ITRON INC /WA/
Form 10-Q
August 09, 2007

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 June 30, 2007

OR

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

For the transition period from to

Commission file number 0-22418

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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 July 31, 2007, there were outstanding 30,328,207 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Itron, Inc.
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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

ITRON, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands, except per share data)			
Revenues	$ 401,559	$ 163,810	$ 549,470	$ 319,363
Cost of revenues	276,845	94,778	363,431	183,557
Gross profit	124,714	69,032	186,039	135,806
Operating expenses				
Sales and marketing	34,393	16,321	49,313	31,802
Product development	25,521	14,920	41,342	27,790
General and administrative	27,387	12,519	41,631	24,641
Amortization of intangible assets	25,223	7,612	32,263	14,925
In-process research and development	35,551	-	35,551	-
Total operating expenses	148,075	51,372	200,100	99,158
Operating income (loss)	(23,361)	17,660	(14,061)	36,648
Other income (expense)				
Interest income	2,216	360	8,305	722
Interest expense	(22,927)	(2,585)	(28,424)	(8,331)
Other income (expense), net	5,433	(241)	6,941	(689)
Total other income (expense)	(15,278)	(2,466)	(13,178)	(8,298)
Income (loss) before income taxes	(38,639)	15,194	(27,239)	28,350
Income tax benefit (provision)	14,759	(4,990)	10,539	(11,077)
Net income (loss)	$ (23,880)	$ 10,204	$ (16,700)	$ 17,273
Earnings (loss) per share				
Basic	$ (0.79)	$ 0.40	$ (0.58)	$ 0.68
Diluted	$ (0.79)	$ 0.39	$ (0.58)	$ 0.66
Weighted average number of shares outstanding				
Basic	30,068	25,415	28,641	25,237
Diluted	30,068	26,360	28,641	26,216

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

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ITRON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2007	December 31, 2006
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 105,873	$ 361,405
Short-term investments, held to maturity	-	34,583
Accounts receivable, net	325,970	109,924
Inventories	171,141	52,496
Deferred income taxes, net	25,525	20,916
Other	48,521	17,121
Total current assets	677,030	596,445
Property, plant and equipment, net	309,954	88,689
Intangible assets, net	623,375	112,682
Goodwill	1,248,794	126,266
Prepaid debt fees	32,159	13,161
Deferred income taxes, net	88,814	47,400
Other	15,123	3,879
Total assets	$ 2,995,249	$ 988,522
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Trade payables	$ 210,203	$ 35,803
Accrued expenses	71,032	6,402
Wages and benefits payable	59,218	24,214
Taxes payable	23,834	1,717
Current portion of debt	11,561	-
Current portion of warranty	18,861	7,999
Unearned revenue	30,701	27,449
Total current liabilities	425,410	103,584
Long-term debt	1,611,027	469,324
Warranty	17,329	10,149
Pension plan and other employee benefits	65,040	-
Deferred income taxes, net	210,390	-
Other obligations	50,239	14,483
Total liabilities	2,379,435	597,540
Commitments and contingencies		
Shareholders' equity		
Preferred stock	-	-
Common stock	598,860	351,018

Accumulated other comprehensive income (loss), net	(4,722)	1,588
Retained earnings	21,676	38,376
Total shareholders' equity	615,814	390,982
Total liabilities and shareholders' equity	$ 2,995,249	$ 988,522

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

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

	Six Months Ended June 30,	
	2007	**2006**
	(in thousands)	
Operating activities		
Net income (loss)	$ (16,700)	$ 17,273
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	47,156	22,291
In-process research and development	35,551	-
Employee stock plans income tax benefits	5,773	11,686
Excess tax benefits from stock-based compensation	(5,029)	(8,371)
Stock-based compensation	5,849	4,096
Amortization of prepaid debt fees	2,813	3,155
Deferred income taxes, net	(30,133)	(953)
Other, net	394	435
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(12,604)	18,038
Inventories	17,983	(9,575)
Trade payables, accrued expenses and taxes payable	25,811	1,142
Wages and benefits payable	(7,299)	(3,623)
Unearned revenue	(4,348)	4,230
Warranty	391	1,678
Other long-term obligations	(47)	(181)
Other, net	(2,642)	(4,550)
Net cash provided by operating activities	62,919	56,771
Investing activities		
Proceeds from the maturities of investments, held to maturity	35,000	-
Acquisitions of property, plant and equipment	(18,306)	(14,420)
Business acquisitions, net of cash and cash equivalents acquired	(1,715,626)	(7,778)
Other, net	5,897	1,444
Net cash used in investing activities	(1,693,035)	(20,754)
Financing activities		
Proceeds from borrowings	1,159,027	-
Payments on debt	(2,890)	(42,703)
Issuance of common stock	236,220	11,326
Excess tax benefits from stock-based compensation	5,029	8,371
Prepaid debt fees	(23,058)	(62)
Net cash provided by (used in) financing activities	1,374,328	(23,068)
Effect of exchange rate changes on cash and cash equivalents	256	-
Increase (decrease) in cash and cash equivalents	(255,532)	12,949
Cash and cash equivalents at beginning of period	361,405	33,638
Cash and cash equivalents at end of period	$ 105,873	$ 46,587

Non-cash transactions:				
Fixed assets purchased but not yet paid	$	3,506	$	3,103
Pre-acquisition costs incurred but not yet paid		1,006		-
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes	$	7,425	$	833
Interest		31,272		5,623

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
June 30, 2007
(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

Basis of Consolidation

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 Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006, Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006 and Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006 of Itron and our consolidated subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature. Intercompany transactions and balances are eliminated upon consolidation.

We consolidate all entities in which we have a greater than 50% ownership interest. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. We have no investments in variable interest entities.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (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 2006 audited financial statements and notes included in our Annual Report on Form 10-K, as filed with the SEC on February 23, 2007. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

On April 18, 2007, we completed the acquisition of Actaris Metering Systems SA (Actaris), which is reported as our Actaris operating segment. The operating results of this acquisition are included in our condensed consolidated financial statements commencing on the date of acquisition (see Note 4).

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. Cash equivalents are recorded at cost, which approximates fair value.

Short-Term Investments

Investment securities are classified into one of three categories: held to maturity, trading or available for sale. Debt securities that we have the intent and ability to hold to maturity are classified as held to maturity and are reported at amortized cost (including amortization of premium or accretion of discount). Investment purchases and sales are accounted for on a trade date basis. Market value at a period end is based upon quoted market prices for each security.

Realized gains and losses are determined using the specific identification method and are included in earnings. Premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities. At June 30, 2007, we held no short-term investments. The investments held at December 31, 2006 matured during the first quarter of 2007.

Derivative Instruments

We account for derivative instruments and hedging activities in accordance with Statement of Financial Accounting Standards 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), as amended. All derivative instruments, whether designated in hedging relationships or not, are required to be recorded on the Condensed Consolidated Balance Sheets at fair value as either assets or liabilities. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) and are recognized in earnings when the hedged item affects earnings. Ineffective portions of fair value changes or derivative instruments that do not qualify for hedging activities are recognized in earnings. Derivatives are not used for trading or speculative purposes.

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On February 25, 2007, we signed a stock purchase agreement to acquire Actaris and entered into foreign currency range forward contracts (transactions where put options were sold and call options were purchased) to reduce our exposure to declines in the value of the U.S. dollar and pound sterling relative to the euro denominated purchase price. Under SFAS 133, the Actaris stock purchase agreement is considered an unrecognized firm commitment; therefore, these foreign currency range forward contracts can not be designated as fair value hedges. In April 2007, we completed the acquisition of Actaris and realized a $2.8 million gain in other income (expense) from the termination of the foreign currency range forward contracts.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded for invoices issued to customers in accordance with our contractual arrangements. Interest and late payment fees are minimal. Unbilled receivables are recorded when revenues are recognized upon product shipment or service delivery and invoicing occurs at a later date. The allowance for doubtful accounts is based on our historical experience of bad debts and our specific review of outstanding receivables at period end. Accounts receivable are written-off against the allowance when we believe an account, or a portion thereof, is no longer collectible.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Cost includes raw materials and labor, plus applied direct and indirect costs, including those costs required under SFAS 151, *Inventory Costs—an amendment of ARB 43, Chapter 4* (SFAS 151), which was effective for inventory costs incurred on or after January 1, 2006. Service inventories consist primarily of subassemblies and components necessary to support post-sale maintenance. A large portion of our low-volume manufacturing and all of our domestic handheld meter reading unit repair services are provided by an outside vendor.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally thirty years for buildings and three to five years for equipment, computers and furniture. Leasehold improvements are amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Costs related to internally developed software and software purchased for internal uses are capitalized in accordance with Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*. 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 may not be recoverable. There were no significant impairments in the three and six months ended June 30, 2007 and 2006. If there was an indication of impairment, management would prepare an estimate of future undiscounted cash flows expected to result from the use of the asset over its remaining economic life and its eventual disposition. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. Assets held for sale are classified within other current assets in the Condensed Consolidated Balance Sheets and are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Prepaid Debt Fees

Prepaid debt fees represent the capitalized direct costs incurred related to the issuance of debt and are recorded in other noncurrent assets. These costs are amortized to interest expense over the lives of the respective borrowings using

the effective interest method. Debt fees associated with convertible notes are amortized through the date of the earliest put or conversion option. When debt is repaid early, the portion of unamortized prepaid debt fees related to the early principal repayment is written-off and included in interest expense in the Condensed Consolidated Statements of Operations.

