in thousands)	
Revenues	$7,910	$11,885
Net income (loss)	(3,808)	(6,579)

The following supplemental pro forma results are based on the individual historical results of Itron and SmartSynch, with adjustments to give effect to the combined operations as if the acquisition had been consummated on January 1, 2011.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			

Revenues	$504,063	$627,237	$1,665,897	$1,811,413
Net income (loss)	35,273	(519,943)	87,220	(463,944)

The significant nonrecurring adjustments, net of the estimated tax impact, include the following:

- Elimination from the supplemental pro forma net income of acquisition-related expenses incurred by SmartSynch prior to the acquisition and by Itron pre- and post-acquisition totaling $5.1 million for the nine months ended September 30, 2012.

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The supplemental pro forma results are intended for information purposes only and do not purport to represent what the combined companies' results of operations would actually have been had the transaction in fact occurred at an earlier date or project the results for any future date or period.

Note 17: Subsequent Events

Stock Repurchases

Subsequent to September 30, 2012, we repurchased 157,772 shares of our common stock, including 23,671 shares executed during September 2012 but settled in October 2012, under the stock repurchase program authorized by the Board of Directors on October 24, 2011. The average price paid per share was $42.73.

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

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes included in this report and with our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission (SEC) on February 17, 2012, and as disclosed in our Current Report on Form 8-K, filed with the SEC on May 24, 2012.

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

Certain Forward-Looking Statements

This document contains forward-looking statements concerning our operations, financial performance, revenues, earnings growth, liquidity, and other items. This document reflects our current plans and expectations and is based on information currently available as of the date of this Quarterly Report on Form 10-Q. When we use the words "expect," "intend," "anticipate," "believe," "plan," "project," "estimate," "future," "objective," "may," "will," "will continue," and simila they are intended to identify forward-looking statements. Forward-looking statements rely on a number of assumptions and estimates. These assumptions and estimates could be inaccurate and cause our actual results to vary materially from expected results. Risks and uncertainties include 1) the rate and timing of customer demand for our products, 2) rescheduling or cancellations of current customer orders and commitments, 3) changes in estimated liabilities for product warranties and/or litigation, 4) our dependence on customers' acceptance of new products and their performance, 5) competition, 6) changes in domestic and international laws and regulations, 7) changes in foreign currency exchange rates and interest rates, 8) international business risks, 9) our own and our customers' or suppliers' access to and cost of capital, 10) future business combinations, and 11) other factors. You should not solely rely on these forward-looking statements as they are only valid as of the date of this Quarterly Report on Form 10-Q. We do not have any obligation to publicly update or revise any forward-looking statement in this document. For a more complete description of these and other risks, refer to Item 1A: "Risk Factors" included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which was filed with the SEC on February 17, 2012.

Results of Operations

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

As part of our global reorganization that was announced in the first quarter of 2011, we now manage and report under two operating segments, Energy and Water. A transition to the new organizational structure, including changes to operations and financial and operational management systems, was completed in the first quarter of 2012. Therefore, financial reporting as of and for the three and nine months ended September 30, 2012 is based on the new operating segments, Energy and Water. Prior period segment information has been recast to reflect our new operating segments.

The Energy operating segment includes our global electricity and gas businesses, and the Water operating segment includes our global water and heat businesses.

We have three measures of segment performance: revenue, gross profit (margin), and operating income (margin). Our operating segments have distinct products, and therefore intersegment revenues are minimal. Corporate operating expenses, interest income, interest expense, other income (expense), and income tax provision (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss. In addition, we allocate only certain production assets and intangible assets to our operating segments. We do not manage the performance of the segments on a balance sheet basis.

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Overview

Revenues for the three and nine months ended September 30, 2012 were $504 million and $1.7 billion, compared with $616 million and $1.8 billion for the same periods last year. Fluctuations in foreign currency exchange rates unfavorably impacted revenues by $35 million and $83 million for the three and nine months ended September 30, 2012. Excluding the foreign currency translation impact, revenues decreased during these same periods in 2012 due to our five largest OpenWay projects in North America nearing completion, lower gas module shipments in North America, and lower Energy product shipments in Asia/Pacific, the combination of which was partially offset by an increase in Water revenue. Gross margin for the third quarter of 2012 was 34.1%, compared with a gross margin of 28.8% for the same period last year. Gross margin for the nine months ended September 30, 2012 was 33.3% compared with a gross margin of 30.9% for the corresponding period in 2011. Reduced warranty costs accounted for gross margin improvement of 5.4 percentage points for the quarter and 1.9 percentage points for the nine month period in 2012.

For the three and nine months ended September 30, 2012, we had tax provisions of 15.4% and 22.2%, based on a percentage of income before tax, as compared with tax provisions of 1.2% and 3.6%, based on a percentage of loss before income tax, for the same periods in 2011. The three and nine months ended September 30, 2012 included minimal discrete tax benefits, while the same periods in 2011 included the impact of the goodwill impairment of $540 million, which was not deductible for income tax purposes.

Total backlog was $1.1 billion and twelve-month backlog was $592 million at September 30, 2012.

On October 24, 2011, our Board of Directors authorized a twelve-month repurchase program of up to $100 million of our common stock. On September 13, 2012, the Board approved the extension of the expiration date of the stock repurchase program until February 15, 2013, or until the aggregate limit of $100 million of outstanding common stock has been repurchased, whichever occurs first. During the nine months ended September 30, 2012, we repurchased 1,044,105 shares of our common stock for $40.7 million. Since the inception of the repurchase program and through September 30, 2012, we have repurchased 1,867,454 shares for $70.1 million.

