BADGER METER INC
Form 10-K
March 06, 2007

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

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006

BADGER METER, INC.

4545 W. Brown Deer Road
Milwaukee, Wisconsin 53223
(414) 355-0400
A Wisconsin Corporation
IRS Employer Identification No. 39-0143280
Commission File No. 1-6706

The Company has the following classes of securities registered pursuant to Section 12(b) of the Act:

Title of class:	Name of each exchange on which registered:
Common Stock	American Stock Exchange
Common Share Purchase Rights	American Stock Exchange

The Company does not have any securities registered pursuant to Section 12(g) of the Act.

Indicate by check mark if the Company is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the Company is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

Indicate by check mark whether the Company (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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The aggregate market value of the Common Stock held by non-affiliates of the Company as of June 30, 2006 was $355,828,383. For purposes of this calculation only, (i) shares of Common Stock are deemed to have a market value of $27.00 per share, the closing price of the Common Stock as reported on the American Stock Exchange on June 30, 2006, and (ii) each of the executive officers and directors is deemed to be an affiliate of the Company.

As of February 13, 2007, there were 14,192,176 shares of Common Stock outstanding with a par value of $1 per share.

Portions of the Company s Proxy Statement for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission under Regulation 14A within 120 days after the end of the registrant s fiscal year, are incorporated by reference from the definitive Proxy Statement into Part III.

Special Note Regarding Forward Looking Statements

Certain statements contained in this Form 10-K, as well as other information provided from time to time by the Company or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words anticipate, believe, estimate, expect, think, should and objective or similar expressions are intended to identify forward looking statements. All such forward looking statements are based on the Company s then current views and assumptions and involve risks and uncertainties that include, among other things:

- the continued shift in the Company s business from lower cost, local read meters toward more expensive, value-added automatic meter reading (AMR) systems;
- the success or failure of newer Company products, including the Orion® radio frequency AMR system, the absolute digital encoder (ADE™) and the Galaxy® fixed network AMR system;
- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, local read meters;
- the actions (or lack thereof) of the Company s competitors;
- changes in the Company s relationships with its alliance partners, primarily its alliance partners that provide AMR connectivity solutions, and particularly those that sell products that do or may compete with the Company s products;
- changes in the general health of the United States and foreign economies, including housing starts in the United States and overall industrial activity;
- increases in the cost and/or availability of needed raw materials and parts, including recent increases in the cost of brass housings as a result of increases in the commodity prices for copper and zinc at the supplier level and resin as a result of increases in petroleum and natural gas prices;
- the ability of the Company to maximize the value of the remaining assets in its discontinued French operations;
- changes in foreign economic conditions, particularly currency fluctuations between the United States dollar and the euro;
- the loss of certain single-source suppliers; and
- changes in laws and regulations, particularly laws dealing with the use of lead (which can be used in the manufacture of certain meters incorporating brass housings) and Federal Communications Commission rules affecting the use and/or licensing of radio frequencies necessary for AMR products.

All of these factors are beyond the Company s control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

PART I

ITEM 1. BUSINESS

The Company is a leading marketer and manufacturer of products, and a provider of services, using flow measurement and control technologies serving markets worldwide. The Company was incorporated in 1905.

Available Information

The Company s Internet address is http://www.badgermeter.com. The Company makes available free of charge (other than an investor s own Internet access charges) through its Internet website its Annual Report on

Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, on the same day they are electronically filed with, or furnished to, the Securities and Exchange Commission. The Company is not including the information contained on or available through its website as a part of, or incorporating such information by reference into, this Annual Report on Form 10-K.