Business Combinations

In accordance with SFAS 141, *Business Combinations*, we record the results of operations of an acquired business from the date of acquisition. Net assets of the company acquired and intangible assets that arise from contractual/legal rights, or are capable of being separated, are recorded at their fair values as of the date of acquisition. The balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Amounts allocated to in-process research and development (IPR&D) are expensed in the period of acquisition.

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Goodwill and Intangible Assets

Goodwill is tested for impairment as of October 1 of each year, or more frequently, if a significant impairment indicator occurs under the guidance of SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142). Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the incremental discounted cash flows associated with each reporting unit. Intangible assets with a finite life are amortized based on estimated discounted cash flows unless discounted cash flows can not be relied upon, in which case the intangible assets are amortized straight-line over their estimated useful lives. Intangible assets are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We use estimates in determining the value of goodwill and intangible assets, including estimates of useful lives of intangible assets, discounted future cash flows and fair values of the related operations. In testing goodwill for impairment, we forecast discounted future cash flows at the reporting unit level based on estimated future revenues and operating costs, which take into consideration factors such as existing backlog, expected future orders, supplier contracts and general market conditions.

Warranty

We offer standard warranties on our hardware products and large application software products. Standard warranty accruals represent the estimated cost of projected warranty claims and are based on historical and projected product performance trends, business volume assumptions, supplier information and other business and economic projections. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Continuing quality control efforts during manufacturing reduce our exposure to warranty claims. If our quality control efforts fail to detect a fault in one of our products, we could experience an increase in warranty claims. We track warranty claims to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be assessed and recorded when a failure event is probable and the cost can be reasonably estimated. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The warranty allowances may fluctuate due to changes in estimates for material, labor and other costs we may incur to replace projected product failures, and we may incur additional warranty and related expenses in the future with respect to new or established products. The long-term warranty balance includes estimated warranty claims beyond one year.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
	(in thousands)			
Beginning balance	$ 19,840	$ 15,111	$ 18,148	$ 15,276
Actaris acquisition opening balance	17,769	-	17,769	-
New product warranties	1,013	734	1,709	1,319
Other changes/adjustments to warranties	338	3,147	3,274	4,512
Claims activity	(2,655)	(2,038)	(4,597)	(4,153)
Effect of change in exchange rates	(115)	-	(113)	-
Ending balance, June 30	36,190	16,954	36,190	16,954
Less: current portion of warranty	(18,861)	(7,927)	(18,861)	(7,927)
Long-term warranty	$ 17,329	$ 9,027	$ 17,329	$ 9,027

Total warranty expense, which consists of new product warranties issued and other changes and adjustments to warranties, totaled approximately $1.4 million and $3.9 million for the three months ended June 30, 2007 and 2006

and approximately $5.0 million and $5.8 million for the six months ended June 30, 2007 and 2006, respectively. Warranty expense is classified within cost of revenues.

Contingencies

An estimated loss for a 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 the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially affect our financial position and results of operations.

Defined Benefit Pension Plans

As part of the Actaris acquisition, we assumed Actaris' defined benefit pension plans. Actaris sponsors both funded and unfunded non-U.S. defined benefit pension plans. Financial Accounting Standards Board (FASB) Statement 87, *Employers' Accounting for Pensions*, as amended by SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158*)*, requires the assignment of the purchase price to individual assets acquired and liabilities assumed to include 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. SFAS 158 also requires employers to recognize on a prospective basis the funded status of their defined benefit pension plans on their consolidated balance sheet and recognize as a component of other comprehensive income (loss), net of tax, the actuarial gains or losses, prior service costs or credits and transition assets or obligations, if any, that arise during the period but are not recognized as components of net periodic benefit cost. See Note 8 for additional disclosures required by SFAS 158.

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Income Taxes

We account for income taxes using the asset and liability method. Under this method, deferred income taxes are recorded for the temporary differences between the financial reporting basis and tax basis of our assets and liabilities. These deferred taxes are measured using the tax rates expected to be in effect when the temporary differences reverse. We establish a valuation allowance for a portion of the deferred tax asset when we believe it is more likely than not that a portion of the deferred tax asset will not be utilized. Deferred tax liabilities have been recorded on undistributed earnings of foreign subsidiaries that are not permanently reinvested.

We adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB 109* (FIN 48) on January 1, 2007. This interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based solely on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognizing, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures (see Note 9). We recognize interest expense and penalties accrued related to unrecognized tax benefits in our provision for income taxes.

Foreign Exchange

Our condensed consolidated financial statements are reported in U.S. dollars. Assets and liabilities of foreign subsidiaries are translated to U.S. dollars at the exchange rates in effect on the balance sheet date. Revenues and expenses for these subsidiaries are translated to U.S. dollars using an average rate for the relevant reporting period. Translation adjustments resulting from this process are included, net of tax, in accumulated other comprehensive income (loss) in shareholders' equity. Gains and losses that arise from exchange rate fluctuations for balances that are not denominated in the local currency are included in the Condensed Consolidated Statements of Operations. Currency gains and losses of intercompany balances deemed to be long-term in nature and considered to be hedges of the net investment in foreign subsidiaries are included, net of tax, in accumulated other comprehensive income (loss) in shareholders' equity.

Revenue Recognition

Revenues consist of hardware sales, software license fees, custom software development services, field and project management service and engineering, consulting, implementation, installation, professional services and post-sale maintenance support. Outsourcing services include installation, operation and maintenance of meter reading systems to provide meter information to a customer for billing and management purposes. Outsourcing services can be provided for systems we own, as well as those owned by our customers.

Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) have value to the customer on a standalone basis, there is objective and reliable evidence of fair value of the undelivered item(s) and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria considered for each unit of accounting. For our standard contract arrangements that combine deliverables such as hardware, meter reading system software, installation and project management services, each deliverable is generally considered a single unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect and is not contingent upon the delivery/performance of additional items.

Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable and (4) collectibility is reasonably assured. Hardware revenues are generally recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions. For software arrangements with multiple elements, revenue recognition is also dependent upon the availability of vendor-specific objective evidence (VSOE) of fair value for each of the elements. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for software arrangements. If implementation services are essential to a software arrangement, revenue is recognized using either the percentage of completion methodology if project costs can be estimated or the completed contract methodology if project costs can not be reliably estimated. Hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract.

Unearned revenue is recorded for products or services that have not been provided and have been paid for by a customer, or when products or services have been provided but the criteria for revenue recognition have not been met. Shipping and handling costs and incidental expenses, which are commonly referred to as "out-of-pocket" expenses, billed to customers are recorded as revenue, with the associated costs charged to cost of revenues. We record sales, use and value added taxes billed to our customers on a net basis in our Condensed Consolidated Statements of Operations.

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Product and Software Development Costs

Product and software development costs primarily include payroll and third party contracting fees. For software we develop to be marketed or sold, SFAS 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed (as amended)*, requires the capitalization of development costs after technological feasibility is established. Due to the relatively short period of time between technological feasibility and the completion of product and software development, and the immaterial nature of these costs, we generally do not capitalize product and software development expenses.

Earnings Per Share

Basic earnings per share (EPS) is calculated using net income (loss) divided by the weighted average common shares outstanding during the period. We compute dilutive earnings per share by adjusting the weighted average number of common shares outstanding to consider the effect of potentially dilutive securities, including stock-based awards and our convertible senior subordinated notes. Shares that are contingently issuable are included in the dilutive EPS calculation as of the beginning of the period when all necessary conditions have been satisfied. For periods in which we report a net loss, diluted net loss per share is the same as basic net loss per share.

Stock-Based Compensation

SFAS 123(R), *Share-Based Payment* (SFAS 123(R)), requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors, based on estimated fair values. We record stock-based compensation expenses under SFAS 123(R) for awards of stock options, our Employee Stock Purchase Plan (ESPP) and issuance of restricted and unrestricted stock awards and units. The fair value of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate and expected life. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We expense stock-based compensation using the straight-line method over the requisite service period. A substantial portion of our stock-based compensation can not be expensed for tax purposes. The benefits of tax deductions in excess of the compensation cost recognized are classified as financing cash inflows in the Condensed Consolidated Statements of Cash Flows.

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. Because of various factors affecting future costs and operations, actual results could differ from estimates.

Reclassifications

As a result of the Actaris acquisition, certain prior year balances have been reclassified to conform to the current year presentation. Such reclassifications did not affect total revenues, operating income or net income.

New Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, on a prospective basis. We are currently evaluating the

impact of the adoption of SFAS 157 on our financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (SFAS 159). This statement permits entities to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected would be reported in net income. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of the adoption of SFAS 159 on our financial statements.

