

ITRON INC /WA/  
Form 10-Q  
August 06, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934  
For the quarterly period ended June 30, 2013

OR

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

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

91-1011792  
(I.R.S. Employer Identification Number)

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

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

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

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

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

As of July 31, 2013 there were outstanding 39,111,850 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

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## PART I: FINANCIAL INFORMATION

## Item 1: Financial Statements (Unaudited)

## ITRON, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

## (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Revenues	\$482,175	\$579,140	\$929,711	\$1,150,780
Cost of revenues	322,587	382,395	630,000	770,930
Gross profit	159,588	196,745	299,711	379,850
Operating expenses				
Sales and marketing	46,182	50,847	94,398	100,703
Product development	43,481	46,640	87,689	90,996
General and administrative	38,317	33,450	71,912	70,020
Amortization of intangible assets	10,247	12,025	20,991	23,938
Restructuring expense	3,385	7,720	4,398	8,509
Total operating expenses	141,612	150,682	279,388	294,166
Operating income	17,976	46,063	20,323	85,684
Other income (expense)				
Interest income	194	177	1,255	370
Interest expense	(2,336)	) (2,606)	) (4,674)	) (5,043)
Other income (expense), net	(1,742)	) (779)	) (2,559)	) (2,955)
Total other income (expense)	(3,884)	) (3,208)	) (5,978)	) (7,628)
Income before income taxes	14,092	42,855	14,345	78,056
Income tax benefit (provision)	(1,896)	) (10,564)	) 1,347	) (20,193)
Net income	12,196	32,291	15,692	57,863
Net income (loss) attributable to noncontrolling interests	(203)	) 676	723	895
Net income attributable to Itron, Inc.	\$12,399	\$31,615	\$14,969	\$56,968
Earnings per common share - Basic	\$0.31	\$0.79	\$0.38	\$1.43
Earnings per common share - Diluted	\$0.31	\$0.79	\$0.38	\$1.42
Weighted average common shares outstanding - Basic	39,431	39,887	39,426	39,900
Weighted average common shares outstanding - Diluted	39,678	40,126	39,724	40,170

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

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ITRON, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Net income	\$12,196	\$32,291	\$15,692	\$57,863
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	7,180	(52,331)	) (24,120	) (23,790 )
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	845	(849)	) 772	(849 )
Pension plan benefit liability adjustment	183	22	(197	) 45
Total other comprehensive income (loss), net of tax	8,208	(53,158)	) (23,545	) (24,594 )
Total comprehensive income (loss), net of tax	20,404	(20,867)	) (7,853	) 33,269
Comprehensive income (loss) attributable to noncontrolling interests, net of tax:				
Net income (loss) attributable to noncontrolling interests	(203	) 676	723	895
Foreign currency translation adjustments	5	40	—	40
Amounts attributable to noncontrolling interests	(198	) 716	723	935
Comprehensive income (loss) attributable to Itron, Inc.	\$20,602	\$(21,583)	\$(8,576	) \$32,334

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

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## ITRON, INC.

## CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2013 (unaudited)	December 31, 2012
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 103,662	\$ 136,411
Accounts receivable, net	372,240	375,326
Inventories	190,414	170,719
Deferred tax assets current, net	33,138	33,536
Other current assets	112,014	104,958
Total current assets	811,468	820,950
Property, plant, and equipment, net		
Deferred tax assets noncurrent, net	249,372	255,212
Other long-term assets	55,397	44,584
Intangible assets, net	26,607	28,908
Goodwill	210,849	238,771
Total assets	696,215	701,016
	\$2,049,908	\$2,089,441
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Accounts payable	\$203,092	\$227,739
Other current liabilities	54,988	49,950
Wages and benefits payable	84,831	91,802
Taxes payable	15,481	9,305
Current portion of debt	22,500	18,750
Current portion of warranty	24,709	27,115
Unearned revenue	50,799	42,712
Total current liabilities	456,400	467,373
Long-term debt		
Long-term warranty	387,500	398,750
Pension plan benefit liability	25,923	26,490
Deferred tax liabilities noncurrent, net	89,948	90,533
Other long-term obligations	11,235	16,682
Total liabilities	81,229	80,100
	1,052,235	1,079,928
Commitments and contingencies		
Equity		
Preferred stock	—	—
Common stock	1,290,226	1,294,213
Accumulated other comprehensive loss, net	(57,929	) (34,384
Accumulated deficit	(251,893	) (266,862
Total Itron, Inc. shareholders' equity	980,404	992,967

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Noncontrolling interests	17,269	16,546
Total equity	997,673	1,009,513
Total liabilities and equity	\$2,049,908	\$2,089,441

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Six Months Ended	
	June 30,	
	2013	2012
	(in thousands)	
Operating activities		
Net income	\$15,692	\$57,863
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	49,031	54,271
Stock-based compensation	10,122	9,256
Amortization of prepaid debt fees	829	763
Deferred taxes, net	(11,543)	) 628
Restructuring expense, non-cash	27	1,487
Other adjustments, net	324	(11)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	(4,278)	) 8,046
Inventories	(25,124)	) (2,786)
Other current assets	(9,408)	) (13,663)
Other long-term assets	4,489	3,559
Accounts payable, other current liabilities, and taxes payable	(10,280)	) (5,817)
Wages and benefits payable	(5,661)	) (11,244)
Unearned revenue	10,497	5,627
Warranty	(1,797)	) (11,991)
Other operating, net	(3,946)	) (3,598)
Net cash provided by operating activities	18,974	92,390
Investing activities		
Acquisitions of property, plant, and equipment	(28,895)	) (23,547)
Business acquisitions, net of cash and cash equivalents acquired	(860)	) (79,605)
Other investing, net	241	3,993
Net cash used in investing activities	(29,514)	) (99,159)
Financing activities		
Proceeds from borrowings	15,000	70,000
Payments on debt	(22,500)	) (67,502)
Issuance of common stock	2,590	2,407
Repurchase of common stock	(16,126)	) (25,976)
Other financing, net	2,220	(271)
Net cash used in financing activities	(18,816)	) (21,342)
Effect of foreign exchange rate changes on cash and cash equivalents	(3,393)	) (2,175)
Decrease in cash and cash equivalents	(32,749)	) (30,286)
Cash and cash equivalents at beginning of period	136,411	133,086
Cash and cash equivalents at end of period	\$103,662	\$102,800

Non-cash transactions:

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Property, plant, and equipment purchased but not yet paid	\$7,284	\$4,364
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net	\$8,200	\$20,173
Interest, net of amounts capitalized	3,804	4,275

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, 2013

(UNAUDITED)

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

Note 1: Summary of Significant Accounting Policies

We were incorporated in the state of Washington in 1977. We provide a portfolio of products and services to utilities for the energy and water markets throughout the world.