Markets and Products

The Company is a leading marketer and manufacturer of products using flow measurement and control technologies developed both internally and with other technology companies. Its products are used to measure and control the flow of liquids in a variety of applications. The Company s product lines fall into two general categories, utility and industrial. The utility category is comprised of two product lines, residential and commercial water meters (with various automatic meter reading (AMR) technology systems), which are generally sold to water utilities and constitute a majority of the Company s sales. Industrial product line sales comprise the remainder of the Company s sales and include automotive fluid meters, small precision valves, electromagnetic meters, impeller flow meters and industrial process meters (all with related accessories and instrumentation).

Residential and commercial water meters and related systems are classified as local (or manual) read meters or AMR products. Local read meters consist of a water meter and a register. With AMR meters, the register digitally encodes the mechanical reading and its radio frequency transmitter communicates the data to a computerized system that collects the data and sends it to specific utility computerized programs. Net sales and the corresponding net earnings depend on unit volume and mix of products, with the Company generally earning higher margins on residential AMR products (the impact of AMR on commercial products is not as significant given the higher sales prices of commercial meters). The Company sells AMR products of other companies as well as its own proprietary products, Orion® and the Galaxy® fixed network AMR system. Proprietary products generally have higher margins than the other AMR products. Net sales and the corresponding net earnings are therefore also dependent on the mix of AMR products between proprietary and non-proprietary products. Orion® is currently being sold as a walk-by/drive-by system, but also has the ability to connect with a variety of other technologies, such as power line carrier, broadband over power line, municipal WI-FI and radio frequency systems to allow for remote reading of the data. The Galaxy® fixed network AMR system was introduced in late 2005 and has had limited sales to date.

The base level of annual business for utility products is driven by replacement units and, to a much lesser extent, housing starts. Sales above the base level depend on conversions to AMR away from manual read meters. The Company believes that conversion from local read meters to AMR products can accelerate replacements of meters and result in growth, because it is estimated that only 20-25% of the water meter market has been converted to AMR. Badger Meter s strategy is to solve customers metering needs with its proprietary meter reading systems or other systems available through alliances within the marketplace.

The industrial products generally serve niche markets and have in the past utilized technology derived from utility products to serve industrial uses. As these markets evolve, these products are becoming more specialized to meet industrial flow measurement and communication protocol requirements. Serving these markets allows the Company to expand its technologies into other areas of flow measurement and control, as well as utilize existing capacity and spread fixed costs over a larger sales base.

The Company s products are primarily manufactured and assembled in the Company s Milwaukee, Wisconsin; Tulsa, Oklahoma; Nogales, Mexico; and Brno, Czech Republic facilities. Products are also assembled in the Company s Stuttgart, Germany facility.

The Company s products are sold throughout the world through various distribution channels including direct sales representatives, distributors and independent sales representatives. There is a moderate seasonal impact on sales, primarily relating to higher sales of certain utility products during the spring and summer months. No single customer accounts for more than 10% of the Company s sales.

Competition

There are competitors in each of the markets in which the Company sells its products, and the competition varies from moderate to intense. Major competitors include Sensus Metering Systems, Inc., Neptune Technologies and AMCO Water Metering Systems for utility water meters. The Company s primary competitor for the water utility AMR products is Itron, Inc. While the Company sells its own proprietary AMR systems (e.g., Orion®), it is also a reseller of the Itron products. A number of the Company s competitors in certain markets have greater financial resources. The Company believes it currently provides the leading technology in water meters and AMR systems for water utilities. As a result of significant research and development activities, the Company enjoys favorable patent positions for several of its products.

Backlog

The dollar amounts of the Company s total backlog of unshipped orders at December 31, 2006 and 2005 were $25.1 million and $28.6 million, respectively. The backlog is comprised of firm orders and signed contractual commitments, or portions of such commitments, that call for shipment within 12 months. Backlog can be significantly affected by the timing of orders for large utility projects.