Total Company Revenues, Gross Profit and Margin, and Unit Shipments

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	% Change	2012	2011	% Change
	(in thousands)			(in thousands)		
Revenues	$504,063	$615,555	(18)%	$1,654,843	$1,791,647	(8)%
Gross Profit	$171,797	$176,996	(3)%	$551,647	$553,925	—%
Gross Margin	34.1 %	28.8 %		33.3 %	30.9 %	

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Revenues by Region				
United States and Canada (North America)	$224,956	$292,322	$802,542	$852,715
Europe, Middle East, and Africa (EMEA)	211,195	227,884	648,050	702,296
Other	67,912	95,349	204,251	236,636
Total revenues	$504,063	$615,555	$1,654,843	$1,791,647

Revenues

Revenues decreased $111.5 million and $136.8 million, or 18% and 8%, for the three and nine months ended September 30, 2012, compared with the same periods last year. The net translation effect of our operations denominated in foreign currencies resulted in an unfavorable impact to revenues of $35.5 million and $83.1 million for the three and nine months ended September 30, 2012, compared with the same periods in 2011. A more detailed analysis of these fluctuations is provided in Operating Segment Results.

One customer, BC Hydro and Power Authority, accounted for 10% of total Company revenues during the nine months ended September 30, 2012, while no single customer accounted for more than 10% of total revenues for the three months ended September 30, 2012 and during the three and nine months ended September 30, 2011. Our 10 largest customers accounted for 25% and 29% of total revenues for the three and nine months ended September 30, 2012, and 35% and 31% for the three and nine months ended

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September 30, 2011, respectively.

Gross Margins

Gross margin for the third quarter of 2012 was 34.1%, compared with a gross margin of 28.8% for the same period last year. For the first nine months of 2012, gross margin was 33.3% compared with 30.9% in the same period in 2011. Gross margin improved over the prior year for the quarter and nine months primarily due to lower warranty costs, which positively impacted gross margin by 5.4 percentage points in the quarter and 1.9 percentage points in the nine month period. In addition, gross margin for the nine months ended September 30, 2012 improved as a result of favorable product mix and lower manufacturing costs in both the Energy and Water segments. A more detailed analysis of these fluctuations is provided in Operating Segment Results.

Meter and Module Summary

We classify meters into three categories:

- Standard metering – no built-in remote reading communication technology
- Advanced metering – one-way communication of meter data
- Smart metering – two-way communication including remote meter configuration and upgrade (consisting primarily of our OpenWay® technology)

Advanced and smart meter communication modules can be sold separately from the meter. A summary of our total electricity, gas, water & heat meter and communication module shipments is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(units in thousands)			
Meters				
Standard	4,110	4,910	13,610	14,850
Advanced and smart	1,700	2,380	6,110	6,310
Total meters	5,810	7,290	19,720	21,160
Stand-alone communication modules				
Advanced and smart	1,500	1,560	5,050	4,840

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Operating Segment Results

For a description of our operating segments, refer to Item 1: “Financial Statements Note 15: Segment Information”.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	% Change	2012	2011	% Change
Segment Revenues	(in thousands)			(in thousands)		
Energy						
Electricity	$226,552	$313,728	(28)%	$794,496	$880,529	(10)%
Gas	150,937	170,020	(11)%	465,338	509,450	(9)%
Total Energy	377,489	483,748	(22)%	1,259,834	1,389,979	(9)%
Water	126,574	131,807	(4)%	395,009	401,668	(2)%
Total revenues	$504,063	$615,555	(18)%	$1,654,843	$1,791,647	(8)%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Margin
Segment Gross Profit and Margin	(in thousands)		(in thousands)		(in thousands)		(in thousands)	
Energy	$125,503	33.2%	$144,120	29.8%	$409,057	32.5%	$426,457	30.7%
Water	46,294	36.6%	32,876	24.9%	142,590	36.1%	127,468	31.7%
Total gross profit and margin	$171,797	34.1%	$176,996	28.8%	$551,647	33.3%	$553,925	30.9%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin
Segment Operating Income (Loss) and Operating Margin	(in thousands)		(in thousands)		(in thousands)		(in thousands)	
Energy	$30,978	8%	$(166,197)	(34)%	$116,211	9%	$(77,566)	(6)%
Water	22,293	18%	(321,191)	(244)%	49,896	13%	(290,582)	(72)%
Corporate unallocated	(7,304)		(9,864)		(34,456)		(30,930)	
Total Company	$45,967	9%	$(497,252)	(81)%	$131,651	8%	$(399,078)	(22)%

Energy:

Revenues - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Electricity revenues decreased $87.2 million, or 28%, for the three months ended September 30, 2012, compared with the same period last year. Revenues in 2012 were lower primarily driven by $75.8 million in scheduled decreases in

our five largest OpenWay projects in North America, by decreased product shipments in Asia-Pacific of $15 million, and by $13.3 million for the currency translation effect of our operations denominated in foreign currencies. These decreases were partially offset by $8 million in increased product shipments in EMEA.

Gas revenues decreased $19.1 million, or 11%, for the three months ended September 30, 2012, compared with the same period last year, primarily as the result of $8.4 million in lower shipments of smart gas communication modules in North America, due to normal period-to-period fluctuations in the timing of customer projects, and $10.5 million for the translation effect of our operations denominated in foreign currencies.

One customer represented 11% and 10% of the Energy operating segment revenues in the three months ended September 30, 2012 and 2011.

Revenues - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
Electricity revenues for the first nine months of 2012 were lower by $86.0 million, or 10%, when compared with the same period in 2011. In 2012, OpenWay project revenues shipments in North America decreased by $60.2 million from the same period in 2011. Our 2012 revenues were unfavorably impacted by lower revenues in Latin America and Asia-Pacific and also by $30.9 million related to the translation effect of our operations denominated in foreign currencies. These decreases were partially offset

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by an increase in Electricity professional services in EMEA.