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Note 2: Earnings Per Share and Capital Structure

The following table sets forth the computation of basic and diluted EPS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
	(in thousands, except per share data)			
Basic earnings (loss) per share:				
Net income (loss) available to common shareholders	$ (23,880)	$ 10,204	$ (16,700)	$ 17,273
Weighted average number of shares outstanding	30,068	25,415	28,641	25,237
Basic	$ (0.79)	$ 0.40	$ (0.58)	$ 0.68
Diluted earnings (loss) per share:				
Net income (loss) available to common shareholders	$ (23,880)	$ 10,204	$ (16,700)	$ 17,273
Weighted average number of shares outstanding	30,068	25,415	28,641	25,237
Dilutive effect of stock-based awards	-	945	-	979
Adjusted weighted average number of shares outstanding	30,068	26,360	28,641	26,216
Diluted	$ (0.79)	$ 0.39	$ (0.58)	$ 0.66

The dilutive effect of stock-based awards is calculated using the treasury stock method. Under this method, EPS 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. Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock-based awards. At June 30, 2007 and 2006, we had stock-based awards outstanding of approximately 1.9 million and 1.8 million at weighted average option exercise prices of $34.83 and $22.99, respectively. As a result of our net loss, approximately 816,000 and 798,000 of stock-based awards were excluded from the calculation of diluted earnings per share for three and six months ended June 30, 2007, respectively. Approximately 27,000 and 41,000 stock-based awards were excluded from the calculation of diluted EPS for the three and six months ended June 30, 2006, respectively, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

In August 2006, we issued $345 million of convertible senior subordinated notes (convertible notes) that if converted in the future, would have a potentially dilutive effect on our earnings per share. Under the indenture for the convertible notes, upon conversion we are required to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares or a combination. The effect on diluted earnings per share is calculated under the net share settlement method in accordance with the FASB’s Emerging Issues Task Force 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*. Under the net share settlement method, we include the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are converted. The average closing price of our common stock for each of the periods presented is used as the basis for determining the dilutive effect on EPS. The average price of our common stock for the three and six months ended June 30, 2007 exceeded the conversion price of $65.16 and, therefore, approximately 364,000 and 182,000 shares, respectively, would have been dilutive if we had net income and included the dilutive shares in the calculation of diluted earnings per share. These shares could be dilutive in future periods.

On March 1, 2007, we issued 4.1 million shares of common stock, no par value, for net proceeds of $225.3 million, which were used to partially fund the acquisition of Actaris on April 18, 2007.

We have authorized 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 stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, rates and subject to such adjustments as set by the Board of Directors. There was no preferred stock issued or outstanding at June 30, 2007 and 2006.

Note 3: Certain Balance Sheet Components

Accounts receivable, net	**At June 30, 2007**	**At December 31, 2006**
	(in thousands)	
Trade (net of allowance for doubtful accounts of $5,679 and $589)	$ 316,478	$ 100,162
Unbilled revenue	9,492	9,762
Total accounts receivable, net	$ 325,970	$ 109,924

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Beginning balance	$ 615	$ 379	$ 589	$ 598
Actaris acquisition opening balance	4,891	-	4,891	-
Provision (benefit) for doubtful accounts	300	92	386	(105)
Recoveries	-	-	-	-
Accounts charged off	(127)	(2)	(187)	(24)
Ending balance, June 30	$ 5,679	$ 469	$ 5,679	$ 469

Inventories

A summary of the inventory balances is as follows:	At June 30, 2007	At December 31, 2006
	(in thousands)	
Materials	$ 85,805	$ 29,650
Work in process	16,421	5,220
Finished goods	67,884	16,433
Total manufacturing inventories	170,110	51,303
Service inventories	1,031	1,193
Total inventories	$ 171,141	$ 52,496

Property, plant and equipment, net	At June 30, 2007	At December 31, 2006
	(in thousands)	
Machinery and equipment	$ 173,052	$ 75,571
Computers and purchased software	58,937	40,368
Buildings, furniture and improvements	127,489	45,670
Land	39,443	2,482
Total cost	398,921	164,091
Accumulated depreciation	(88,967)	(75,402
Property, plant and equipment, net	$ 309,954	$ 88,689

Depreciation expense was $10.5 million and $3.8 million for the three months ended June 30, 2007 and 2006, respectively. Depreciation expense was $14.9 million and $7.4 million for the six months ended June 30, 2007 and 2006, respectively.

Note 4: Business Combinations

Actaris Metering Systems

On April 18, 2007, we completed the acquisition of Actaris Metering Systems SA (Actaris) for €800 million (approximately $1.1 billion) plus the retirement of $626.9 million of debt. The acquisition was financed with a $1.2

billion credit facility (credit facility), $225 million in net proceeds from the sale of 4.1 million shares of common stock and cash on hand. The acquisition included all of Actaris' electricity, gas and water meter manufacturing and sales operations, located primarily outside of North America and provided geographic expansion of our business and product offerings. The purchase price included a significant premium to the assets acquired and liabilities assumed, due to expected synergies from products and markets of the combined entity, which resulted in a substantial amount of goodwill.

The preliminary purchase price, which includes estimated direct transaction costs and net of cash acquired of $28.9 million, is summarized as follows (in thousands):

Cash consideration, net of cash acquired	$ 1,698,107
Direct transaction costs	18,641
Total purchase price	$ 1,716,748

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We have made preliminary allocations of the purchase price to the assets acquired and liabilities assumed based on estimated fair value assessments; however, we are still completing those assessments, including an analysis of the discounted cash flows. Once we finalize the fair values, we may have changes in the following areas: tangible and intangible assets, goodwill, commitments and contingencies, deferred taxes and restructuring activities. The following information reflects our preliminary allocation of the purchase price.

	April 18, 2007 Fair Value (in thousands)	Useful Life (in years)
Fair value of tangible assets acquired and liabilities assumed, net	$ 4,837	
In-process research and development	35,551	
Identified intangible assets - amortizable		
Core-developed technology	213,424	10
Customer relationships	201,744	10
Trademarks and tradenames	124,921	10
Other	7,018	1
Goodwill	1,129,253	
Total net assets acquired	$ 1,716,748	

Significant tangible assets acquired consisted of accounts receivable, inventory and property, plant and equipment. Significant liabilities assumed consisted of accounts payable, accrued expenses, wages and benefits payable, deferred taxes and pension benefit obligations.

Our acquisition of Actaris resulted in $35.6 million of IPR&D expense, consisting primarily of next generation technology. The IPR&D projects were analyzed according to exclusivity, substance, economic benefit, incompleteness, measurability and alternative future use. The primary projects are intended to make key enhancements and improve functionality of our residential and commercial and industrial meters. We value IPR&D using the income approach, which uses the present value of the projected cash flows that are expected to be generated. The risk adjusted discount rate was 12 percent, which was based on an industry composite of weighted average cost of capital, with certain premiums for equity risk and size, and the uncertainty associated with the completion of the development effort and subsequent commercialization.

The preliminary values assigned to 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.

The balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. For tax purposes, goodwill is not deductible, as we acquired the stock of Actaris.

The following pro forma results are based on the individual historical results of Itron, Inc. and Actaris (prior to the acquisition on April 18, 2007) with adjustments to give effect to the combined operations as if the acquisition had been consummated on January 1, 2006. The significant adjustments were as follows:

- Increased amortization expense related to the acquired identified intangible assets of $16.0 million and $32.0 million for the three and six months ended June 30, 2006 and $3.9 million and $24.2 million for the three and six months ended June 30, 2007.
- Additional net interest expense of $11.9 million and $21.9 million for the three and six months ended June 30, 2006 and $1.8 million and $10.1 million for the three and six months ended June 30, 2007, related to the borrowings

incurred upon acquisition, net of the retirement of Actaris' previous debt.

- o Adjustment to revise the income tax provision utilizing Itron's estimated statutory rate of 31%.