Raw Materials

Raw materials used in the manufacture of the Company s products include metal or alloys (such as bronze, which uses copper as its main component, aluminum, stainless steel, cast iron, brass and stellite), plastic resins, glass, microprocessors and other electronic subassemblies and components. There are multiple sources for these raw materials, but the Company purchases most bronze castings and certain electronic subassemblies from single suppliers. The Company believes these items would be available from other sources, but that the loss of its current suppliers would result in higher cost of materials, delivery delays, short-term increases in inventory and higher quality control costs in the short term. The Company carries business interruption insurance on key suppliers. World commodity markets may also affect prices.

Research and Development

Expenditures for research and development activities relating to the development of new products, improvement of existing products and manufacturing process improvements were $5.5 million in 2006, compared to $5.3 million in 2005, and $4.6 million during 2004. Research and development activities are primarily sponsored by the Company. The Company also engages in some joint research and development with other companies.

Intangible Assets

The Company owns or controls many patents, trademarks, trade names and license agreements in the United States and other countries that relate to its products and technologies. No single patent, trademark, trade name or license is material to the Company s business as a whole.

Environmental Protection

The Company is subject to contingencies relative to compliance with federal, state and local provisions and regulations relating to the protection of the environment. Currently, the Company is in the process of resolving environmental issues related to two landfill sites. The Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. Expenditures during 2006, 2005 and 2004 for compliance with environmental control provisions and regulations were not material and the Company does not anticipate any material future expenditures.

Employees

The Company and its subsidiaries employed 1,113 persons at December 31, 2006, 222 of whom are covered by a collective bargaining agreement with District 10 of the International Association of Machinists. The Company is currently operating under a four-year contract with the union, which expires October 31, 2008. The Company believes it has good relations with the union and all of its employees.

Foreign Operations and Export Sales

The Company has distributors and sales representatives throughout the world. Additionally, the Company has a sales, assembly and distribution facility near Stuttgart, Germany; sales and customer service offices in Mexico, Singapore and Slovakia; a manufacturing facility in Nogales, Mexico; and a manufacturing and sales facility in Brno, Czech Republic. The Company exports products from the United States that are manufactured in Milwaukee, Wisconsin and Tulsa, Oklahoma.

Information about the Company s foreign operations and export sales is included in Note 10 Industry Segment and Geographic Areas in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K.

Financial Information about Industry Segments

The Company operates in one industry segment as a marketer and manufacturer of flow measurement and control products as described in Note 10 Industry Segment and Geographic Areas in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS

Shareholders, potential investors and other readers are urged to consider the significant business risks described below in addition to the other information set forth or incorporated by reference in this 2006 Annual Report on Form 10-K. If any of the events contemplated by the following risks actually occur, our financial condition or results of operations could be materially adversely affected. The following list of risk factors may not be exhaustive. We operate in a continually changing business, economic and geopolitical environment, and new risk factors may emerge from time to time. We can neither predict these new risk factors nor assess the impact, if any, on the business, or the extent to which any factor, or combination of factors, may cause the actual results of operations to differ materially.

Competitive pressures in the marketplace could decrease revenues and profits:

Competitive pressures in the marketplace for our products could adversely affect our competitive position, leading to a possible loss of market share or a decrease in prices, either of which could result in decreased revenues and profits. We operate in an environment where competition varies from moderate to intense and a number of our competitors have greater financial resources. Our competitors also include alliance partners that sell products that do or may compete with our products, particularly those that provide automatic meter reading (AMR) connectivity solutions. The principal elements of competition for our most significant product lines, residential and commercial water meters (with various AMR technology systems) for the utility market, are price, product technology, quality and service. The competitive environment is also affected by the movement toward AMR technologies away from local (or manual) read meters, the demand for replacement units and, to a lesser extent, the number of housing starts in the United States. For our industrial products, the competitive environment is affected by the general economic health of the industrial sectors in the United States and Europe.