Financial Statement Preparation

The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Consolidated Statements of Operations and the Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2013 and 2012, the Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2012 audited financial statements and notes included in our Annual Report on Form 10-K filed with the SEC on February 22, 2013. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation

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

Noncontrolling Interests

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

Business Acquisitions

On May 1, 2012, we completed the acquisition of SmartSynch, Inc. (SmartSynch). SmartSynch provides smart grid solutions that utilize cellular networks for communications.

In January 2011, we completed the acquisition of a software and consulting services company in France, which included contingent and deferred consideration amounts that were paid in the first quarters of 2012 and 2013. See Business Combinations policy below.

#### Cash and Cash Equivalents

We consider all highly liquid instruments with remaining maturities of three months or less at the date of acquisition to be cash equivalents.

#### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded for invoices issued to customers in accordance with our contractual arrangements. Interest and late payment fees are minimal. Unbilled receivables are recorded when revenues are recognized upon product shipment or service delivery and invoicing occurs at a later date. We record an allowance for doubtful accounts representing our estimate of the probable losses in accounts receivable at the date of the balance sheet based on our historical experience of bad debts and our specific review

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of outstanding receivables. Accounts receivable are written-off against the allowance when we believe an account, or a portion thereof, is no longer collectible.

### Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Cost includes raw materials and labor, plus applied direct and indirect costs.

### Derivative Instruments

All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP. The net fair value of our derivative instruments may switch between a net asset and a net liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position.

For any derivative designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. For any derivative designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) (OCI) and are recognized in earnings when the hedged item affects earnings. Ineffective portions of cash flow hedges are recognized in other income (expense) in the Consolidated Statements of Operations. For a hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Upon termination of a net investment hedge, the net derivative gain/loss will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated operations. Ineffective portions of fair value changes or the changes in fair value of derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

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

### Property, Plant, and Equipment

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

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset group may not be recoverable. Assets held for sale are classified within other current assets in the Consolidated Balance Sheets, are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Gains and losses from asset disposals and impairment losses are classified within the Consolidated

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

#### Prepaid Debt Fees

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

#### Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree's results of operations are also included as of the date of acquisition in our consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and

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

### Goodwill and Intangible Assets

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

Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the forecasted discounted cash flows associated with each reporting unit.

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

Determining the fair value of a reporting unit is judgmental in nature and involves the use of significant estimates and assumptions. We forecast discounted future cash flows at the reporting unit level using risk-adjusted discount rates and estimated future revenues and operating costs, which take into consideration factors such as existing backlog, expected future orders, supplier contracts, and expectations of competitive and economic environments. We also identify similar publicly traded companies and develop a correlation, referred to as a multiple, to apply to the operating results of the reporting units. These combined fair values are then reconciled to the aggregate market value

of our common stock on the date of valuation, while considering a reasonable control premium.

#### Contingencies

A loss contingency is recorded if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We evaluate, among other factors, the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of the ultimate loss. Loss contingencies that we determine to be reasonably possible, but not probable, are disclosed but not recorded. Changes in these factors and related estimates could materially affect our financial position and results of operations. Legal costs to defend against contingent liabilities are expensed as incurred.

#### Bonus and Profit Sharing

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

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

### Warranty

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

### Restructuring and Asset Impairments

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

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

### Defined Benefit Pension Plans

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

### Share Repurchase Plan

We may repurchase up to \$50 million of shares of Itron common stock under a twelve-month program, which was authorized by our Board of Directors on March 8, 2013. Share repurchases are made in the open market or in privately negotiated transactions and in accordance with applicable securities laws. Under applicable Washington State law, shares repurchased are retired and not displayed separately as treasury stock on the financial statements; the value of

the repurchased shares is deducted from common stock.

#### Revenue Recognition

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

The majority of our revenue arrangements involve multiple deliverables, which combine two or more of the following: hardware, meter reading system software, installation, and/or project management services. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) has value to the customer on a standalone basis and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria considered for each unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect and that is not contingent upon

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the delivery/performance of additional items. Revenues for each deliverable are then recognized based on the type of deliverable, such as 1) when the products are shipped, 2) services are delivered, 3) percentage-of-completion when implementation services are essential to other deliverables in the arrangement, 4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. The majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

If, among other factors, the data collection system does not use standard internet protocols and network design services are deemed complex and extensive, hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions. Revenue from network software and services is recognized using the units-of-delivery method of contract accounting, as network design services and network software are essential to the functionality of the related hardware (network). This methodology results in the deferral of costs and revenues as professional services and software implementation commence prior to deployment of hardware.

In all other instances, hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions. Network software is recognized when shipped if all other revenue recognition criteria are met and services are not essential to the functionality of the software. If implementation services are essential to the functionality of the network software, software and implementation revenues are recognized using the percentage-of-completion methodology of contract accounting when project costs are reliably estimated.

We also enter into multiple deliverable software arrangements that do not include hardware. For this type of arrangement, revenue recognition is dependent upon the availability of vendor specific objective evidence (VSOE) of fair value for each of the deliverables. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for multiple deliverable software arrangements. Certain of our revenue arrangements include an extended or noncustomary warranty provision that covers all or a portion of a customer's replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, a portion of the arrangement's total consideration is allocated to this extended warranty deliverable. This revenue is deferred and recognized over the extended warranty coverage period. Extended or noncustomary warranties do not represent a significant portion of our revenue. We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using VSOE, if it exists, otherwise we use third-party evidence (TPE). We define VSOE as a median price of recent standalone transactions that are priced within a narrow range. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP) to determine the price at which we would transact if the product or service were regularly sold by us on a standalone basis. Our determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. The factors considered include the cost to produce the deliverable, the anticipated margin on that deliverable, our ongoing pricing strategy and policies, and the characteristics of the varying markets in which the deliverable is sold.