Gas revenues decreased $44.1 million, or 9%, for the nine months ended September 30, 2012, compared with the same period last year, primarily due to $7.5 million in lower OpenWay project revenues in North America resulting from the completion of a large OpenWay project during 2011, lower product shipments in EMEA, and $25.3 million for the currency translation effect of our operations denominated in foreign currencies.

One customer represented 13% and 11% of the Energy operating segment revenues in the nine months ended September 30, 2012 and 2011.

Gross Margin - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Gross margin was 33.2% for the three months ended September 30, 2012, compared with a gross margin of 29.8% for the same period last year. During the third quarter of 2012, gross margin was positively impacted by $14.5 million of lower warranty expense when compared with the same period in 2011, and reduced product costs as a result of our restructuring and global procurement projects, which were initiated in the fourth quarter of 2011. Warranty expense in the third quarter of 2012 was favorably impacted by $2.7 million for reductions in warranty reserves based on updated cost estimates.

Gross Margin - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
Gross margin was 32.5% for the nine months ended September 30, 2012, compared with a gross margin of 30.7% for the corresponding period in 2011. Gross margin was positively impacted by $18.3 million of lower warranty expense when compared with the nine months ended September 30, 2011, product mix, and reduced costs as a result of our restructuring and global procurement projects, which were initiated in the fourth quarter of 2011. Warranty expense in the first nine months of 2012 was favorably impacted by a $5.0 million adjustment, which reduced a warranty reserve originally recorded in 2011, as a result of lower than estimated replacements. Warranty expense in 2011 was negatively impacted by a $7.7 million charge related to certain products in Brazil and $8.3 million due to corrective actions for specific customers in North America, which were partially offset by an $8.6 million insurance recovery associated with product claims in Sweden in 2010.

Operating Expenses - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Energy operating expenses decreased $215.8 million, or 69.5%, for the three months ended September 30, 2012, compared with the same period last year, primarily due to the goodwill impairment of $216.1 million recognized in 2011, favorable foreign currency translation impact of $5.9 million, and scheduled decreases in amortization of intangible assets. These decreases were offset by increased sales and marketing costs and product development costs for the development of new and enhanced products. Apart from the goodwill impairment and restructuring, operating expenses as a percentage of revenues were 25% for the three months ended September 30, 2012, compared with 19% for the same period last year. Itron Cellular Solutions, formerly SmartSynch, contributed $5.5 million of operating expenses during the third quarter of 2012.

Operating Expenses - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
For the first nine months of 2012, Energy operating expenses decreased $211.2 million, or 42%, compared with 2011, primarily due to the goodwill impairment of $216.1 million recognized in 2011, favorable foreign currency translation impact of $13.6 million during the nine months ended September 30, 2012, and scheduled decreases in amortization of intangible assets. These decreases were offset by increased sales and marketing and product development costs for development of new and enhanced products and $1.7 million in increased restructuring expenses. Operating expenses, excluding the goodwill impairment and restructuring, as a percentage of revenues were 23% for the nine months ended September 30, 2012, compared with 21% for the same period last year. Itron Cellular Solutions contributed $10.2 million of operating expenses since the acquisition on May 1, 2012.

Water:

Revenues - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Revenues decreased $5.2 million, or 4%, for the three months ended September 30, 2012, compared with the same period last year. Excluding the translation effect of a stronger U.S. dollar against most foreign currencies in the third quarter of 2012, as compared with the third quarter of 2011, revenues increased 5%. The increase was driven primarily by higher communication module shipments in North America, as well as increased product shipments in EMEA and Asia-Pacific.

No single customer represented more than 10% of the Water operating segment revenues in the three months ended September 30, 2012 and 2011.

Revenues - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
Water revenues decreased $6.7 million, or 2%, for the nine months ended September 30, 2012, compared with the same period

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last year. The translation effect of foreign currencies to the U.S. dollar had an unfavorable impact of $26.9 million in the first nine months of 2012. Excluding the translation effect of a stronger U.S. dollar against most foreign currencies in the nine months ended September 30, 2012, revenue increased 5%. Sales increased in all regions with higher shipments of communication modules in North America and meters and systems in all other regions.

No single customer represented more than 10% of the Water operating segment revenues in the nine months ended September 30, 2012 and 2011.

Gross Margin - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Water gross margin increased to 36.6% for the three months ended September 30, 2012, compared with a gross margin of 24.9% for the same period last year, primarily as a result of $12.6 million in increased warranty costs in 2011 associated with a vendor-supplied component and a more favorable product mix in 2012.

Gross Margin - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
For the first nine months of 2012, gross margin increased to 36.1% from 31.7% in the same period in 2011, primarily as a result of $12.6 million in increased warranty costs in 2011 associated with a vendor-supplied component. Gross margin for the first three quarters of 2012 was also favorably impacted by product mix and manufacturing efficiencies.

Operating Expenses - Three months ended September 30, 2012 vs. Three months ended September 30, 2011
Operating expenses for the three months ended September 30, 2012 decreased by $330.1 million over the third quarter of 2011. This decrease was the result of a goodwill impairment of $324.3 million recognized in 2011 and a recovery of $5.4 million in restructuring expense related to the goodwill allocated to a non-core business which was sold during the second quarter of 2012. Increases in sales and marketing and product development costs for smart and advanced meter products were partially offset by scheduled decreases in amortization of intangible assets and $2.8 million for the favorable foreign currency translation impact of the stronger U.S. dollar. Operating expenses, excluding goodwill impairment and restructuring expense, as a percentage of revenue, were 23% for the three months ended September 30, 2012 and 2011.