Technological developments could harm future success:

We believe that our future success depends, in part, on our ability to develop technologically advanced products that meet or exceed appropriate industry standards. Although we believe that we currently have such advantages over our competitors, maintaining such advantages will require continued investment in research and development, sales and marketing. There can be no assurance that we will have sufficient resources to make such investments or that we will be able to make the technological advances necessary to maintain such competitive advantages. We are not currently aware of any emerging standards or new products that could render our existing products obsolete.

The inability to obtain adequate supplies of raw materials could decrease profit margins and hinder timely delivery to customers:

We are affected by the availability and prices for raw materials, including metal or alloys (such as bronze, which uses copper as its main component, aluminum, stainless steel, cast iron, brass and stellite), plastic resins, glass, microprocessors and other electronic subassemblies and components that are used in the manufacturing process. The inability to obtain adequate supplies of raw materials for our products at favorable prices could have a material adverse effect on our business, financial condition or results of operations by decreasing profit margins and by hindering timely delivery to customers. In the past, we have been able to offset increases in raw materials by increased sales prices, active materials management, product engineering programs and the diversity of materials used in the production processes. However, we cannot be certain that we will be able to accomplish this in the future. Since we do not control the actual production of these raw materials, there may be delays caused by interruption in the production of raw materials for reasons that are beyond our control. World commodity markets and inflation may also affect raw material prices.

A significant economic downturn could cause a material adverse impact on sales and operating results:

As a supplier of products primarily to water utilities, we may be adversely affected by general economic downturns that affect independent distributors, large city utilities, private water companies and numerous smaller municipal water utilities. These customers may delay capital projects, including non-critical maintenance and upgrades, during economic downturns. While we also serve several industrial markets to avoid a dependency on any one, a significant downturn in these markets could also cause a material adverse impact on sales and operating results. In addition, a terrorist attack such as the one on September 11, 2001 could cause instability in world markets, which, we believe, could temporarily impact product purchases in the industry. Therefore, any significant downturn in general economic conditions, as well as in our customers markets, could result in a reduction in demand for our products and services and could harm the business.

Failure to manufacture quality products could impact the ability to attract and retain customers, which could have a material adverse effect on revenues and profitability:

If we fail to maintain and enforce quality control and testing procedures, our products will not meet the performance standards in the industry. Product quality and performance are a priority for us since our products are used in various industries where precise control of fluids is essential, and we believe we have a very good reputation for product quality. Substandard products would seriously harm our reputation, resulting in both a loss of current customers to competitors and damage to our ability to attract new customers, which could have a material adverse effect on revenues and profitability.

Changes in environmental or regulatory requirements could entail additional expenses that could decrease profitability:

We cannot predict the nature, scope or effect of future environmental or regulatory requirements to which our operations might be subject or the manner in which existing or future laws will be administered or interpreted. Compliance with such laws or regulations may entail additional expenses that could decrease profitability. We are subject to a variety of environmental laws, such as lead content in certain meters incorporating brass housings, and regulatory laws affecting the use and/or licensing of radio frequencies necessary for AMR products, as well as regulations related to customs and trade practices. Currently, the cost of complying with existing laws does not have a material effect on the business or financial position.

Risks related to foreign markets could decrease profitability:

Since we sell products worldwide as well as manufacture products in several countries, we are subject to risks associated with doing business internationally. These risks include changes in foreign currency exchange rates, changes in a specific country s or region s political or economic conditions, potentially negative consequences from changes in tax laws or regulatory requirements, differing labor regulations, and the difficulty of managing widespread operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The principal facilities utilized by the Company at December 31, 2006 are listed below. Except as indicated, the Company owns all such facilities in fee simple. The Company believes that its facilities are generally well maintained and have sufficient capacity for its current needs.

Location	Principal use	Approximate area (square feet)
Milwaukee, Wisconsin	Manufacturing and offices	323,000
Tulsa, Oklahoma	Manufacturing and offices	59,500
Rio Rico, Arizona	Manufacturing and offices	36,000
Nogales, Mexico	Manufacturing and offices	62,300(1)
Nogales, Mexico	Manufacturing and offices	41,300
Neuffen, Germany	Assembly and offices	11,500
Stuttgart, Germany	Assembly and offices	31,800(2)
Brno, Czech Republic	Manufacturing and offices	24,300
Nancy, France	Assembly and offices	52,500

(1) Leased facility. Lease term expires January 31, 2008.