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

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of \$83.7 million and \$74.9 million at June 30, 2013 and December 31, 2012 related primarily to professional services and software associated with our smart metering contracts, extended or noncustomary warranty, and prepaid post-contract support. Deferred costs are recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were \$27.7 million and \$24.4 million at June 30, 2013 and December 31, 2012 and are recorded within other assets in the Consolidated Balance Sheets.

Hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract. Shipping and handling costs and incidental expenses billed to customers are recorded as revenue, with the associated cost charged to cost of revenues. We record sales, use, and value added taxes billed to our customers on a net basis.

**Product and Software Development Costs**

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

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## Stock-Based Compensation

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

## Income Taxes

We compute our interim income tax provision through the use of an estimated annual effective tax rate (ETR) applied to year-to-date operating results and specific events that are discretely recognized as they occur. In determining the estimated annual ETR, we analyze various factors, including the forecasted mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and uncertain tax positions, amount other items. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than included in the estimated annual ETR.

Deferred tax assets and liabilities are recognized based upon anticipated future tax consequences, in each of the jurisdictions in which we operate, attributable to: (1) the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases; and (2) operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of our tax liabilities involves applying complex tax regulations in different jurisdictions to our tax positions. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amount of deferred tax assets if it is more likely than not that such assets will not be realized. We do not record tax liabilities on undistributed earnings of international subsidiaries that are permanently reinvested.

We utilize a two step approach to account for uncertain tax positions. A tax position is first evaluated for recognition based on its technical merits. Tax positions that have a greater than fifty percent likelihood of being realized upon ultimate settlement are then measured to determine amounts to be recognized in the financial statements. This measurement incorporates information about potential settlements with taxing authorities. A previously recognized tax position is derecognized in the first period in which the position no longer meets the more-likely-than-not recognition threshold or upon expiration of the statute of limitations. We classify interest expense and penalties related to

uncertain tax positions and interest income on tax overpayments as part of income tax expense.

#### Foreign Exchange

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

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Fair Value Measurements

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

Use of Estimates

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

New Accounting Pronouncements

The Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013.11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" on July 18, 2013. The ASU concludes an unrecognized tax benefit should be presented as a reduction of a deferred tax asset when settlement in this manner is available under the law. We will adopt this amendment as of January 2014. The result of adoption may be to reclassify certain long term liabilities to long term deferred tax assets, and the adoption will not result in a change to the tax provision. Management does not believe that the impact on the balance sheet will be significant.

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## Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Net income available to common shareholders	\$ 12,399	\$ 31,615	\$ 14,969	\$ 56,968
Weighted average common shares outstanding - Basic	39,431	39,887	39,426	39,900
Dilutive effect of stock-based awards	247	239	298	270
Weighted average common shares outstanding - Diluted	39,678	40,126	39,724	40,170
Earnings per common share - Basic	\$0.31	\$0.79	\$0.38	\$1.43
Earnings per common share - Diluted	\$0.31	\$0.79	\$0.38	\$1.42

## Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 1.1 million and 1.2 million stock-based awards were excluded from the calculation of diluted EPS for each of the three and six months ended June 30, 2013, and approximately 1.4 million and 1.3 million stock-based awards were excluded from the calculation of diluted EPS for each of the three and six months ended June 30, 2012, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

## Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock would 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. There was no preferred stock issued or outstanding at June 30, 2013 and December 31, 2012.

## Stock Repurchase Plan

On March 8, 2013, the Board authorized a twelve-month repurchase program of up to \$50 million of our common stock. As of June 30, 2013, we have repurchased 384,800 shares of our common stock, totaling \$16.1 million, with \$33.9 million remaining under the repurchase program. Repurchases are made in the open market or in privately negotiated transactions, and in accordance with applicable securities laws. Refer to Part II, Item 2: "Unregistered Sales of Equity Securities and Use of Proceeds" for additional information related to our share repurchase program.

## Note 3: Certain Balance Sheet Components

	June 30, 2013	December 31, 2012
	(in thousands)	
Accounts receivable, net	\$ 330,956	\$ 329,352
Trade receivables (net of allowance of \$6,948 and \$7,372)	41,284	45,974
Unbilled receivables	\$ 372,240	\$ 375,326
Total accounts receivable, net		

At June 30, 2013 and December 31, 2012, \$19.0 million and \$20.0 million were recorded within trade receivables as billed but not yet paid by customers, in accordance with contract retainage provisions. At June 30, 2013 and December 31, 2012, contract retainage amounts that were unbilled and classified as unbilled receivables were \$11.1 million. We had no long-term unbilled receivables or long-term retainage contract receivables at June 30, 2013 and December 31, 2012, as we expect to collect all contract retainage receivables within the following 12 months.

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Allowance for doubtful account activity	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Beginning balance	\$6,144	\$5,983	\$7,372	\$6,049
Provision (release) of doubtful accounts, net	1,075	(230)	171	(290)
Accounts written-off	(198)	(22)	(303)	(261)
Effects of change in exchange rates	(73)	(350)	(292)	(117)
Ending balance	\$6,948	\$5,381	\$6,948	\$5,381

Inventories	June 30, 2013	December 31, 2012
	(in thousands)	
Materials	\$104,283	\$92,038
Work in process	13,879	12,568
Finished goods	72,252	66,113
Total inventories	\$190,414	\$170,719

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

Consigned inventory is held at third-party locations; however, we retain title to the inventory until purchased by the third-party. Consigned inventory, consisting of raw materials and finished goods, was \$5.7 million and \$5.0 million at June 30, 2013 and December 31, 2012, respectively.

Property, plant, and equipment, net	June 30, 2013	December 31, 2012
	(in thousands)	
Machinery and equipment	\$290,500	\$287,791
Computers and software	88,186	84,980
Buildings, furniture, and improvements	143,420	146,191
Land	24,663	25,318
Construction in progress, including purchased equipment	33,529	26,097
Total cost	580,298	570,377
Accumulated depreciation	(330,926)	(315,165)
Property, plant, and equipment, net	\$249,372	\$255,212

Depreciation expense and capitalized interest	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Depreciation expense	\$14,027	\$15,019	\$28,040	\$30,333
Capitalized interest	21	—	64	—

In conjunction with the upgrade of our global enterprise resource planning software systems, we have capitalized \$11.1 million within construction in progress at June 30, 2013. Amounts capitalized include internal labor costs and related benefits, software, third-party consulting fees, and \$21,000 and \$64,000 of interest for the three and six months ended June 30, 2013, respectively.