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

	Pro Forma Three Months Ended June 30,		Pro Forma Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands, except per share data)			
Revenues	$ 432,756	$ 411,666	$ 796,991	$ 785,636
Net income	$ (7,894)	$ 4,240	$ (13,492)	$ 5,320
Basic net income per share	(0.26)	0.14	(0.45)	0.18
Diluted net income per share	(0.26)	0.14	(0.45)	0.18
Weighted average shares assumed outstanding				
Basic	30,068	29,502	29,973	29,324
Diluted	30,068	30,447	29,973	30,303

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Note 5: Identified Intangible Assets

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

	At June 30, 2007			At December 31, 2006		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$ 373,737	$ (95,395)	$ 278,342	$ 162,930	$ (77,783)	$ 85,147
Patents	7,088	(5,244)	1,844	7,088	(5,059)	2,029
Capitalized software	5,065	(5,065)	-	5,065	(5,065)	-
Distribution and production rights	3,935	(3,452)	483	3,935	(3,384)	551
Customer contracts and relationships	218,048	(12,821)	205,227	16,888	(7,931)	8,957
Trademarks and tradenames	150,212	(17,088)	133,124	26,210	(12,022)	14,188
Other	16,988	(12,633)	4,355	9,752	(7,942)	1,810
Total identified intangible assets	$ 775,073	$ (151,698)	$ 623,375	$ 231,868	$ (119,186)	$ 112,682

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Beginning balance, intangible assets, gross	$ 231,061	$ 211,328	$ 231,868	$ 211,328
Intangible assets acquired	547,107	9,630	547,107	9,630
Intangible assets adjusted	-	-	(1,220)	-
Effect of change in exchange rates	(3,095)	163	(2,682)	163
Ending balance, intangible assets, gross	$ 775,073	$ 221,121	$ 775,073	$ 221,121

Identified intangible assets increased during the second quarter of 2007 as a result of the Actaris acquisition. Based on the final determination of fair values of intangible assets acquired in the Flow Metrix, Inc. acquisition, which was consummated in November 2006, adjustments to the intangible assets recorded were made during the first quarter of 2007. Identified intangible assets increased during the second quarter of 2006 as a result of the Quantum Consulting, Inc. (Quantum) and ELO Sistemas e Tecnologia Ltda. (ELO) acquisitions. Intangible assets are recorded in the local currency of our foreign subsidiaries; therefore, the carrying amount of intangible assets can also increase or decrease, with a corresponding change in accumulated other comprehensive income (loss), due to changes in foreign currency exchange rates for those intangible assets owned by our foreign subsidiaries. Intangible asset amortization expense was $25.2 million and $7.6 million for the three months ended June 30, 2007 and 2006, respectively. Intangible asset amortization expense was $32.3 million and $14.9 million for the six months ended June 30, 2007 and 2006, respectively.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization

		(in thousands)
2007 (amount remaining at June 30, 2007)	$	51,298
2008		110,636
2009		100,936
2010		79,853
2011		69,499
Beyond 2011		211,153
Total identified intangible assets, net	$	623,375

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Note 6: Goodwill

The following table reflects goodwill allocated to each operating segment during the six months ended June 30, 2007 and 2006, respectively.

	Itron North America	Actaris	Total Company
		(in thousands)	
Goodwill balance, January 1, 2006	$ 116,032	$ -	$ 116,032
Goodwill acquired	2,934	-	2,934
Effect of change in exchange rates	538	-	538
Goodwill balance, June 30, 2006	$ 119,504	$ -	$ 119,504
Goodwill balance, January 1, 2007	$ 126,266	$ -	$ 126,266
Goodwill acquired	-	1,129,253	1,129,253
Goodwill adjustments	987	-	987
Effect of change in exchange rates	1,050	(8,762)	(7,712)
Goodwill balance, June 30, 2007	$ 128,303	$ 1,120,491	$ 1,248,794

Goodwill increased during the second quarter of 2007 as a result of the Actaris acquisition. Based on the final determination of fair values of intangible assets acquired in the Flow Metrix, Inc. acquisition, which was consummated in November 2006, adjustments to goodwill were recorded during the first quarter of 2007. Goodwill increased during the second quarter of 2006 as a result of the Quantum and ELO acquisitions. Goodwill is recorded in the local currency of our foreign subsidiaries; therefore, goodwill balances may also increase or decrease, with a corresponding change in accumulated other comprehensive income (loss), due to changes in foreign currency exchange rates.

Note 7: Debt

The components of our borrowings are as follows:

	At June 30, 2007	At December 31, 2006
	(in thousands)	
Credit facility		
USD denominated term loan	$ 603,587	$ -
EUR denominated term loan	449,816	-
GBP denominated term loan	99,810	-
Convertible senior subordinated notes	345,000	345,000
Senior subordinated notes	124,375	124,324
	1,622,588	469,324
Current portion of debt	(11,561)	-
Total long-term debt	$ 1,611,027	$ 469,324

Credit Facility

The Actaris acquisition was financed in part by a $1.2 billion credit facility. The credit facility is comprised of a $605.1 million first lien U.S. dollar denominated term loan; a €335 million first lien euro denominated term loan; a £50 million first lien pound sterling denominated term loan (collectively the term loans); and a $115 million multicurrency revolving line-of-credit (revolver), which was undrawn at close. Interest rates on the credit facility are based on the respective borrowings; denominated LIBOR rate (U.S. dollar, euro or pound sterling) or the Wells Fargo Bank, National Association's prime rate, plus an additional margin subject to factors including our consolidated leverage ratio. Scheduled amortization of principal payments is 1% per year (0.25% quarterly) with an excess cash flow provision for additional annual principal repayment requirements. Maturities of the term loans and multicurrency revolver are seven years and six years, respectively, from the date of issuance with certain acceleration features relating to our current outstanding subordinated notes. At June 30, 2007, there were no borrowings outstanding under the revolver and $46.0 million was utilized by outstanding standby letters of credit resulting in $69.0 million being available for additional borrowings.

This credit facility replaced an original $185 million seven-year senior secured credit facility we entered into in 2004. We repaid $24.7 million remaining on our 2004 senior secured term loan during the first quarter of 2006.

Senior Subordinated Notes

Our senior subordinated notes (subordinated notes) consist of $125 million aggregate principal amount of 7.75% notes, issued in May 2004 and due in 2012. The subordinated notes were discounted to a price of 99.265 to yield 7.875%. The discount on the subordinated notes is accreted resulting in a balance of $124.4 million at June 30, 2007. The subordinated notes are registered with the SEC and are generally transferable. Prepaid debt fees are amortized over the life of the notes using the effective interest method. Fixed interest payments of $4.8 million are required every six months, in May and November. The notes are subordinated to our senior secured borrowings and are guaranteed by all of our domestic operating subsidiaries. The subordinated notes contain covenants, which place restrictions on the incurrence of debt, the payment of dividends, certain investments and mergers. The Actaris acquisition and the associated financing were not prohibited under these covenants. We were in compliance with these debt covenants at June 30, 2007. Some or all of the subordinated notes may be redeemed at our option at any time on or after May 15, 2008, at their principal amount plus a specified premium. At any time after May 15, 2008, we may, at our option, redeem the subordinated notes at a redemption price of 103.875%, decreasing each year thereafter.

Convertible Senior Subordinated Notes

On August 4, 2006, we issued $345 million of 2.50% convertible notes due August 2026. Fixed interest payments of $4.3 million are required every six months, in February and August. For each six month period beginning August 2011, contingent interest payments of approximately 0.19% of the average trading price of the convertible notes will be made if certain thresholds and events are met, as outlined in the indenture. The convertible notes are registered with the SEC and are generally transferable. Our convertible notes are not considered conventional convertible debt as defined in Emerging Issues Task Force (EITF) 05-02, *The Meaning of "Conventional Convertible Debt Instruments" in Issue 00-19*, as the number of shares, or cash, to be received by the holders was not fixed at the inception of the obligation. We have concluded that the conversion feature of our convertible notes does not require bifurcation from the host contract in accordance with SFAS 133, as the conversion feature is indexed to the Company's own stock and would be classified within stockholders' equity if it were a freestanding instrument as provided by EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.*

The convertible notes may be converted under the following circumstances, at the option of the holder, at an initial conversion rate of 15.3478 shares of our common stock for each $1,000 principal amount of the convertible notes (conversion price of $65.16 per share), as defined in the indenture:

- during any fiscal quarter commencing after September 30, 2006, if the closing sale price per share of our common stock exceeds 120% of the conversion price ($78.19) for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding fiscal quarter;
- between July 1, 2011 and August 1, 2011, and any time after August 1, 2024;
- during the five business days after any five consecutive trading day period in which the trading price of the convertible notes for each day was less than 98% of the conversion value of the convertible notes;
- if the convertible notes are called for redemption;
- if a fundamental change occurs; or
- upon the occurrence of defined corporate events.

The convertible notes also contain put options, which may require us, at the option of the holder, to repurchase all or a portion of the convertible notes on August 1, 2011, August 1, 2016 and August 1, 2021 at the principal amount, plus accrued and unpaid interest.

Upon conversion, the principal amount of the convertible notes will be settled in cash and, at our option, the remaining conversion obligation (stock price in excess of conversion price) may be settled in cash, shares or a

combination. The conversion rate for the convertible notes is subject to adjustment upon the occurrence of certain corporate events, as defined in the indenture, to ensure that the economic rights of the convertible notes are preserved. We may redeem some or all of the convertible notes for cash, on or after August 1, 2011, for a price equal to 100% of the principal amount plus accrued and unpaid interest.

The convertible notes are unsecured and subordinate to all of our existing and future senior secured borrowings. The convertible notes are unconditionally guaranteed, joint and severally, by all of our operating subsidiaries, except for our foreign subsidiaries, all of which are wholly owned. The convertible notes contain covenants, which place restrictions on the incurrence of debt and certain mergers. The Actaris acquisition and the associated financing were not prohibited under these covenants. We were in compliance with these debt covenants at June 30, 2007. The aggregate principal amount of the convertible notes is included in long-term debt as they can not be converted prior to July 2011, unless certain defined events occur. At such time the holders have the ability to convert, we will reclassify the convertible notes from long-term to current to reflect the holders' conversion rights.