Operating Expenses - Nine months ended September 30, 2012 vs. Nine months ended September 30, 2011
Operating expenses decreased $325.4 million for the nine months ended September 30, 2012 compared with the same period in 2011. The significant decrease was the result of a goodwill impairment of $324.3 million in 2011. In 2012, increases in sales and marketing and product development costs for smart and advanced meter products were largely offset by scheduled decreases in amortization of intangible assets and $6.6 million for the favorable foreign currency translation impact of the stronger U.S. dollar. Excluding goodwill impairment and restructuring, operating expenses, as a percentage of revenue, were 24% and 23% for the nine months ended September 30, 2012 and 2011, respectively.

Corporate unallocated:

Operating expenses not directly associated with an operating segment are classified as “Corporate unallocated.” These expenses decreased $2.6 million in the three months ended September 30, 2012, compared with the same period last year, due to lower corporate marketing and IT related spending. Corporate unallocated expenses increased by $3.5 million for the nine months ended September 30, 2012, compared with 2011. The increases were primarily due to acquisition related expenses for the SmartSynch acquisition of $3.0 million for the nine months ended September 30, 2012. In addition, we incurred approximately $3.4 million during the first nine months of 2012 for management training and development costs in connection with the implementation of our new organization and for preliminary planning costs, prior to application development, for our global enterprise resource planning (ERP) software initiative, which commenced in the third quarter of 2012. These increases in operating expenses were partially offset by lower corporate marketing and IT related spending.

Bookings and Backlog of Orders

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

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Quarter Ended	Quarterly Bookings	Ending Total Backlog	Ending 12-Month Backlog
	(in millions)		
September 30, 2012	$459	$1,079	$592
June 30, 2012	447	1,122	637
March 31, 2012	488	1,221	760
December 31, 2011	515	1,296	766
September 30, 2011	441	1,439	901

Information on bookings by our operating segments is as follows:

Quarter Ended	Total Bookings (in millions)	Energy	Water
September 30, 2012	$459	$341	$118
June 30, 2012	447	330	117
March 31, 2012	488	341	147
December 31, 2011	515	400	115
September 30, 2011	441	317	124

Upon the closing of the SmartSynch acquisition on May 1, 2012, $60 million was added to total backlog during the second quarter of 2012. However, it was not included in total bookings for that period.

Operating Expenses

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012 (in thousands)	% of Revenues	2011 (in thousands)	% of Revenues	2012 (in thousands)	% of Revenues	2011 (in thousands)	% of Revenues
Sales and marketing	$44,913	9%	$ 44,870	7%	$145,616	9%	$ 138,019	8%
Product development	43,299	9%	38,377	6%	134,295	8%	119,147	7%
General and administrative	30,743	6%	33,492	5%	100,763	6%	104,627	6%
Amortization of intangible assets	11,929	2%	16,013	3%	35,867	2%	47,807	3%
Restructuring	(5,054)	(1)%	1,096	—%	3,455	—%	3,003	—%
Goodwill impairment	—	—%	540,400	88%	—	—%	540,400	30%
Total operating expenses	$125,830	25%	$ 674,248	110%	$419,996	25%	$ 953,003	53%

Operating expenses decreased $548.4 million and $533.0 million for the three and nine months ended September 30, 2012, compared with the same periods last year, primarily due to the absence of goodwill impairment in 2012 compared with $540.4 million of goodwill impairment recognized during the three and nine months ended September 30, 2011. In addition, there was a scheduled decrease in amortization of intangible assets of $4.1 and $11.9 million

and a favorable impact from foreign currency translation of $47.6 million and $59.1 million for the three and nine months ended September 30, 2012. These decreases were partially offset by increased sales and marketing and product development costs for development of new and enhanced products, acquisition related expenses for the SmartSynch acquisition of $44,000 and $3.0 million for the three and nine months ended September 30, 2012. In addition, we incurred approximately $616,000 and $3.4 million during the three and nine months ended September 30, 2012 for management training and development costs in connection with the implementation of our new organization and for preliminary planning costs, prior to application development, for our global ERP software initiative which commenced in the third quarter of 2012.

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Other Income (Expense)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Interest income	$297	$155	$667	$631
Interest expense	(2,138)	(7,696)	(6,418)	(28,965)
Amortization of prepaid debt fees	(413)	(3,100)	(1,176)	(5,365)
Other income (expense), net	(1,269)	(1,402)	(4,224)	(4,342)
Total other income (expense)	$(3,523)	$(12,043)	$(11,151)	$(38,041)

Interest income: Interest income is generated from our cash and cash equivalents. Interest rates have continued to remain low.

Interest expense: Interest expense continues to decline each period as a result of our declining principal balance of outstanding debt and lower interest rates on our 2011 credit facility, when compared with the interest rates on the 2007 credit facility, which was outstanding during the first seven months of 2011. Total debt was $421.3 million and $496.3 million at September 30, 2012 and September 30, 2011, respectively.

Amortization of prepaid debt fees: Amortization of prepaid debt fees for the three and nine months ended September 30, 2012 decreased from the same periods last year due to a lower balance of capitalized prepaid debt fees, combined with a $2.4 million write-off of unamortized prepaid debt fees associated with the payoff of the 2007 credit facility in August 2011. Refer to Item 1: “Financial Statements Note 6: Debt” for additional details related to our long-term borrowings.

Other income (expense), net: Other expenses, net, consist primarily of unrealized and realized foreign currency gains and losses from balances denominated in a currency other than the reporting entity's functional currency and other non-operating income (expenses). Foreign currency losses, net of hedging, were $1.2 million and $2.7 million for the three and nine months ended September 30, 2012, compared with net foreign currency losses of $1.1 million and $3.0 million in the same periods in 2011.