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## Note 4: Intangible Assets

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

	June 30, 2013			December 31, 2012		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	\$420,055	\$(338,145)	\$81,910	\$407,024	\$(332,763)	\$74,261
Customer contracts and relationships	281,644	(159,231)	122,413	292,252	(154,890)	137,362
Trademarks and trade names	71,356	(64,897)	6,459	72,770	(65,090)	7,680
Other	11,091	(11,024)	67	11,094	(11,026)	68
Total intangible assets subject to amortization	784,146	(573,297)	210,849	783,140	(563,769)	219,371
In-process research and development	—	—	—	19,400	—	19,400
Total intangible assets	\$784,146	\$(573,297)	\$210,849	\$802,540	\$(563,769)	\$238,771

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

	Six Months Ended June 30,	
	2013	2012
	(in thousands)	
Beginning balance, intangible assets, gross	\$802,540	\$749,194
Intangible assets acquired	(1,500)	) 43,400
Effect of change in exchange rates	(16,894)	) (13,835)
Ending balance, intangible assets, gross	\$784,146	\$778,759

Intangible assets acquired in 2012 were related to the SmartSynch acquisition on May 1, 2012, including IPR&D assets that consisted primarily of projects to upgrade the hardware components of cellular communication modules to be compatible with 3G cellular network standards. Upon completion of these projects in March 2013, we performed a qualitative assessment and determined that it was more than likely that the carrying amount of IPR&D was not impaired. Accordingly, the carrying amount of IPR&D was reclassified as core-developed technology and will be amortized over its expected useful life of seven years based on the SmartSynch acquisition discounted cash flow valuation model. For the six months ended June 30, 2013, the adjustment of \$1.5 million to intangible assets acquired is associated with the correction of an error for a long-term revenue contract from the SmartSynch acquisition. See Note 5 for further discussion of the correction of the error and its impact on goodwill.

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

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)

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2013 (amount remaining at June 30, 2013)	\$20,734
2014	43,434
2015	34,800
2016	27,345
2017	20,314
Beyond 2017	64,222
Total intangible assets, net	\$210,849

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## Note 5: Goodwill

The following table reflects the goodwill balance as of June 30, 2013:

	Energy (in thousands)	Water	Total Company
Balance at January 1, 2013			
Goodwill before impairment	\$ 859,454	\$ 414,394	\$ 1,273,848
Accumulated impairment losses	(249,502	) (323,330	) (572,832
Goodwill, net	609,952	91,064	701,016
Adjustments of previous acquisition	3,958	—	3,958
Effect of change in exchange rates	(7,551	) (1,208	) (8,759
Balance at June 30, 2013			
Goodwill before impairment	851,471	407,497	1,258,968
Accumulated impairment losses	(245,112	) (317,641	) (562,753
Goodwill, net	\$ 606,359	\$ 89,856	\$ 696,215

During the second quarter of 2013, we finalized the purchase price allocation related to the SmartSynch acquisition, which was completed on May 1, 2012, and recorded certain adjustments that are reflected as Adjustments of previous acquisition. These adjustments primarily affected the fair value calculation of certain accrued liabilities associated with specific contracts. Among these adjustments is the correction of an error associated with a long-term revenue contract acquired from SmartSynch. In May 2013, we determined that certain manufacturing costs were not reflected in the model used to value this contract at acquisition. Once these costs were properly added to the total cost and profitability estimates, we determined the total contract would result in a loss of \$2.4 million over the contract term. Therefore, we recognized a liability for this expected loss on the contract and made a corresponding adjustment to goodwill. Further, we had previously recognized a customer relationship intangible asset of \$1.5 million associated with this contract, with amortization scheduled to begin in 2014 based on the contract's original projected cash flow. Since the contract is in an overall loss position, we determined that the intangible asset had no value. We reduced the value of this intangible asset to zero with a corresponding adjustment to goodwill. In accordance with relevant accounting guidance, we evaluated the materiality of the error from a qualitative and quantitative perspective. Based on such evaluation, we concluded that recognizing the contract liability and adjusting the intangible asset value would not be material, quantitatively or qualitatively, to our results of operations for the three months ended June 30, 2013 or our expected full year results of operations for 2013 and would not have had a material impact on our results for the year ended December 31, 2012. Because these adjustments were not material individually or in aggregate, we have not retrospectively adjusted the comparative amounts on the Consolidated Balance Sheet as of December 31, 2012.

Accumulated impairment losses relate to goodwill impairment charges recorded during 2011 as a result of a significant decline in the price of our shares of common stock at the end of September 2011, which reduced our aggregate market value significantly below the carrying value of our net assets as of September 30, 2011.

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

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## Note 6: Debt

The components of our borrowings were as follows:

	June 30, 2013 (in thousands)	December 31, 2012
Credit facility:		
USD denominated term loan	\$270,000	\$277,500
Multicurrency revolving line of credit	140,000	140,000
Total debt	410,000	417,500
Less: current portion of debt	22,500	18,750
Long-term debt	\$387,500	\$398,750

## Credit Facility

Our credit facility is dated August 5, 2011. The credit facility consists of a \$300 million U.S. dollar term loan (the term loan) and a multicurrency revolving line of credit (the revolver) with a principal amount of up to \$660 million. Both the term loan and the revolver mature on August 8, 2016, and amounts borrowed under the revolver are classified as long-term. Amounts borrowed under the revolver during the credit facility term may be repaid and reborrowed until the revolver's maturity, at which time the revolver will terminate, and all outstanding loans, together with all accrued and unpaid interest, must be repaid. Amounts not borrowed under the revolver are subject to a commitment fee, which is paid in arrears on the last day of each fiscal quarter, ranging from 0.20% to 0.40% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter. Amounts repaid on the term loan may not be reborrowed. The credit facility permits us and certain of our foreign subsidiaries to borrow in U.S. dollars, euros, British pounds, or, with lender approval, other currencies readily convertible into U.S. dollars. All obligations under the credit facility are guaranteed by Itron, Inc. and material U.S. domestic subsidiaries and are secured by a pledge of substantially all of the assets of Itron, Inc. and material U.S. domestic subsidiaries, including a pledge of 100% of the capital stock of material U.S. domestic subsidiaries and up to 66% of the voting stock (100% of the non-voting stock) of their first-tier foreign subsidiaries. In addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents. The credit facility includes debt covenants, which contain certain financial ratios and place certain restrictions on the incurrence of debt, investments, and the issuance of dividends. We were in compliance with the debt covenants under the credit facility at June 30, 2013.