Prepaid Debt Fees & Interest Expense

Prepaid debt fees for our outstanding borrowings are amortized over the respective terms using the effective interest method. Total unamortized prepaid debt fees were approximately $32.2 million and $13.2 million at June 30, 2007 and December 31, 2006, respectively. Accrued interest expense was $19.3 million and $4.8 million at June 30, 2007 and December 31, 2006, respectively.

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Note 8: Pension Benefits

With the acquisition of Actaris, we now sponsor both funded and unfunded non-U.S. defined benefit pension plans offering death and disability, retirement and special termination benefits to employees in Germany, France, Spain, Italy, Belgium, Chile, Portugal, Hungary and Indonesia. The defined benefit obligation is calculated annually by using the projected unit credit method and is updated quarterly. The measurement date for the pension plans was April 18, 2007, the date of acquisition.

Our general funding policy for these qualified pension plans is to contribute amounts at least sufficient to satisfy regulatory funding standards of the respective countries for each plan. Assuming that actual plan asset returns are consistent with our expected rate of return in 2007 and beyond, and that interest rates remain constant, we expect to contribute approximately $75,000 in the second half of 2007 to our defined benefit pension plans.

The following table rolls forward the benefit obligation and plan assets and summarizes the funded status of the defined benefit plans and amounts recognized in the Condensed Consolidated Balance Sheet at June 30, 2007.

	Period ended June 30, 2007 (in thousands)
Change in benefit obligation:	
Benefit obligation at beginning of period (April 18, 2007)	$ 71,452
Service cost	408
Interest cost	644
Settlements and curtailments	(93)
Benefits paid	(892)
Other – foreign exchange rate changes	(436)
Benefit obligation at end of period	71,083
Change in plan assets:	
Fair value of plan assets at beginning of period (April 18, 2007)	6,420
Actual return of plan assets	47
Company contributions	21
Benefits paid	(38)
Other – foreign exchange rate changes	(37)
Fair value of plan assets at end of period	6,413
Ending balance at fair value	$ 64,670

Amounts recognized on the Condensed Consolidated Balance Sheet consist of:

	Period ended June 30, 2007 (in thousands)
Current portion of pension plan liability in wages and benefits payable	$ 1,030
Long-term portion of pension plan liability	64,010
Plan assets in other long term assets	(370)
Net amount recognized	$ 64,670

The accumulated benefit obligation for our defined benefit pension plans was $66.6 million at June 30, 2007.

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

	Period ended June 30, 2007 (in thousands)
Service cost	$ 408
Interest cost	644
Expected return on plan assets	(47)
Settlements and curtailments	(93)
Net periodic benefit cost	$ 912

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The significant actuarial weighted average assumptions used in determining the benefit obligations and net periodic benefit cost for our benefit plans are as follows:

		Period ended June 30, 2007
Actuarial assumptions used to determine benefit obligations at end of period:		
	Discount rate	4.99%
	Expected annual rate of compensation increase	2.94%
Actuarial assumptions used to determine net periodic benefit cost for the period:		
	Discount rate	4.99%
	Expected rate of return on plan assets	3.76%
	Expected annual rate of compensation increase	2.94%

We determine a discount rate for each individual defined benefit pension plan based on the estimated duration of each plan's liabilities. For our euro denominated defined benefit pension plans, we match the plans' expected future benefit payments against the Merrill Lynch Euro Corp. yield curve. Discount rates for our defined benefit pension plans denominated in another currencies are selected using a similar methodology applied on high quality corporate bond yield data labeled in that currency.

Our expected rate of return on plan assets is derived from a study of actual historic returns achieved and anticipated future long-term performance of plan assets. While the study gives consideration to recent trust performance and historical returns, the assumption represents a long-term prospective return.

Pension plans with accumulated benefit obligations exceeding the fair value of plan assets were as follows:

	Period ended June 30, 2007 (in thousands)	
Projected benefit obligation	$	69,637
Accumulated benefit obligation	$	65,355
Fair value of plan assets	$	4,597

The target allocation for our pension plans assets is as follows:

	Period ended June 30, 2007
Asset category:	
Short-term investments and cash	7%
Insurance funds	93%

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 actual invested positions in various securities change over time based on short and longer-term investment opportunities. Strategic pension plan asset allocations are determined by the objective to achieve an investment return, which together with the contributions paid, is sufficient to maintain reasonable control over the

various funding risks of the plans. Based upon current market and economic environments, the actual asset allocation may periodically be permitted to deviate from policy targets.

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Annual benefit payments, including amounts to be paid from Company assets for unfunded plans, and reflecting expected future service, as appropriate, are expected to be paid as follows:

Year Ending December 31,	Estimated Annual Benefit Payments (in thousands)
2007 (amount remaining at June 30, 2007)	$ 1,700
2008	3,183
2009	3,393
2010	3,939
2011	4,059
2012 - 2016	20,657

Note 9: Income Taxes

Our actual income tax rates typically differ from the federal statutory rate of 35%, and can vary from period to period, due to fluctuations in operating results, new or revised tax legislation and accounting pronouncements, changes in the level of business performed in domestic and international jurisdictions, research credits and state income taxes. We estimate that our 2007 actual income tax rate will be approximately 38%.

At June 30, 2006, our estimated annual effective income tax rate was 42%, resulting in an actual income tax rate of 33% and 39% for the three and six months ended June 30, 2006. At June 30, 2006, our effective tax rate did not include a federal research credit, as the credit had expired. In December 2006, the Tax Relief and Health Care Act was signed into law, extending the research tax credit for qualified research expenses incurred throughout 2006 and 2007. This legislation reduced our estimated 2007 annual effective tax rate as compared with the estimated 2006 annual effective tax rate at June 30, 2006.

Effective January 1, 2007, we adopted FIN 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB 109* (FIN 48). Although our implementation of FIN 48 did not require a cumulative effect adjustment to retained earnings, we recorded $6.1 million of deferred tax assets and noncurrent liabilities to conform to the balance sheet presentation requirements of FIN 48 on January 1, 2007. As of June 30 2007, the amount of unrecognized tax benefits was $35.9 million of which approximately $29.3 million was acquired as part of the Actaris acquisition on April 18, 2007. We do not expect any reasonably possible material changes to the estimated amount of liabilities associated with our unrecognized tax benefits through June 30, 2008. The amount of unrecognized tax benefits that would affect our actual tax rate as of January 1, 2007 and June 30, 2007 was $6.1 million and $6.9 million, respectively.

We are subject to income tax in the U.S. federal jurisdiction and numerous state jurisdictions. The Internal Revenues Service (IRS) has completed its examinations of our federal income tax returns for the tax years 1993 through 1995. Tax years subsequent to 1995 remain open to examination by the major tax jurisdictions to which we are subject. We classify interest and penalties related to unrecognized tax benefits in our provision for income taxes. Accrued interest and penalties were $9,000 and $7.4 million at January 1, 2007 and June 30, 2007, respectively. The increase from January 1, 2007 to June 30, 2007 was the result of the Actaris acquisition on April 18, 2007.

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Note 10: Stock-Based Compensation

We record stock-based compensation expense under SFAS 123(R) for awards of stock options, our Employee Stock Purchase Plan (ESPP) and issuance of restricted and unrestricted stock awards and units. We expense stock-based compensation using the straight-line method over the requisite service period. For the three months ended June 30, 2007 and 2006, stock-based compensation expense was $3.0 million and $2.0 million, before a related income tax benefit of $714,000 and $277,000, respectively. For the six months ended June 30, 2007 and 2006, stock-based compensation expense was $5.9 million and $4.1 million, before a related income tax benefit of $1.4 million and $549,000, respectively.

The fair value of stock options and ESPP awards issued during the three and six months ended June 30, 2007 and 2006 were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

Employee Stock Options

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Dividend yield	-	-	-	-
Expected volatility	38.1%	41.6%	38.4%	41.6%
Risk-free interest rate	4.6%	4.9%	4.6%	4.9%
Expected life (years)	4.94	4.37	4.94	4.37

ESPP

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Dividend yield	-	-	-	-
Expected volatility	24.3%	54.0%	24.3%	48.2%
Risk-free interest rate	5.0%	4.7%	5.1%	4.4%
Expected life (years)	0.25	0.25	0.25	0.25

Expected price volatility is based on a combination of historical volatility of our common stock and the implied volatility of our traded options, for the related vesting period. We believe this combined approach is more reflective of current and historical market conditions and a better 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 remaining term equal to the expected life of the award. The expected life is the weighted average expected life for the entire award based on the fixed period of time between the date the award is granted and the date the award is fully exercised. Factors considered in estimating the expected life are historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay any dividends in the foreseeable future.

Subject to stock splits, dividends and other similar events, 5,875,000 shares of common stock are reserved and authorized for issuance under our Amended and Restated 2000 Stock Incentive Plan, of which 988,552 shares remain available for issuance at June 30, 2007. In addition, of the authorized shares under the plan, no more than 1.0 million

shares can be issued as non-stock options (awards). Awards consist of restricted stock units, restricted stock awards and the Board of Directors' unrestricted stock awards. Shares remaining for issuance as awards were 825,802 at June 30, 2007.