Financial Condition

Cash Flow Information:

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Operating activities	$137,003	$153,801
Investing activities	(110,147)	(59,800)
Financing activities	(68,516)	(136,111)
Effect of exchange rates on cash and cash equivalents	48	2,147
Decrease in cash and cash equivalents	$(41,612)	$(39,963)

Cash and cash equivalents was $91.5 million at September 30, 2012, compared with $133.1 million at December 31, 2011.

Operating activities

Cash provided by operating activities during the nine months ended September 30, 2012 was $16.8 million lower, compared with the same period in 2011, primarily due to a smaller increase in working capital and a reduction of the warranty reserves through higher claims activity during the nine months ended September 30, 2012.

Investing activities

Cash used in investing activities during the nine months ended September 30, 2012 was $50.3 million higher, compared with the same period in 2011. The increase in cash used in investing activities in 2012 is primarily due to the SmartSynch acquisition, offset by a decrease in acquisitions of property, plant, and equipment, compared with the same period in 2011. Refer to Item 1: "Financial Statements, Note 16: Business Combinations" for additional information regarding the acquisition of SmartSynch.

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Financing activities
Net cash used in financing activities during the nine months ended September 30, 2012 was $67.6 million lower, compared with the same period in 2011. During the nine months ended September 30, 2012, we drew $70 million from our multicurrency revolving line of credit for the SmartSynch acquisition. Repayments on borrowings net of draws for the first nine months of 2012 were $31.2 million, compared with $134.3 million during the same period in 2011. The reduction in net repayments was partially offset by the repurchase of $40.7 million of our common stock during the first nine months of 2012 under the share repurchase program authorized by the Board of Directors on October 24, 2011. Refer to Part II Item 2: "Unregistered Sale of Equity Securities and Use of Proceeds" for additional details related to our share repurchase program.

Effect of exchange rates on cash and cash equivalents
The effect of exchange rates on the cash balances of currencies held in foreign denominations for the nine months ended September 30, 2012 was an increase of $48,000, compared with an increase of $2.1 million for the same period in 2011.

Off-balance sheet arrangements:

We have no off-balance sheet financing agreements or guarantees as defined by Item 303 of Regulation S-K at September 30, 2012 and December 31, 2011 that we believe are reasonably likely to have a current or future effect on our financial condition, results of operations, or cash flows.

Liquidity and Capital Resources:

Our principal sources of liquidity are cash flows from operations, borrowings, and sales of common stock. Cash flows may fluctuate and are sensitive to many factors including changes in working capital and the timing and magnitude of capital expenditures and payments on debt. Working capital, which represents current assets less current liabilities, was $353.1 million at September 30, 2012, compared with $329.6 million at December 31, 2011.

Borrowings
In August 2011, we entered into a senior secured credit facility (the 2011 credit facility). The 2011 credit facility consists of a $300 million U.S. dollar term loan and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $660 million.

At September 30, 2012, $140.0 million was outstanding under the revolver, and $49.4 million was utilized by outstanding standby letters of credit, resulting in $470.6 million available for additional borrowings.

For further description of the term loan and the revolver under our 2011 credit facility, refer to Item 1: “Financial Statements, Note 6: Debt”.

For a description of our letters of credit and performance bonds, and the amounts available for additional borrowings or letters of credit under our lines of credit, including the revolver that is part of our 2011 credit facility, refer to Item 1: “Financial Statements, Note 11: Commitments and Contingencies”.

Share Repurchase
On October 24, 2011, our Board of Directors authorized a repurchase program of up to $100 million of our common stock through October 23, 2012. On September 13, 2012, the Board approved the extension of the expiration date of the stock repurchase program until February 15, 2013, or until the aggregate limit of $100 million of outstanding common stock has been repurchased, whichever occurs first. Repurchases are made in the open market or in privately negotiated transactions and in accordance with applicable securities laws. Depending on market conditions and other

factors, these repurchases may be commenced or suspended from time to time without prior notice. During the nine months ended September 30, 2012, we repurchased $40.7 million of our common stock, which represents 1,044,105 shares. As of September 30, 2012, we have repurchased $70.1 million in shares of our common stock, with $29.9 million remaining under the repurchase program. Refer to Part II, Item 2: "Unregistered Sales of Equity Securities and Use of Proceeds" for additional information related to our share repurchase program.

Restructuring

During the fourth quarter of 2011, we announced the approval of projects to restructure our manufacturing operations to increase efficiency and lower our cost of manufacturing. We began implementing these projects in the fourth quarter of 2011, and we expect to substantially complete these projects by the end of 2013.

Total expected costs decreased by approximately $7.9 million to $81.1 million during the third quarter, primarily the result of gains on the dispositions of fixed assets and a correction to the amount of goodwill allocated to one of our non-core businesses

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sold as part of the restructuring process. In addition, expected severance costs were reduced as the result of certain employees in positions that were eliminated under the restructuring plan filling vacant positions within the Company. For further details regarding the correction of the goodwill impairment, refer to Item 1: “Financial Statements, Note 5: Goodwill”. A substantial portion of the total expected charges was recognized in the fourth quarter of 2011, and $21.8 million was accrued at September 30, 2012, of which $19.2 million is expected to be paid over the next 12 months. As a result of our restructuring activities, we anticipate annualized savings in 2012 of approximately $15 million. We expect to achieve annualized cost savings of approximately $30 million by the end of 2013. Certain projects are subject to a variety of labor and employment laws, rules, and regulations which could result in a delay in implementing projects at some locations. Real estate market conditions may impact the timing of our ability to sell some of the manufacturing facilities we have designated for closure and disposal. This may delay the completion of the restructuring projects beyond 2013. For further details regarding our restructuring activities, refer to Item 1: “Financial Statements, Note 12: Restructuring”.