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

Under the credit facility, we elect applicable market interest rates for both the term loan and any outstanding revolving loans. We also pay an applicable margin, which is based on our total leverage ratio (as defined in the credit agreement). The applicable rates per annum may be based on either: (1) the LIBOR rate, plus an applicable margin, or (2) the Alternate Base Rate, plus an applicable margin. The Alternate Base Rate election is equal to the greatest of three rates: (i) the prime rate, (ii) the Federal Reserve effective rate plus 1/2 of 1%, or (iii) one month LIBOR plus 1%. At June 30, 2013, the interest rate for both the term loan and the revolver was 1.45% (the LIBOR rate plus a margin of 1.25%).

Total credit facility repayments were as follows:

Six Months Ended June 30,

	2013	2012
	(in thousands)	
Term loan	\$7,500	\$7,502
Multicurrency revolving line of credit <sup>(1)</sup>	15,000	60,000
Total credit facility repayments	\$22,500	\$67,502

<sup>(1)</sup> We borrowed \$15.0 million and \$70.0 million under the multicurrency revolving line of credit during the six months ended June 30, 2013 and 2012.

At June 30, 2013, \$140.0 million was outstanding under the credit facility revolver, and \$47.0 million was utilized by outstanding standby letters of credit, resulting in \$473.0 million available for additional borrowings.

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Unamortized prepaid debt fees were as follows:

	June 30, 2013 (in thousands)	December 31, 2012
Unamortized prepaid debt fees	\$4,588	\$5,367
Note 7: Derivative Financial Instruments		

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to Note 1, Note 13, and Note 14 for additional disclosures on our derivative instruments.

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as “Level 2”). We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs include interest rate yield curves (swap rates and futures) and foreign exchange spot and forward rates, all of which are available in an active market. We have utilized the mid-market pricing convention for these inputs. We include, as a discount to the derivative asset, the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

The fair values of our derivative instruments at June 30, 2013 and December 31, 2012 were as follows:

Balance Sheet Location		Fair Value June 30, 2013 (in thousands)	December 31, 2012
<b>Asset Derivatives</b>			
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current assets	\$122	\$146
<b>Liability Derivatives</b>			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other current liabilities	\$1,348	\$629
Interest rate swap contracts	Other long-term obligations	134	2,096
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	108	114
Total liability derivatives		\$1,590	\$2,839

A summary of the potential effect of netting arrangements on our financial position related to the offsetting of our recognized derivative assets and liabilities under master netting arrangements or similar agreements is as follows:

## Offsetting of Derivative Assets

Gross Amounts of Recognized Assets Presented in the Consolidated Balance Sheets (in thousands)	Gross Amounts Not Offset in the Consolidated Balance Sheets		
	Derivative Financial Instruments	Cash Collateral Received	Net Amount

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June 30, 2013	\$ 122	\$(122	) \$—	\$—
December 31, 2012	\$ 146	\$(135	) \$—	\$11

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## Offsetting of Derivative Liabilities

	Gross Amounts of Recognized Liabilities Presented in the Consolidated Balance Sheets (in thousands)	Gross Amounts Not Offset in the Consolidated Balance Sheets Derivative Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2013	\$1,590	\$(122 )	\$—	\$1,468
December 31, 2012	\$2,839	\$(135 )	\$—	\$2,704

Our derivative assets and liabilities consist of foreign exchange forward and interest rate swap contracts with nine counterparties at June 30, 2013 and eight counterparties at December 31, 2012. None of our counterparties were individually significant at June 30, 2013 or December 31, 2012. Our derivative contracts with each of these counterparties exist under agreements that provide for the net settlement of all contracts through a single payment in a single currency in the event of default. We have no pledges of cash collateral against our obligations nor have we received pledges of cash collateral from our counterparties under the associated derivative contracts.

OCI during the reporting periods for our derivative hedging instruments, net of tax, was as follows:

	2013 (in thousands)	2012
Net unrealized loss on hedging instruments at January 1,	\$(16,069 )	\$(14,380 )
Unrealized gain (loss) on derivative instruments	772	(849 )
Net unrealized loss on hedging instruments at June 30,	\$(15,297 )	\$(15,229 )

Included in the net unrealized loss on hedging instruments at June 30, 2013 and 2012 is a loss of \$14.4 million, net of tax, related to our nonderivative net investment hedge, which terminated in 2011. This loss on our net investment hedge will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

## Cash Flow Hedges

As a result of our floating rate debt, we are exposed to variability in our cash flows from changes in the applicable interest rate index. We enter into swaps to achieve a fixed rate of interest on the hedged portion of debt in order to increase our ability to forecast interest expense. The objective of these swaps is to reduce the variability of cash flows from increases in the LIBOR base borrowing rates on our floating rate credit facility. The swaps do not protect us from changes to the applicable margin under our credit facility.

In May 2012, we entered into six forward starting pay-fixed receive one-month LIBOR interest rate swaps. The interest rate swaps convert \$200 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.00% (excluding the applicable margin on the debt) and are effective July 31, 2013 to August 8, 2016. These cash flow hedges are expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swaps are recorded as a component of OCI and will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedges will be recognized as adjustments to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is \$1.3 million. At June 30, 2013, our LIBOR based debt balance was \$410.0 million.

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

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The before-tax effect of our cash flow derivative instruments on the Consolidated Balance Sheets and the Consolidated Statements of Operations for the three and six months ended June 30 were as follows:

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	2013	2012	Location	Amount	Location	Amount
	(in thousands)			2013	2012	2013
Three Months Ended June 30,						
Interest rate swap contracts	\$ 1,336	\$ (1,365 )	Interest expense	\$ —	\$ —	Interest expense \$— \$—
Six Months Ended June 30,						
Interest rate swap contracts	\$ 1,244	\$ (1,365 )	Interest expense	\$ —	\$ —	Interest Expense \$— \$—

## Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts (a total of 247 contracts were entered into during the six months ended June 30, 2013), which are not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these non-functional currency assets and liabilities. The notional amounts of the contracts ranged from \$251,000 to \$11.0 million, offsetting our exposures to the euro, Saudi riyal, Canadian dollar, Australian dollar, Brazilian real, South African rand, and various other currencies.