Stock Option Plans

Stock options to purchase the Company's common stock are granted with an exercise price equal to the fair market value of the stock on the date of grant upon approval by our Board of Directors. Options generally become exercisable in three or four equal installments beginning a year from the date of grant and generally expire 10 years from the date of grant.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. For the three and six months ended June 30, 2007, we issued 180,000 and 200,000 shares with weighted average fair values of $27.26 and $27.21, respectively. For the three months ended June 30, 2006, we issued 30,000 shares with a weighted average fair value of $25.82. No stock options were granted during the three month period ended March 31, 2006. Compensation expense related to stock options recognized under SFAS 123(R) for the three months ended June 30, 2007 and 2006 was $2.4 million and $1.8 million, respectively and $4.8 million and $3.6 million for the six months ended June 30, 2007 and 2006, respectively. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on our historical experience and future expectations.

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A summary of our stock option activity for the six months ended June 30, 2007 and 2006 is as follows:

	Shares (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2006	2,443	$ 21.24	6.89	$ 46,189
Granted	30	63.56		
Exercised	(591)	17.12		
Forfeited	(46)	32.04		
Outstanding, June 30, 2006	1,836	$ 22.99	7.25	$ 66,741
Exercisable and expected to vest, June 30, 2006	1,747	$ 22.48	7.21	$ 64,375
Exercisable, June 30, 2006	964	$ 17.26	6.25	$ 40,478
Outstanding, January 1, 2007	2,225	$ 29.78	7.46	$ 49,469
Granted	200	66.94		
Exercised	(441)	22.87		
Forfeited	(45)	43.96		
Expired	(7)	42.62		
Outstanding, June 30, 2007	1,932	$ 34.83	7.38	$ 83,264
Exercisable and expected to vest, June 30, 2007	1,724	$ 33.23	7.20	$ 77,069
Exercisable, June 30, 2007	903	$ 19.92	5.72	$ 52,421

The aggregate intrinsic value in the table above is before applicable income taxes, based on our closing stock price as of the last business day of the period, which represents amounts that would have been received by the optionees had all options been exercised on that date. As of June 30, 2007, total unrecognized stock-based compensation expense related to nonvested stock options, net of estimated forfeitures, was approximately $13.1 million, which is expected to be recognized over a weighted average period of approximately 24 months.

Restricted Stock Units

During 2007, we issued restricted stock units (RSUs) with a cliff vesting period of three years from the anniversary of the grant date as set forth in the award agreements. Upon vesting, the RSUs are converted into shares of the Company's stock on a one-for-one basis and issued to employees, subject to any deferral elections made by a recipient or required by the plan. Restricted stock is reserved in the recipients' name at the grant date and issued upon vesting. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holder upon vesting of the award.

Total compensation expense relating to RSUs and restricted stock was $125,000 for the three months ended June 30, 2007 as the first grant date was May 14, 2007. Unrecognized compensation cost in connection with these awards, net of estimated forfeitures, totaled $2.8 million at June 30, 2007. The cost is expected to be recognized over three years. Grants of RSUs were 60,667 for the three months ended June 30, 2007. There were no RSUs that were forfeited and returned to the plan at June 30, 2007.

Long-Term Performance Plan

We have a Long-Term Performance Plan (LTPP) for senior management, payments of which are contingent on the attainment of yearly goals payable in the Company's common stock with a three-year cliff vesting period. Restricted stock units will be used for the 2007 plan. Restricted stock awards were used for the 2006 and 2005 plans.

Restricted stock units that are attainable are established at the beginning of the performance period based on a percentage of the participant's base salary and the fair market value of the Company's common stock on the first business day of the performance period. The maximum restricted stock units attainable at the beginning of the year for the 2007 performance period consisted of 57,523 restricted stock units at a grant-date fair value of $62.52.

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The 2006 and 2005 restricted stock awards were granted in the year following attainment, as approved by our Board of Directors, with the value of the award based on a percentage of the participant's base salary and the performance objectives for the period. The restricted stock award for 2005 consisted of 30,542 shares of restricted stock issued on February 15, 2006, at a grant-date fair value of $59.16. The restricted stock award for 2006 consisted of 25,065 shares of restricted stock issued on February 23, 2007, at a grant-date fair value of $62.90.

Under each of the plans, compensation expense is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. Total compensation expense recognized for the LTPP plan was $381,000 and $137,000 for the three months ended June 30, 2007 and 2006, respectively. Total compensation expense recognized for the LTPP plan was $658,000 and $174,000 for the six months ended June 30, 2007 and 2006, respectively.

Board of Directors' Unrestricted Stock Awards

We issue unrestricted stock awards to our Board of Directors as part of the Board of Directors' compensation. During the three months ended June 30, 2007 and 2006, we issued 300 and 420 shares of unrestricted stock to our Board of Directors, with a weighted average grant-date fair value of $66.41 and $70.99, respectively. The expense related to these awards for the three months ended June 30, 2007 and 2006 was $20,000 and $30,000, respectively. During the six months ended June 30, 2007 and 2006, we issued 3,210 and 3,396 shares of unrestricted stock to our Board of Directors, with a weighted average grant-date fair value of $52.78 and $44.09, respectively. The expense related to these awards for the six months ended June 30, 2007 and 2006 was $170,000 and $150,000, respectively. All awards were fully vested and expensed when granted.

Employee Stock Purchase Plan

Eligible employees who have completed three months of service, work more than 20 hours each week and are employed more than five months in any calendar year are eligible to participate in our employee stock purchase plan. Employees who own 5% or more of our common stock are not eligible to participate in the ESPP. Under the terms of the ESPP, eligible employees can choose payroll deductions each year of up to 10% of their regular cash compensation. Such deductions are applied toward the discounted purchase price of our common stock. The purchase price of the common stock is 85% of the fair market value of the stock at the end of each fiscal quarter. Under the ESPP, we sold 23,320 and 27,666 shares to employees in the six months ended June 30, 2007 and 2006, respectively. The fair value of ESPP awards issued is estimated using the Black-Scholes option-pricing model. The weighted average fair value of the ESPP awards issued in the six months ended June 30, 2007 and 2006 was $8.99 and $8.17, respectively. The expense related to ESPP recognized under SFAS 123(R) for the three months ended June 30, 2007 and 2006 was $97,000 and $112,000, respectively. The expense related to ESPP recognized under SFAS 123(R) for the six months ended June 30, 2007 and 2006 was $192,000, in both periods. We had no unrecognized compensation cost at June 30, 2007 associated with the awards issued under the ESPP.

Note 11: Commitments and Contingencies

Guarantees and Indemnifications

Under FASB Interpretation 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, we record a liability for certain types of guarantees and indemnifications for agreements entered into or amended subsequent to December 31, 2002. We had no such guarantees or indemnifications as of June 30, 2007 and December 31, 2006.

We maintain bid and performance bonds for certain customers. Bonds in force were $23.8 million and $6.0 million at June 30, 2007 and December 31, 2006, respectively (the increase in bid bonds was the result of the Actaris acquisition.) Bid bonds guarantee that we will enter into a contract consistent with the terms of the bid. Performance bonds 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. We also have standby letters of credit to guarantee our performance under certain contracts. In addition to the outstanding standby letters of credit under our credit facility, our Actaris operating segment has unsecured revolving lines of credit totaling €7.2 million, £1.0 million and $6.4 million, denominated in euros, pound sterling and U.S. dollars, respectively, with total outstanding standby letters of credit of $1.9 million at June 30, 2007. The total outstanding amounts of standby letters of credit were $47.9 million and $23.0 million at June 30, 2007 and December 31, 2006, respectively.

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. The terms of the indemnification normally do not limit the maximum potential future payments. We also provide an indemnification 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 the indemnification generally do not limit the maximum potential payments.

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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 in accordance with SFAS 5, *Accounting for Contingencies* (SFAS 5), and related pronouncements. In accordance with SFAS 5, a liability is recorded 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. Legal contingencies at June 30, 2007 and December 31, 2006 were not material to our financial condition and results of operations.

Note 12: Segment Information

At December 31, 2006, we reported three operating segments reflecting our major product lines. With the Actaris acquisition on April 18, 2007, we aligned our operating segments into two groups, Itron North America and Actaris, to reflect the way we are now managing the business. Our Itron North America operating segment represents our operations prior to the Actaris acquisition, and are primarily located in North America. Our Actaris operating segment represents the operations of the Actaris acquisition, which are primarily located outside of North America. We have three measures of segment performance: revenue, gross profit (margin) and operating income. There were no intersegment revenues.

Corporate operating expenses, interest income, interest expense, other income (expense) and income tax expense (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss. Assets and liabilities are not used in our measurement of segment performance and, therefore, are not allocated to our segments. Approximately 99% of depreciation expense was allocated to our segments at June 30, 2007 and 2006, with the remaining portion reported under corporate unallocated.