(2) Leased facility. Lease term expires June 30, 2007.

In 2005, the Company purchased land and an existing building with 11,500 square feet in Neuffen, Germany. The Company is in the process of constructing an 8,500 square foot addition to the existing building. It expects to occupy this facility in 2007 and vacate the above-mentioned leased Stuttgart facility when the lease expires for that facility in June 2007. In addition, the Company purchased land in Nogales, Mexico in 2005 where a 41,300 square foot building was constructed in 2006. This new facility replaced the Company s Rio Rico, Arizona facility, which was held for sale at the end of 2006. In connection with discontinuing the operations of the Company s French subsidiaries, the facility in Nancy, France was also held for sale at the end of 2006.

ITEM 3. LEGAL PROCEEDINGS

There are currently no material legal proceedings pending with respect to the Company. The more significant legal proceedings are discussed below.

The Company is a defendant in numerous multi-party asbestos lawsuits pending in various states. These lawsuits assert claims alleging that certain industrial products were manufactured by the defendants and were the cause of injury and harm. The Company is vigorously defending itself against these alleged claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

The Company is subject to contingencies relative to the protection of the environment. Information about the Company s compliance with environmental regulations is included in Part I, Item 1 of this 2006 Annual Report on Form 10-K under the heading Environmental Protection.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company s shareholders during the quarter ended December 31, 2006.

Executive Officers of the Company

The following table sets forth certain information regarding the executive officers of the Company.

Name	Position	Age at 2/28/2007
Richard A. Meeusen	Chairman, President and Chief Executive Officer	52
William R. A. Bergum	Vice President General Counsel and Secretary	42
Bryan L. Cieslak	Vice President Operations	41
Ronald H. Dix	Senior Vice President Administration	62
Horst E. Gras	Vice President International Operations	51
Richard E. Johnson	Senior Vice President Finance, Chief Financial Officer and Treasurer	52
Beverly L.P. Smiley	Vice President Controller	57
Dennis J. Webb	Vice President Sales, Marketing and Engineering	59
Daniel D. Zandron	Vice President Business Development	58

There are no family relationships between any of the executive officers. All of the officers are elected annually at the first meeting of the Board of Directors held after each annual meeting of the shareholders. Each officer holds office until his successor has been elected or until his death, resignation or removal. There is no arrangement or understanding between any executive officer and any other person pursuant to which he was elected as an officer.

Mr. Meeusen was elected Chairman, President and Chief Executive Officer in April 2004. Mr. Meeusen served as President and Chief Executive Officer from April 2002 to April 2004, and as President from November 2001 to April 2002.

Mr. Bergum was elected Vice President General Counsel and Secretary in February 2006, and served as General Counsel from September 2003 to February 2006. Prior to joining the Company, Mr. Bergum served as Corporate Counsel of Onyx Waste Services, Inc. from March 2003 to September 2003, and as Vice President and Assistant General Counsel at Fortis Insurance Company prior to March 2003.

Mr. Cieslak was elected Vice President Operations in August 2005. Prior to joining the Company in August 2005, Mr. Cieslak served as Vice President and General Manager of Trombetta LLC for more than five years.

Mr. Dix was elected Senior Vice President Administration in February 2006, and served as Senior Vice President Administration and Secretary from February 2005 to February 2006. Mr. Dix served as Senior Vice President Administration/Human Resources from May 2003 to February 2005 and Secretary from August 2003 to February 2005. Mr. Dix served as Vice President Administration and Human Resources from November 2001 to May 2003.

Mr. Gras has served as Vice President International Operations for more than five years.