The effect of our foreign exchange forward derivative instruments on the Consolidated Statements of Operations for the three and six months ended June 30 was as follows:

Derivatives Not Designated as Hedging Instrument under ASC 815-20	Gain (Loss) Recognized on Derivatives in Other Income (Expense)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Foreign exchange forward contracts	\$ (971 )	\$ (244 )	\$ (757 )	\$ (421 )
Note 8: Defined Benefit Pension Plans				

We sponsor both funded and unfunded defined benefit pension plans for our international employees, primarily in Germany, France, Italy, Indonesia, and Spain, offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2012.

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

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	June 30, 2013 (in thousands)	December 31, 2012
<b>Assets</b>		
Plan assets in other long-term assets	\$226	\$227
<b>Liabilities</b>		
Current portion of pension plan liability in wages and benefits payable	3,157	2,899
Long-term portion of pension plan liability	89,948	90,533
Net pension plan benefit liability	\$92,879	\$93,205

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

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general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan. We contributed \$110,000 and \$355,000 to the defined benefit pension plans for the six months ended June 30, 2013 and 2012, respectively. The timing of when contributions are made can vary by plan and from year to year. For 2013, assuming that actual plan asset returns are consistent with our expected rate of return, and that interest rates remain constant, we expect to contribute approximately \$568,000 to our defined benefit pension plans. We contributed \$440,000 to the defined benefit pension plans for the year ended December 31, 2012.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Service cost	\$1,011	\$676	\$1,992	\$1,414
Interest cost	786	909	1,586	1,835
Expected return on plan assets	(79	) (82	) (158	) (167
Settlements and other	—	—	(814	) —
Amortization of actuarial net loss	246	2	497	4
Amortization of unrecognized prior service costs	17	17	34	34
Net periodic benefit cost	\$1,981	\$1,522	\$3,137	\$3,120

## Note 9: Stock-Based Compensation

We record stock-based compensation expense for awards of stock options, stock sold pursuant to our ESPP, and the issuance of restricted stock units and unrestricted stock awards. We expense stock-based compensation primarily using the straight-line method over the requisite service period. Capitalized stock-based compensation amounts were not material for the three and six months ended June 30, 2013 and 2012. For the three and six months ended June 30, stock-based compensation expense and the related tax benefit were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Stock options	\$519	\$337	\$992	\$609
Restricted stock units	4,158	4,375	8,393	7,891
Unrestricted stock awards	205	205	402	410
ESPP	144	141	335	346
Total stock-based compensation	\$5,026	\$5,058	\$10,122	\$9,256
Related tax benefit	\$1,391	\$1,375	\$2,755	\$2,564

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

Subject to stock splits, dividends, and other similar events, 3,500,000 shares of common stock are reserved and authorized for issuance under our 2010 Stock Incentive Plan (Stock Incentive Plan). Awards consist of stock options, restricted stock units, and unrestricted stock awards. At June 30, 2013, 431,758 shares were available for grant under the Stock Incentive Plan. The Stock Incentive Plan shares are subject to a fungible share provision such that, with respect to grants made after December 31, 2009, the authorized share reserve is reduced by (i) one share for every one share subject to a stock option or share appreciation right granted under the Plan and (ii) 1.7 shares for every one share of common stock that was subject to an award other than an option or stock appreciation right.

### Stock Options

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

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

	Three Months Ended June 30,		Six Months Ended June 30,		
	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>	2013	2012	
Dividend yield	—	% —	% —	% —	%
Expected volatility	—	% —	% 38.1	% 42.7	%
Risk-free interest rate	—	% —	% 1.0	% 0.9	%
Expected term (years)	—	—	5.45	5.14	

<sup>(1)</sup> There were no employee stock options granted for the three months ended June 30, 2013 and 2012.

Expected volatility is based on a combination of the historical volatility of our common stock and the implied volatility of our traded options for the related expected term. We believe this combined approach is reflective of current and historical market conditions and is an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected life of the award. The expected life is the weighted average expected life of an award based on the period of time between the date the award is granted and the estimated date the award will be fully exercised. Factors considered in estimating the expected life include historical experience of similar awards, contractual terms, vesting schedules, and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

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

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value <sup>(1)</sup> (in thousands)	Weighted Average Grant Date Fair Value
Outstanding, January 1, 2012	1,109	\$ 55.97	4.51	\$ 2,323	
Granted	54	48.23			\$ 18.64
Exercised	(28 )	20.32		\$ 576	
Expired	(32 )	69.69			
Outstanding, June 30, 2012	1,103	\$ 56.10	4.32	\$ 3,090	
Outstanding, January 1, 2013	1,137	\$ 54.06	4.81	\$ 3,815	
Granted	128	42.76			\$ 15.44
Exercised	(32 )	23.36		\$ 639	
Expired	(8 )	49.92			
Outstanding, June 30, 2013	1,225	\$ 53.71	4.99	\$ 2,388	
Exercisable, June 30, 2013	901	\$ 57.52	3.43	\$ 2,186	
Expected to vest, June 30, 2013	304	\$ 43.17	9.32	\$ 190	

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

of stock options exercised during the period is calculated based on our stock price at the date of exercise.

As of June 30, 2013, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$4.1 million, which is expected to be recognized over a weighted average period of approximately 2.3 years.

#### Restricted Stock Units

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

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

Prior to 2013, the performance-based restricted stock units issued under the Long-Term Performance Restricted Stock Unit Award Agreement (Performance Award Agreement) were determined based on the attainment of certain performance goals after the end of the one-year performance period. During the year, if management determined that it was probable that the targets would be achieved, compensation expense, net of forfeitures, was recognized on a straight-line basis over the annual performance and subsequent vesting period for each separately vesting portion of the award. Performance awards typically vested and were released in three equal installments at the end of each year following attainment of the performance goals. For U.S. participants who retire during the vesting period, unvested restricted stock units immediately vest at the date of retirement. For the 2012 performance awards, no awards became eligible for vesting as minimum performance thresholds for the 2012 performance year were not met.