Other Liquidity Considerations

We have tax credits and net operating loss carryforwards in various jurisdictions that are available to reduce cash taxes. However, utilization of tax credits and net operating losses are limited in certain jurisdictions. Based on current projections we expect to pay approximately $18.9 million in U.S. federal and state taxes and $23.4 million in local and foreign taxes in 2012. For a discussion of our tax provision and unrecognized tax benefits, see Item 1: “Financial Statements, Note 10: Income Taxes”.

As of September 30, 2012, there was $35.1 million of cash and cash equivalents held by foreign subsidiaries that could be repatriated, if necessary to fund U.S. operations. Tax is one of the many factors that we consider in the management of global cash. Included in the determination of the tax costs in repatriating foreign cash into the United States are the amount of earnings and profits in a particular jurisdiction, withholding taxes that would be imposed, and available foreign tax credits. Accordingly, the amount of taxes that we would need to accrue and pay to repatriate foreign cash could vary significantly.

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, Inc, we consolidate them because we have a greater than 50% ownership interest or because we exercise control over the operations. 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. Approximately $16.2 million of our consolidated cash balance at September 30, 2012 resides in our joint venture entities. As a result, the minority shareholders of these entities control their proportional share of this cash balance, and there may be limitations on Itron to repatriate cash to the U.S. from these entities.

For a description of our funded and unfunded non-U.S. defined benefit pension plans and our expected 2012 contributions, refer to Item 1: “Financial Statements, Note 8: Defined Benefit Pension Plans”.

For a description of our bonus and profit sharing plans, including the amounts accrued at September 30, 2012 and the expected timing of payment, refer to Bonus and Profit Sharing within Critical Accounting Estimates below.

General Liquidity Overview

We expect to grow through a combination of internal new product development, licensing technology from and to others, distribution agreements, partnership arrangements, and acquisitions of technology or other companies. We expect these activities to be funded with existing cash, cash flow from operations, borrowings, and the sale of common stock or other securities. We believe existing sources of liquidity will be sufficient to fund our existing operations and obligations for the next 12 months and into the foreseeable future, but offer no assurances. Our liquidity could be affected by unforeseen changes in the energy and water industries, competitive pressures, changes

in estimated liabilities for product warranties and/or litigation, future business combinations, capital market fluctuations, international risks, and other factors described under “Risk Factors” within Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which was filed with the SEC on February 17, 2012, as well as “Quantitative and Qualitative Disclosures About Market Risk” within Item 3 of Part I included in this Quarterly Report on Form 10-Q.

Contingencies

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

Critical Accounting Estimates

Revenue Recognition
The majority of our revenue arrangements involve multiple deliverables, which require us to determine the fair value of each deliverable and then allocate the total arrangement consideration among the separate deliverables based on the relative fair value

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percentages. 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 arrangements, 4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. A majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

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

If implementation services are essential to a software arrangement, revenue is recognized using either the percentage-of-completion methodology if project costs can be reliably estimated or the completed contract methodology if project costs cannot be reliably estimated. The estimation of costs through completion of a project is subject to many variables such as the length of time to complete, changes in wages, subcontractor performance, supplier information, and business volume assumptions. Changes in underlying assumptions/estimates may adversely or positively affect financial performance.

Certain of our revenue arrangements include an extended or noncustomary warranty provision which 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 vendor specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP).

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

If we are unable to establish selling price using VSOE or TPE, we use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Specifically, we consider the cost to produce the deliverable, the anticipated margin on that deliverable, the selling price and profit margin for similar parts, our ongoing pricing strategy and policies (as evident in the price list established and updated by management on a regular basis), the value of any enhancements that have been built into the deliverable, and the characteristics of the varying markets in which the deliverable is sold. We analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices are analyzed on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

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

Restructuring and Asset Impairments

We record a liability for costs associated with an exit or disposal activity at its fair value in the period in which the liability is incurred. Employee termination benefits considered post-employment benefits are accrued when the obligation is probable and

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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 later of when we terminate a contract in accordance with the contract terms or when we cease using the rights conveyed by the contract.

Asset impairments, net, 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 are less than the net book value less costs to sell. 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, the asset group may consist of property, plant, equipment, intangible assets, and goodwill.

In determining restructuring projects, we analyze our future operating requirements, including the required headcount by business functions and facility space requirements. Our restructuring costs and any resulting accruals involve significant estimates using the best information available at the time the estimate are made. Our estimates involve a number of risks and uncertainties, some of which are beyond our control, including real estate market conditions and local labor and employment laws, rules, and regulations. If the amounts and timing of cash flows from restructuring activities are significantly different from what we have estimated, the actual amount of restructuring and asset impairment charges could be materially different, either higher or lower, than those we have recorded.

Income Taxes

The calculation of our annual estimated effective tax rate requires significant judgment and is subject to several factors, including fluctuations in the forecasted mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items. Changes in tax laws and unanticipated tax liabilities could significantly impact our tax rate.

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

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

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

Inventories

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

Goodwill and Intangible Assets

Goodwill and intangible assets may result from our acquisitions. We use estimates, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations, in determining the value assigned to goodwill and intangible assets. Our intangible assets have finite lives and are amortized over their estimated useful

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lives based on estimated discounted cash flows. 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.

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. Prior to 2012, we had four reporting units: Itron North America (INA), Itron International (INL) Electricity, INL Gas, and INL Water. Effective January 1, 2012, our three new reporting units are Electricity, Gas, and Water. Our new Energy operating segment consists of the Electricity and Gas reporting units, while our new Water operating segment consists of the Water reporting unit. In the first quarter of 2012, we reallocated the goodwill from our former INA reporting unit to the three new reporting units based on the relative fair values of the electricity, gas, and water product lines within INA on January 1, 2012. We also reassigned the goodwill from our former INL Electricity, INL Gas, and INL Water reporting units to the new reporting units, Electricity, Gas, and Water, respectively.