Revenues by region were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
	(in thousands)			
Revenues by region				
Europe	$ 186,996	$ 1,405	$ 188,450	$ 2,010
United States and Canada	148,437	154,610	284,895	304,963
Other	66,126	7,795	76,125	12,390
Total revenues	$ 401,559	$ 163,810	$ 549,470	$ 319,363

Segment Products

Itron North America	Electricity meters with and without automated meter reading (AMR); gas and water AMR modules; handheld, mobile and network AMR data collection technologies; advanced metering infrastructure (AMI) technologies; software, installation, implementation, maintenance support and other services.
Actaris	Electromechanical and electronic electricity meters; mechanical and ultrasonic water and heat meters and diaphragms; turbine and rotary gas meters; one-way and two-way electricity prepayment systems, including smart key, keypad and

smart card; two-way gas prepayment systems using smart card; AMR data collection technologies; installation, implementation, maintenance support and other services.

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Segment Information

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Revenues				
Itron North America	$ 151,912	$ 163,810	$ 299,823	$ 319,363
Actaris	249,647	-	249,647	-
Total Company	$ 401,559	$ 163,810	$ 549,470	$ 319,363
Gross profit				
Itron North America	$ 63,366	$ 69,032	$ 124,691	$ 135,806
Actaris	61,348	-	61,348	-
Total Company	$ 124,714	$ 69,032	$ 186,039	$ 135,806
Operating income (loss)				
Itron North America	$ 16,130	$ 23,884	$ 32,896	$ 50,094
Actaris	(31,650)	-	(31,650)	-
Corporate unallocated	(7,841)	(6,224)	(15,307)	(13,446)
Total Company	(23,361)	17,660	(14,061)	36,648
Total other income (expense)	(15,278)	(2,466)	(13,178)	(8,298)
Income (loss) before income taxes	$ (38,639)	$ 15,194	$ (27,239)	$ 28,350

No single customer represented more than 10% of total Company revenues for the three and six months ended June 30, 2007. No single customer represented more than 10% of the Itron North America operating segment revenues for the three and six months ended June 30, 2007. No single customer represented more than 10% of the Actaris operating segment revenues from April 18, 2007 to June 30, 2007.

One customer, Progress Energy, accounted for 19% and 21% of total Company and Itron North America segment revenues for the three and six months ended June 30, 2006, respectively.

Note 13: Other Comprehensive Income (Loss)

Other comprehensive income (loss) is reflected as an increase (decrease) to shareholders' equity and is not reflected in our results of operations. Other comprehensive income (loss) during the period, net of tax, was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Net income (loss)	$ (23,880)	$ 10,204	$ (16,700)	$ 17,273
Change in foreign currency translation adjustments, net of tax	(6,542)	791	(6,310)	681
Total other comprehensive income (loss)	$ (30,422)	$ 10,995	$ (23,010)	$ 17,954

Accumulated other comprehensive income (loss), net of tax, was approximately ($4.7) million and $1.6 million at June 30, 2007 and December 31, 2006, respectively, and consisted of the adjustments for foreign currency translation as indicated above.

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Note 14: Consolidating Financial Information

The credit facility, senior subordinated notes and convertible notes were issued by Itron, Inc. and are guaranteed by all our operating subsidiaries, except for our foreign subsidiaries, all of which are wholly owned. The guarantees under our senior subordinated notes include all current and future U.S. legal entities and are joint and several, full, complete and unconditional. At the date of issuance, our convertible notes were not guaranteed by any of our subsidiaries at the date of issuance. However, any future subsidiaries that guarantee our obligations under the senior subordinated notes will guarantee our convertible notes, joint and several, full, complete and unconditional. There are currently no restrictions on the ability of the subsidiary guarantors to transfer funds to the parent company.

For the year ended December 31, 2006, our guarantor subsidiaries were considered minor as a result of legal entity mergers into the parent company during 2006, eliminating the consolidating financial information disclosure in our Annual Report on Form 10-K, as required by SEC Regulation S-X Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered,* (Rule 3-10). On April 18, 2007, we acquired a legal entity in the United States as part of the Actaris acquisition. As a result of this acquisition, our guarantor subsidiaries are no longer considered minor and, therefore, the following consolidating financial information has been prepared and presented pursuant to Rule 3-10. We have allocated a portion of our credit facility borrowings to this newly acquired entity, based on its relative equity as compared with the entire Actaris acquisition.

The guarantor subsidiaries of our senior subordinated notes, which are not guarantors of our convertible notes, consisted of three non-operating subsidiaries of which we had equity in earnings (losses) of $300,000 and ($2.6 million)for the three and six months ended June 30, 2007 and ($40,000) and ($43,000) for the three and six months ended June 30, 2006. Our investment in these non-operating subsidiaries was $2.1 million and $531,000 at June 30, 2007 and December 31, 2006, respectively.

Condensed Consolidating Statement of Operations
Three Months Ended June 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 139,992	$ 14,535	$ 257,291	$ (10,259)	$ 401,559
Cost of revenues	82,482	11,256	193,630	(10,523)	276,845
Gross profit	57,510	3,279	63,661	264	124,714
Operating expenses					
Sales and marketing	13,393	1,449	19,551	-	34,393
Product development	17,449	440	7,680	(48)	25,521
General and administrative	13,595	808	12,984	-	27,387
Amortization of intangible assets	6,655	-	18,568	-	25,223
In-process research and development	-	-	35,551	-	35,551
Total operating expenses	51,092	2,697	94,334	(48)	148,075
Operating income (loss)	6,418	582	(30,673)	312	(23,361)

Other income (expense)					
Interest income	25,336	44	999	(24,163)	2,216
Interest expense	(21,314)	(2,246)	(23,525)	24,158	(22,927)
Other income (expense), net	6,331	80	(978)	-	5,433
Total other income (expense)	10,353	(2,122)	(23,504)	(5)	(15,278)
Income (loss) before income taxes	16,771	(1,540)	(54,177)	307	(38,639)
Income tax benefit (provision)	4,280	(131)	10,610	-	14,759
Equity in earnings (losses) of non-guarantor subsidiaries	(43,872)	305	-	43,567	-
Net loss	$ (22,821)	$ (1,366)	$ (43,567)	$ 43,874	$ (23,880)

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Condensed Consolidating Statement of Operations
Three Months Ended June 30, 2006

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
		(in thousands)		
Revenues	$ 158,077	$ 15,189	$ (9,456)	$ 163,810
Cost of revenues	91,908	12,192	(9,322)	94,778
Gross profit	66,169	2,997	(134)	69,032
Operating expenses				
Sales and marketing	14,773	1,548	-	16,321
Product development	15,035	107	(222)	14,920
General and administrative	11,646	750	123	12,519
Amortization of intangible assets	7,404	208	-	7,612
Total operating expenses	48,858	2,613	(99)	51,372
Operating income	17,311	384	(35)	17,660
Other income (expense)				
Interest income	368	46	(54)	360
Interest expense	(2,416)	(223)	54	(2,585)
Other income (expense), net	(305)	29	35	(241)
Total other income (expense)	(2,353)	(148)	35	(2,466)
Income before income taxes	14,958	236	-	15,194
Income tax (provision) benefit	(5,594)	604	-	(4,990)
Equity in earnings of				
non-guarantor subsidiaries	840	-	(840)	-
Net income	$ 10,204	$ 840	$ (840)	$ 10,204

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Condensed Consolidating Statement of Operations
Six Months Ended June 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 281,339	$ 14,535	$ 274,969	$ (21,373)	$ 549,470
Cost of revenues	164,183	11,256	208,447	(20,455)	363,431
Gross profit	117,156	3,279	66,522	(918)	186,039
Operating expenses					
Sales and marketing	25,712	1,449	22,152	-	49,313
Product development	33,152	440	7,846	(96)	41,342
General and administrative	26,935	808	13,888	-	41,631
Amortization of intangible assets	13,264	-	18,999	-	32,263
In-process research and development	-	-	35,551	-	35,551
Total operating expenses	99,063	2,697	98,436	(96)	200,100
Operating income (loss)	18,093	582	(31,914)	(822)	(14,061)
Other income (expense)					
Interest income	31,632	44	1,036	(24,407)	8,305
Interest expense	(26,711)	(2,246)	(23,883)	24,416	(28,424)
Other income (expense), net	7,828	80	(967)	-	6,941
Total other income (expense)	12,749	(2,122)	(23,814)	9	(13,178)
Income (loss) before income taxes	30,842	(1,540)	(55,728)	(813)	(27,239)
Income tax benefit (provision)	1,050	(131)	9,620	-	10,539
Equity in losses of non-guarantor subsidiaries	(47,779)	(2,574)	-	50,353	-
Net loss	$ (15,887)	$ (4,245)	$ (46,108)	$ 49,540	$ (16,700)

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Condensed Consolidating Statement of Operations
Six Months Ended June 30, 2006