For 2013, the performance-based restricted stock units to be issued under the Performance Award Agreement are determined based on (1) our achievement of specified non-GAAP EPS targets, as established at the beginning of each year for each of the calendar years contained in the performance periods (2-year and 3-year awards) (the performance condition) and (2) our total shareholder return (TSR) relative to the TSR attained by companies that are included in the Russell 3000 Index during the performance periods (the market condition). Compensation expense, net of forfeitures, is recognized on a straight-line basis, and the units vest upon achievement of the performance condition, provided participants are employed by Itron at the end of the respective performance periods. For U.S. participants who retire during the performance period, a pro-rated number of restricted stock units (based on the number of days of employment during the performance period) immediately vest based on the attainment of the performance goals as assessed after the end of the performance period.

Depending on the level of achievement of the performance condition, the actual number of shares to be earned ranges between 0% and 160% of the awards originally granted. At the end of the 2-year and 3-year performance periods, if the performance conditions are achieved at or above threshold, the number of shares earned is further adjusted by a TSR multiplier payout percentage, which ranges between 75% and 125%, based on the market condition. Therefore, based on the attainment of the performance and market conditions, the actual number of shares that vest may range from 0% to 200% of the awards originally granted. Due to the presence of the TSR multiplier market condition, we utilize a Monte Carlo valuation model to determine the fair value of the awards at the grant date. This pricing model uses multiple simulations to evaluate the probability of our achievement of various stock price levels to determine our expected TSR performance ranking. The weighted-average assumptions used to estimate the fair value of performance-based restricted stock units awarded and the resulting weighted average fair-value are as follows:

	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013	
Dividend yield	—	% —	%
Expected volatility	39.1	% 39.1	%
Risk-free interest rate	0.3	% 0.3	%
Expected term (years)	2.53	2.53	
Weighted-average fair value	\$45.70	\$45.03	

Expected volatility is based on the historical volatility of our common stock for the related expected term. We believe this approach is reflective of current and historical market conditions and is an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected term of the award. The expected term is the term of an award based on the period of time between the date of the award and the date the award is expected to vest. The expected term assumption is based

upon the plan's performance period as of the date of the award. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

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The following table summarizes restricted stock unit activity for the six months ended June 30:

	Number of Restricted Stock Units (in thousands)	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value <sup>(1)</sup> (in thousands)
Outstanding, January 1, 2012	625		
Granted <sup>(2)</sup>	443	\$47.33	
Released	(176)	)	\$11,536
Forfeited	(28)	)	
Outstanding, June 30, 2012	864		
Outstanding, January 1, 2013	774		
Granted <sup>(2)</sup>	255	\$42.51	
Released	(253)	)	\$13,562
Forfeited	(11)	)	
Outstanding, June 30, 2013	765		
Vested but not released, June 30, 2013	29		\$1,244
Expected to vest, June 30, 2013	672		\$28,496

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

Restricted stock units granted in 2012 and 2013 do not include awards under the Performance Award Agreement for the respective years, as these awards are not granted until final attainment of performance goals has been determined at the conclusion of the performance period, which had not occurred as of June 30, 2012 and 2013, respectively.

At June 30, 2013, unrecognized compensation expense on restricted stock units was \$24.2 million, which is expected to be recognized over a weighted average period of approximately 1.9 years.

#### Unrestricted Stock Awards

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Shares of unrestricted stock granted	4,518	4,526	8,847	9,979
Weighted average grant date fair value per share	\$45.37	\$45.26	\$45.40	\$41.05

#### Employee Stock Purchase Plan

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

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The following table summarizes ESPP activity for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Shares of stock sold to employees <sup>(1)</sup>	27,489	30,619	47,308	53,676
Weighted average fair value per ESPP award <sup>(2)</sup>	\$6.37	\$6.19	\$6.69	\$6.55

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

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

At June 30, 2013, all compensation cost associated with the ESPP had been recognized. There were approximately 553,000 shares of common stock available for future issuance under the ESPP at June 30, 2013.

#### Note 10: Income Taxes

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

Our tax benefit for the first six months of 2013 reflects the favorable discrete tax benefit for the retroactive extension of the 2012 research and experimentation credit in the amount of \$4.0 million. The American Taxpayer Relief Act of 2012 was signed into law on January 2, 2013 and extended several business tax provisions including the research and experimentation credit. Our annual estimated effective tax rate for 2013 was favorably impacted by a higher percentage of projected earnings in foreign jurisdictions with tax rates below 35%, the benefit of certain interest expense deductions, and an election under U.S. Internal Revenue Code Section 338 with respect to a foreign acquisition in 2007. Accordingly, our 2013 annual estimated effective tax rate is lower than our 2012 annual estimated effective tax rate.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Net interest and penalties expense	\$ 168	\$(22 )	\$ 339	\$ 265

Accrued interest and penalties recorded are as follows:

	June 30, 2013	December 31, 2012
	(in thousands)	
Accrued interest	\$3,251	\$3,095

Accrued penalties	3,009	3,030
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Unrecognized tax benefits related to uncertain tax positions and the amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate are as follows:

	June 30, 2013 (in thousands)	December 31, 2012
Unrecognized tax benefits related to uncertain tax positions	\$26,853	\$26,433
The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate	26,141	25,852

We believe it is reasonably possible that our unrecognized tax benefits may decrease by approximately \$1.3 million within the next twelve months due to the expiration of the statute of limitations. At June 30, 2013, we are not able to reasonably estimate the timing of future cash flows relating to our uncertain tax positions.

Note 11: Commitments and Contingencies

#### Guarantees and Indemnifications

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

Our available lines of credit, outstanding standby LOCs, and bonds are as follows:

	June 30, 2013 (in thousands)	December 31, 2012
Credit facilities <sup>(1)</sup>		
Multicurrency revolving line of credit	\$660,000	\$660,000
Long-term borrowings	(140,000	) (140,000
Standby LOCs issued and outstanding	(47,037	) (54,328
Net available for additional borrowings and LOCs	\$472,963	\$465,672
Unsecured multicurrency revolving lines of credit with various financial institutions		
Multicurrency revolving lines of credit	\$97,456	\$67,308
Standby LOCs issued and outstanding	(29,581	) (29,906
Short-term borrowings <sup>(2)</sup>	(2,731	) (851
Net available for additional borrowings and LOCs	\$65,144	\$36,551
Unsecured surety bonds in force	\$136,934	\$164,820

(1) See Note 6 for details regarding our secured credit facilities.