We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. The impairment test involves comparing the fair value 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 for a goodwill impairment loss. This second step revalues all assets and liabilities of the reporting unit to their current fair values 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.

As a result of the considerable decline in the price of our shares of common stock in 2011, our aggregate market value was significantly lower than the aggregate carrying value of our net assets. Therefore, we performed an interim impairment test of our goodwill as of September 30, 2011, which resulted in a goodwill write-down of $584.8 million in 2011. The goodwill impairment did not affect the debt covenants under the Company's existing credit facility.

The goodwill impairment before the reorganization into the new reporting units was associated with two reporting units from the Itron International operating segment. The goodwill balance associated with these reporting units before and after the goodwill impairment was as follows:

	September 30, 2011		
Reporting Unit	Before Impairment	Impairment	After Impairment
	(in thousands)		
Itron International - Electricity	$363,626	$254,735	$108,891
Itron International - Water	389,308	330,112	59,196
		$584,847	

Following the allocation of goodwill from the previous reporting units to the new reporting units (Electricity, Gas, and Water) on January 1, 2012, the fair value of each reporting unit exceeded the carrying value by a minimum of 35%.

As a result of the SmartSynch acquisition and based on the preliminary purchase price allocation, we recognized $46.9 million in goodwill. Based on synergies expected to be realized by the Electricity and Gas reporting units within the Energy operating segment, $37.3 million was assigned to the Electricity reporting unit and $9.6 million was assigned to the Gas reporting unit.

Changes in market demand, fluctuations in the economies in which we operate, the volatility and decline in the worldwide equity markets, and a significant decline in our market capitalization could negatively impact the remaining carrying value of our goodwill, which could have a significant effect on our current and future results of operations and financial condition.

Derivative Instruments

All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (also known as “Level 2”), as defined by U.S. generally accepted

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accounting principles. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position. Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility, credit risks, and default rates). Derivatives are not used for trading or speculative purposes. Our derivatives are with major international financial institutions, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments.

Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our international employees, primarily in Germany, France, Italy, Indonesia, and Spain. 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 (OCI), net of tax, the actuarial gains or losses and prior service costs or credits, if any, that arise during the period but are not recognized as components of net periodic benefit cost.

Several economic assumptions and actuarial data are used in calculating the expense and obligations related to these plans. The assumptions are updated annually at December 31 and include the discount rate, the expected remaining service life, the expected rate of return on plan assets, and rate of future compensation increase. The discount rate is a significant assumption used to value our pension benefit obligation. We determine a discount rate for our plans based on the estimated duration of each plan’s liabilities. For our euro denominated defined benefit pension plans, which represent 92% of our benefit obligation, we use two discount rates, (separated between shorter and longer duration plans), using a hypothetical yield curve developed from euro-denominated AA-rated corporate bond issues, partially weighted for market value, with minimum amounts outstanding of €250 million for bonds with less than 10 years to maturity and €50 million for bonds with 10 or more years to maturity, and excluding 10% of the highest and lowest yielding bonds within each maturity group. The discount rates derived for our shorter duration euro denominated plans (less than 10 years) and longer duration plans (greater than 10 years) were 4.50% and 5.25%, respectively. The weighted average discount rate used to measure the projected benefit obligation for all of the plans at December 31, 2011 was 5.51%. A change of 25 basis points in the discount rate would change our pension benefit obligation by approximately $2.3 million. The financial and actuarial assumptions used at December 31, 2011 may differ materially from actual results due to changing market and economic conditions and other factors. These differences could result in a significant change in the amount of pension expense recorded in future periods. Gains and losses resulting from changes in actuarial assumptions, including the discount rate, are recognized in OCI in the period in which they occur.

Our general funding policy for these qualified pension plans is to contribute amounts at least sufficient to satisfy funding standards of the respective countries for each plan. Refer to Item 1: “Financial Statements, Note 8: Defined Benefit Pension Plans” for our expected contributions for 2012.

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 estimated progress toward the achievement of the annual targets, the actual results at the end of the year may require awards that are significantly greater or less than the estimates made in earlier quarters. For the three and nine months ended September 30, 2012, we accrued $3.7 million and $15.6 million for such awards, compared with $3.7 million and

$19.3 million in the same periods in 2011. Awards are typically distributed in the first quarter of the following year.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including awards of stock options, stock sold pursuant to our Employee Stock Purchase Plan (ESPP), 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 life. In valuing our stock options, significant judgment is required in determining the expected volatility of our common stock and the expected life that individuals will hold their stock options prior to exercising. Expected volatility is based on the historical and implied volatility of our own common stock. The expected life of stock option grants is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option. While volatility and estimated life are assumptions that do not bear the risk of change subsequent to the grant date of stock options,

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these assumptions may be difficult to measure as they represent future expectations based on historical experience. Further, our expected volatility and expected life may change in the future, which could substantially change the grant-date fair value of future awards of stock options and ultimately the expense we record. For ESPP awards, the fair value is the difference between the market close price of our common stock on the date of purchase and the discounted purchase price. For restricted stock units and unrestricted stock awards, the fair value is the market close price of our common stock on the date of grant. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates. We expense stock-based compensation 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 both performance and service conditions, 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. 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.

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Item 3: Quantitative and Qualitative Disclosures about Market Risk

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

Interest Rate Risk

We are exposed to interest rate risk through our variable rate debt instruments. In May 2012, we entered into six forward starting pay-fixed receive one-month LIBOR interest rate swaps. The interest rate swaps convert $200 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.00% (excluding the applicable margin on the debt) and are effective July 31, 2013 to August 8, 2016.