Mr. Johnson was elected Senior Vice President Finance, Chief Financial Officer and Treasurer in May 2003. Mr. Johnson served as Vice President Finance, Chief Financial Officer and Treasurer from February 2001 to May 2003.

Ms. Smiley has served as Vice President Controller for more than five years.

Mr. Webb was elected Vice President Sales, Marketing and Engineering in August 2005, and served as Vice President Engineering from November 2001 to August 2005.

Mr. Zandron has served as Vice President Business Development for more than five years.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Information required by this Item is set forth in Note 11 Unaudited: Quarterly Results of Operations, Common Stock Price and Dividends in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K.

The following information in Item 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

The following graph compares on a cumulative basis the yearly percentage change since January 1, 2002 in (a) the total shareholder return on the Common Stock with (b) the total return on the American Stock Exchange Corporate Index and (c) the total return of a peer group made up of 11 companies in similar industries and with similar market capitalization as selected by an independent consulting firm. The graph assumes $100 invested on December 31, 2001. It further assumes the reinvestment of dividends. The returns of each component company in the peer group have also been weighted based on such company s relative market capitalization.

Comparison of Five-Year Cumulative Total Return of Company, Peer Group and Broad Market

December 31	2001	2002	2003	2004	2005	2006
Badger Meter	$ 100.00	$ 148.04	$ 181.71	$ 292.52	$ 389.16	$ 555.80
Peer Group*	$ 100.00	$ 86.88	$ 129.47	$ 129.65	$ 135.26	$ 170.58
Broad Market**	$ 100.00	$ 96.01	$ 130.68	$ 149.65	$ 165.03	$ 184.77

* Peer Group consists of Axcess International, Inc., Badger Meter, Inc., Bio-Rad Labs, Inc., Candela Corporation, Frequency Electronics, Inc., Innovex, Inc., Integral Vision, Inc., K-Tron International, Inc., Keithley Instruments, Inc., Newport Corporation, and Research Frontiers, Inc.

** Broad Market consists of the AMEX Market Index.

ITEM 6. SELECTED FINANCIAL DATA

BADGER METER, INC.

Ten Year Summary of Selected Consolidated Financial Data

		Years ended December 31,								
		2006	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**
		(Dollars in thousands except per share data)								
s										
	$	229,754	203,637	188,663	168,728	160,350	138,537	146,389	150,877	143,813
	$	5,458	5,343	4,572	6,070	5,658	5,422	6,562	6,012	6,105
ons										
es	$	27,489	25,664	20,325	15,658	12,359	5,010	10,727	15,659	13,364
ons	$	16,568	16,164	12,056	9,798	7,819	3,364	6,941	9,700	8,247
	$	(9,020)	(2,911)	(2,423)	(2,221)	(548)	n/a	n/a	n/a	n/a
	$	7,548	13,253	9,633	7,577	7,271	3,364	6,941	9,700	8,247
ons										
		7.2%	7.4%	6.4%	5.8%	4.9%	2.4%	4.7%	6.4%	5.7
are										
om										
ons	$	1.19	1.20	0.91	0.76	0.62	0.27	0.53	0.70	0.57
	$	(0.65)	(0.22)	(0.18)	(0.17)	(0.04)	n/a	n/a	n/a	n/a
gs	$	0.54	0.98	0.73	0.59	0.58	0.27	0.53	0.70	0.57
	$	1.15	1.15	0.89	0.75	0.59	0.26	0.50	0.65	0.53
	$	(0.63)	(0.20)	(0.18)	(0.17)	(0.04)	n/a	n/a	n/a	n/a
ings	$	0.52	0.95	0.71	0.58	0.55	0.26	0.50	0.65	0.53
	$	0.31	0.29	0.28	0.27	0.26	0.25	0.22	0.18	0.15
n	$	32.20	25.63	16.00	9.94	8.50	8.31	9.35	10.03	10.16
	$	19.51	13.23	8.53	6.13	5.52	4.94	5.75	9.85	6.25
	$	27.70	19.62	14.98	9.54	8.00	5.61	5.75	7.54	8.91
	$	5.07	5.36	4.77	4.19	3.74	3.38	3.38	3.22	4.71