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
		(in thousands)		
Revenues	$ 309,032	$ 30,117	$ (19,786)	$ 319,363
Cost of revenues	178,684	24,480	(19,607)	183,557
Gross profit	130,348	5,637	(179)	135,806
Operating expenses				
Sales and marketing	28,915	2,887	-	31,802
Product development	27,880	248	(338)	27,790
General and administrative	23,222	1,260	159	24,641
Amortization of intangible assets	14,717	208	-	14,925
Total operating expenses	94,734	4,603	(179)	99,158
Operating income	35,614	1,034	-	36,648
Other income (expense)				
Interest income	708	94	(80)	722
Interest expense	(8,100)	(311)	80	(8,331)
Other income (expense), net	(676)	(13)	-	(689)
Total other income (expense)	(8,068)	(230)	-	(8,298)
Income before income taxes	27,546	804	-	28,350
Income tax (provision) benefit	(11,508)	431	-	(11,077)
Equity in earnings of non-guarantor subsidiaries	1,235	-	(1,235)	-
Net income	$ 17,273	$ 1,235	$ (1,235)	$ 17,273

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Condensed Consolidating Balance Sheet
June 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
ASSETS					
Current assets					
Cash and cash equivalents	$ 43,509	$ 655	$ 61,709	$ -	$ 105,873
Accounts receivable, net	87,144	8,255	230,571	-	325,970
Intercompany accounts receivable	12,133	17	5,450	(17,600)	-
Inventories	51,034	6,196	114,782	(871)	171,141
Deferred income taxes, net	19,957	615	4,953	-	25,525
Other	15,213	1,340	31,968	-	48,521
Intercompany other	22,865	89,042	12,508	(124,415)	-
Total current assets	251,855	106,120	461,941	(142,886)	677,030
Property, plant and equipment, net	86,190	12,639	211,125	-	309,954
Intangible assets, net	90,247	-	533,128	-	623,375
Goodwill	114,469	5,902	1,128,423	-	1,248,794
Prepaid debt fees	30,708	1,451	-	-	32,159
Deferred income taxes, net	57,689	-	31,125	-	88,814
Investment in subsidiaries	12,468	43,924	(46,021)	(10,371)	-
Intercompany notes receivable	1,715,150	(346)	48,869	(1,763,673)	-
Other	2,463	15	12,645	-	15,123
Total assets	$ 2,361,239	$ 169,705	$ 2,381,235	$ (1,916,930)	$ 2,995,249
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities					
Trade payables	$ 38,665	$ 4,545	$ 166,993	$ -	$ 210,203
Accrued expenses	21,203	1,757	48,072	-	71,032
Intercompany accounts payable	(209)	1,652	16,157	(17,600)	-
Wages and benefits payable	16,468	1,667	41,083	-	59,218
Taxes payable	(152)	(642)	24,628	-	23,834
Current portion of debt	10,653	908	-	-	11,561
Current portion of warranty	8,482	139	10,240	-	18,861
Short-term intercompany advances	94,231	6,061	24,123	(124,415)	-
Unearned revenue	20,864	-	9,837	-	30,701
Total current liabilities	210,205	16,087	341,133	(142,015)	425,410
Long-term debt	1,521,156	89,871	-	-	1,611,027

Warranty	10,038	-	7,291	-	17,329
Pension plan and other employee benefits	-	-	65,040	-	65,040
Deferred income taxes, net	59	(844)	211,175	-	210,390
Intercompany notes payable	1,360	45,726	1,716,587	(1,763,673)	-
Other obligations	13,253	-	36,986	-	50,239
Total liabilities	1,756,071	150,840	2,378,212	(1,905,688)	2,379,435
Shareholders' equity					
Preferred stock	-	-	-	-	-
Common stock	598,861	25,110	41,534	(66,645)	598,860
Accumulated other comprehensive income (loss), net	(16,182)	(549)	12,086	(77)	(4,722)
Retained earnings (accumulated deficit)	22,489	(5,696)	(50,597)	55,480	21,676
Total shareholders' equity	605,168	18,865	3,023	(11,242)	615,814
Total liabilities and shareholders' equity	$ 2,361,239	$ 169,705	$ 2,381,235	$ (1,916,930)	$ 2,995,249

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Condensed Consolidating Balance Sheet
December 31, 2006

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
		(in thousands)		
ASSETS				
Current assets				
Cash and cash equivalents	$ 353,483	$ 7,922	$ -	$ 361,405
Short-term investments, held to maturity	34,583	-	-	34,583
Accounts receivable, net	95,041	14,883	-	109,924
Intercompany accounts receivable	6,486	3,263	(9,749)	-
Inventories	49,233	3,263	-	52,496
Deferred income taxes, net	19,758	1,158	-	20,916
Other	15,394	1,727	-	17,121
Intercompany other	1,698	5,000	(6,698)	-
Total current assets	575,676	37,216	(16,447)	596,445
Property, plant and equipment, net	86,594	2,095	-	88,689
Intangible assets, net	104,731	7,951	-	112,682
Goodwill	113,481	12,785	-	126,266
Prepaid debt fees	13,161	-	-	13,161
Deferred income taxes, net	44,702	2,698	-	47,400
Intercompany notes receivable	12,257	1,242	(13,499)	-
Other	28,113	1,390	(25,624)	3,879
Total assets	$ 978,715	$ 65,377	$ (55,570)	$ 988,522
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Trade payables	$ 33,602	$ 2,201	$ -	$ 35,803
Accrued expenses	6,392	10	-	6,402
Intercompany accounts payable	3,263	6,486	(9,749)	-
Wages and benefits payable	22,673	1,541	-	24,214
Taxes payable	1,053	664	-	1,717
Current portion of warranty	7,850	149	-	7,999
Short-term intercompany advances	5,001	1,697	(6,698)	-
Unearned revenue	26,004	1,445	-	27,449
Total current liabilities	105,838	14,193	(16,447)	103,584
Long-term debt	469,324	-	-	469,324
Warranty	10,149	-	-	10,149
Intercompany notes payable	1,241	12,258	(13,499)	-
Other obligations	6,948	7,535	-	14,483
Total liabilities	593,500	33,986	(29,946)	597,540
Shareholders' equity				

Preferred stock	-	-	-	-
Common stock	351,018	30,113	(30,113)	351,018
Accumulated other comprehensive income (loss), net	(4,179)	5,767	-	1,588
Retained earnings (accumulated deficit)	38,376	(4,489)	4,489	38,376
Total shareholders' equity	385,215	31,391	(25,624)	390,982
Total liabilities and shareholders' equity	$ 978,715	$ 65,377	$ (55,570)	$ 988,522

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Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Operating activities					
Net loss	$ (15,887)	$ (4,245)	$ (46,108)	$ 49,540	$ (16,700)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization	21,780	412	24,964	-	47,156
In-process research and development	-	-	35,551	-	35,551
Employee stock plans income tax benefits	5,773	-	-	-	5,773
Excess tax benefits from stock-based compensation	(5,029)	-	-	-	(5,029)
Stock-based compensation	5,849	-	-	-	5,849
Amortization of prepaid debt fees	2,717	96	-	-	2,813
Deferred income taxes, net	(6,832)	(1,072)	(22,229)	-	(30,133)
Other, net	48,170	2,571	6	(50,353)	394
Changes in operating assets and liabilities, net of acquisitions:					
Accounts receivable	7,897	(1,817)	(18,684)	-	(12,604)
Inventories	(1,797)	913	18,054	813	17,983
Trade payables, accrued expenses and taxes payable	22,453	2,016	1,342	-	25,811
Wages and benefits payable	(6,205)	169	(1,263)	-	(7,299)
Unearned revenue	(4,856)	-	508	-	(4,348)
Warranty	639	14	(262)	-	391
Other long-term obligations	194	-	(241)	-	(47)
Intercompany transactions, net	(9,119)	1,635	7,484	-	-
Other, net	785	(981)	(2,446)	-	(2,642)
Net cash provided by (used in) operating activities	66,532	(289)	(3,324)	-	62,919
Investing activities					
Purchases from the maturities of investments, held to maturity	35,000	-	-	-	35,000
Acquisitions of property, plant and equipment	(12,907)	6,779	(12,178)	-	(18,306)
Business acquisitions, net of cash and cash	(1,715,626)	-	-	-	(1,715,626)

equivalents acquired					
Cash transferred to parent	-	(89,042)	-	89,042	-
Cash transferred to non-guarantor subsidiaries	(22,492)	-	-	22,492	-
Intercompany notes, net	52,360	346	(52,706)	-	-
Other, net	(41,253)	(52,097)	99,247	-	5,897
Net cash provided by (used in) investing activities	(1,704,918)	(134,014)	34,363	111,534	(1,693,035)
Financing activities					
Proceeds from borrowings	1,068,248	90,779	-	-	1,159,027
Payments on debt	(2,890)	-	-	-	(2,890)
Issuance of common stock	236,220	-	-	-	236,220
Excess tax benefits from stock-based compensation	5,029	-	-	-	5,029
Prepaid debt fees	(21,511)	(1,547)	-	-	(23,058)
Cash transferred from parent	89,042	-	-	(89,042)	-
Cash transferred from non-guarantor subsidiaries	-	-	22,492	(22,492)	-
Intercompany notes payable	(45,726)	45,726	-	-	-
Net cash provided by financing activities	1,328,412	134,958			