The table below provides information about our financial instruments that are sensitive to changes in interest rates and the scheduled minimum repayment of principal and the weighted average interest rates at September 30, 2012. Weighted average variable rates in the table are based on implied forward rates in the Reuters U.S. dollar yield curve as of September 30, 2012 and our estimated leverage ratio, which determines our additional interest rate margin at September 30, 2012.

	2012	2013	2014	2015	2016	Total
	(in thousands)					
Variable Rate Debt						
Principal: U.S. dollar term loan	$3,750	$18,750	$26,250	$30,000	$202,500	$281,250
Average interest rate	1.49 %	1.48 %	1.60 %	1.84 %	2.17 %	
Principal: Multicurrency revolving line of credit	$—	$—	$—	$—	$140,000	$140,000
Average interest rate	1.49 %	1.48 %	1.60 %	1.84 %	2.17 %	
Interest rate swap on LIBOR based debt						
Average interest rate (Pay)		1.00 %	1.00 %	1.00 %	1.00 %	
Average interest rate (Receive)		0.26 %	0.35 %	0.59 %	0.92 %	
Net/Spread		(0.74)%	(0.65)%	(0.41)%	(0.08)%	

Based on a sensitivity analysis as of September 30, 2012, we estimate that, if market interest rates average one percentage point higher in 2012 than in the table above, our financial results in 2012 would not be materially impacted.

We continually monitor and assess our interest rate risk and may institute additional interest rate swaps or other derivative instruments to manage such risk in the future (refer to Item 1: "Financial Statements, Note 7: Derivative Financial Instruments").

Foreign Currency Exchange Rate Risk

We conduct business in a number of countries. As a result, over half of our revenues and operating expenses are denominated in foreign currencies, which expose our account balances to movements in foreign currency exchange

rates that could have a material effect on our financial results. Our primary foreign currency exposure relates to non-U.S. dollar denominated transactions in our international subsidiary operations, the most significant of which is the euro. Revenues denominated in functional currencies other than the U.S. dollar were 62% and 58% of total revenues for the three and nine months ended September 30, 2012, respectively, compared with 56% for the same periods in 2011.

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts (a total of 429 contracts were entered into during the nine months ended September 30, 2012), which are not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. The notional amounts of the contracts ranged from $120,000 to $51 million, offsetting our exposures from the euro, British pound, Canadian dollar, Australian dollar, Brazilian real, and various other currencies.

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

Item 4: Controls and Procedures

(a) Evaluation of disclosure controls and procedures. At September 30, 2012, an evaluation was performed under the supervision and with the participation of our Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e)) under the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of September 30, 2012, the Company's disclosure controls and procedures were effective to ensure the information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

(b) Changes in internal controls over financial reporting. We are in the process of upgrading our global enterprise resource planning software systems. During the three months ended September 30, 2012, Management continued to update the design and documentation of internal control processes to supplement and complement existing internal controls and procedures relating to the implementation of an Oracle suite of financial applications for financial consolidations and management reporting during the first quarter of 2012. The implementation of these new applications resulted in changes to our internal controls over financial reporting. Management will continue to monitor, evaluate, and update the related processes and internal controls as necessary during the post-implementation period to ensure adequate internal control over financial reporting.

Other than as described above, there have been no changes in our internal control over financial reporting during the three months ended September 30, 2012 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1: Legal Proceedings

There were no material changes, as defined by Item 103 of Regulation S-K, during the third quarter of 2012.

Item 1A: Risk Factors

There were no material changes to risk factors during the third quarter of 2012 from those previously disclosed in Item 1A: "Risk Factors" of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which was filed with the SEC on February 17, 2012.

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable.

(b) Not applicable.

(c) Issuer Repurchase of Equity Securities

The table below summarizes information about the Company's purchases of its shares of common stock, based on settlement date, during the quarterly period ended September 30, 2012.

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share[2]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
July 1 through July 31	112,061	$41.31	112,061	$39,967
August 1 through August 31	125,010	43.89	125,010	34,480
September 1 through September 30	105,344	43.74	105,344	29,873
Total	342,415	$43.00	342,415	

(1) On October 24, 2011, our Board of Directors authorized a twelve-month repurchase program of up to $100 million of our common stock. On September 13, 2012, the Board approved the extension of the expiration date of the stock repurchase program until February 15, 2013, or until the aggregate limit of $100 million of outstanding common stock has been repurchased, whichever occurs first. Repurchases are made in the open market or in privately negotiated transactions, and in accordance with applicable securities laws. No shares were purchased outside of this plan.

(2) Includes commissions.

Subsequent to September 30, 2012, we repurchased 157,772 shares of our common stock, including 23,671 shares executed during September 2012 but settled in October 2012, under the stock repurchase program authorized by the Board of Directors on October 24, 2011. The average price paid per share was $42.73.

Item 5: Other Information

(a) No information was required to be disclosed in a report on Form 8-K during the third quarter of 2012 that was not reported.

(b) Not applicable.

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Item 6: Exhibits

Exhibit Number	Description of Exhibits
10.1	Form of Restricted Stock Unit (RSU) Award Notice and Agreement for All Participants (excluding France) for use in connection with the Company's 2010 Stock Incentive Plan
10.2	Form of RSU Award Notice and Agreement for Participants in France for use in connection with the Company's 2010 Stock Incentive Plan
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ITRON, INC.

November 5, 2012	By:	/s/ STEVEN M. HELMBRECHT
Date		Steven M. Helmbrecht
		Sr. Vice President and Chief Financial Officer