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

In the event any such standby LOC or bond is called, we would be obligated to reimburse the issuer of the standby LOC or bond; however, we do not believe that any outstanding LOC or bond will be called.

We generally provide an indemnification related to the infringement of any patent, copyright, trademark, or other intellectual property right on software or equipment within our sales contracts, which indemnifies the customer from and pays the resulting costs, damages, and attorney's fees awarded against a customer with respect to such a claim provided that (a) the customer promptly notifies us in writing of the claim and (b) we have the sole control of the

defense and all related settlement negotiations. We may also provide an indemnification to our customers for third party claims resulting from damages caused by the negligence or willful misconduct of our employees/agents in connection with the performance of certain contracts. The terms of our indemnifications generally do not limit the maximum potential payments. It is not possible to predict the maximum potential amount of future payments under these or similar agreements.

#### Legal Matters

We are subject to various legal proceedings and claims of which the outcomes are subject to significant uncertainty. Our policy is to assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the liability required, if any, for these contingencies is made after an analysis of each known issue.

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A liability is recorded and charged to operating expense when we determine that a loss is probable and the amount can be reasonably estimated. Additionally, we disclose contingencies for which a material loss is reasonably possible, but not probable. Liabilities recorded for legal contingencies at June 30, 2013 were not material to our financial condition or results of operations.

In 2010 and 2011, Transdata Incorporated (Transdata) filed lawsuits against four of our customers, CenterPoint Energy (CenterPoint), TriCounty Electric Cooperative, Inc. (Tri-County), San Diego Gas & Electric Company (San Diego), and Texas-New Mexico Power Company (TNMP), as well as several other utilities, alleging infringement of three patents owned by Transdata related to the use of an antenna in a meter. Pursuant to our contractual obligations with our customers, we agreed, subject to certain exceptions, to indemnify and defend them in these lawsuits. The complaints seek unspecified damages as well as injunctive relief. CenterPoint, Tri-County, San Diego, and TNMP have denied all of the substantive allegations and filed counterclaims seeking a declaratory judgment that the patents are invalid and not infringed. In December 2011, the Judicial Panel on Multi-District Litigation consolidated all of these cases in the Western District of Oklahoma for pretrial proceedings. On April 17, 2011, the Oklahoma court stayed the litigation pending the resolution of re-examination proceedings in the United States Patent and Trademark Office (U.S. PTO). The U.S. PTO has issued re-examination certificates confirming the patentability of the original claims and allowing certain new claims added by TransData. The parties conducted a claim construction hearing on February 5, 2013 on one claim term -- "electric meter circuitry." After initially adopting defendants' proposed construction of the term, the Court granted TransData's motion for reconsideration by order of June 25, 2013, and has adopted TransData's proposed construction. A claim construction hearing on the remaining terms is scheduled for late September 2013. Most of the remaining deadlines are based on the date of the Court's decision relating to those remaining terms. No trials are scheduled. We do not believe this matter will have a material adverse effect on our business or financial condition, although an unfavorable outcome could have a material adverse effect on our results of operations for the period in which such a loss is recognized.

In June 2011, a lawsuit was filed in the United States District Court for the Eastern District of Texas alleging infringement of three patents owned by EON Corp. IP Holdings, LLC (EON), related to two-way communication networks, network components, and related software platforms. The complaint seeks unspecified damages as well as injunctive relief. The Court has construed key terms of the three patents and has granted requests to file motions for summary judgment. We do not believe this matter will have a material adverse effect on our business or financial condition.

In a series of cases, approximately 270 former employees of Itron Sistemas e Tecnologia Ltda. (Itron Brazil), the majority of whose employment contracts were terminated in 2011, have sued Itron Brazil seeking payment of overtime and salary differential and alleging that the assumption of the employment relationship by Itron Brazil constituted illegal outsourcing under Brazilian law. In 2008, Itron Brazil entered into an agreement to provide installation and maintenance services to one of its customers and, to perform such services, hired over 800 employees of the previous provider of such services. In 2011, Itron Brazil determined to terminate the contract with its customer, which led to the termination of approximately 870 employees. Under applicable statutes of limitation, most additional employee claims must be brought prior to October 31, 2013. Itron Brazil intends to vigorously defend these cases but the ultimate outcome of the cases, and the amount of any liability, cannot be determined at this time.

The Company and its subsidiaries are parties to various employment-related proceedings in jurisdictions where it does business. None of the proceedings are individually material to the Company, and management believes that the Company has made adequate provision such that the ultimate disposition of the proceedings will not materially affect the Company's business or financial condition.

## Warranty

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Beginning balance	\$50,754	\$77,251	\$53,605	\$79,536
New product warranties	1,961	3,507	2,822	5,636
Other changes/adjustments to warranties	3,611	(3,770)	) 5,638	2,061
Claims activity	(5,289	) (8,255	) (10,388	) (19,575
Effect of change in exchange rates	(405	) (2,365	) (1,045	) (1,290
Ending balance	50,632	66,368	50,632	66,368
Less: current portion of warranty	24,709	42,861	24,709	42,861
Long-term warranty	\$25,923	\$23,507	\$25,923	\$23,507

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Total warranty expense is classified within cost of revenues and consists of new product warranties issued, costs related to extended warranty contracts, and other changes and adjustments to warranties. Warranty expense for the three and six months ended June 30 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Total warranty expense	\$5,572	\$(263	) \$8,460	\$7,697

Warranty expense increased during the three and six months ended June 30, 2013, compared with the same periods in 2012. Warranty expense during the three and six months ended June 30, 2012 reflected a \$4.3 million adjustment, which reduced a warranty accrual, originally recorded in 2011, as a result of lower than estimated replacements.

## Unearned Revenue Related to Extended Warranty

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Beginning balance	\$32,363	\$27,140	\$31,960	\$24,448
Unearned revenue for new extended warranties	1,664	2,243	2,625	5,189
Unearned revenue recognized	(525	) (331	) (995	) (631
Effect of change in exchange rates	(107	) (41	) (195	) 5
Ending balance	33,395	29,011		