ing									
	14,154	13,696	13,444	13,170	12,882	12,720	12,828	13,360	10,152
n									
	$ 33,648	32,923	25,461	25,946	6,825	23,170	6,822	11,150	10,776
	1.7 to 1	1.8 to 1	1.6 to 1	1.7 to 1	1.1 to 1	2.0 to 1	1.2 to 1	1.3 to 1	1.3 to 1
by									
	$ 16,750	18,361	6,297	15,221	12,234	8,587	13,251	15,652	15,007
res	$ 11,060	9,088	5,582	5,214	5,914	5,007	6,403	9,981	17,926
	$ 139,383	145,867	142,961	133,851	126,463	101,375	98,023	102,186	96,945
	$ 17,037	13,328	22,887	9,188	26,290	8,264	23,017	16,589	14,315
	$ 5,928	15,360	14,819	24,450	13,046	20,498	5,944	11,493	2,600
uity	$ 71,819	73,416	64,066	55,171	48,095	43,002	43,319	43,009	47,848
of									
ity*	26.8%	30.1%	37.0%	37.9%	45.0%	40.1%	40.1%	39.5%	26.1
ity*	23.1%	22.0%	18.8%	17.8%	16.3%	7.8%	16.0%	22.6%	17.2
o*	24.1	17.1	16.8	12.7	11.1	21.6	11.5	11.6	16.8

(1) The Company s French operations have been presented as discontinued operations for 2002 through 2006, the years of ownership.

(2) 2006 amounts include the adoption of SFAS 123(R), Share-Based Payments, effective January 1, 2006 and the adoption of SFAS 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, effective as of December 31, 2006.

(3) Per share amounts and numbers of shares have been restated to reflect the 2-for-1 stock split completed on June 15, 2006.

* Description of calculations:

Book value equals total shareholders equity at year-end divided by the number of common shares outstanding.

Working capital equals total current assets less total current liabilities.

Current ratio equals total current assets divided by total current liabilities.

Debt as a percent of total debt and equity equals total debt (the sum of short-term debt, current portion of long-term debt and long-term debt) divided by the sum of total debt and total shareholders equity at year-end. The debt of the discontinued French operations is included in this calculation for 2002 through 2006, the years of ownership.

Return on shareholders equity equals net earnings from continuing operations divided by total shareholders equity at year-end.

Price/earnings ratio equals the closing stock price for common stock divided by diluted earnings per share from continuing operations.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business Description and Overview

The Company is a leading marketer and manufacturer of products using flow measurement and control technologies developed both internally and with other technology companies. Its products are used to measure and control the flow of liquids in a variety of applications. The Company s product lines fall into two general categories, utility and industrial. The utility category is comprised of two product lines, residential and commercial water meters (with various automatic meter reading (AMR) technology systems), which are generally sold to water utilities and constitute a majority of the Company s sales. Industrial product line sales comprise the remainder of the Company s sales and include automotive fluid meters, small precision valves, electromagnetic meters, impeller flow meters and industrial process meters (all with related accessories and instrumentation).

Residential and commercial water meters and related systems are classified as local (or manual) read meters or AMR products. Local read meters consist of a water meter and a register. With AMR meters, the register digitally encodes the mechanical reading and its radio frequency transmitter communicates the data to a computerized system that collects the data and sends it to specific utility computerized programs. Net sales and the corresponding net earnings depend on unit volume and mix of products, with the Company generally earning higher margins on residential AMR products (the impact of AMR on commercial products is not as significant given the higher sales prices of commercial meters). The Company sells AMR products of other companies as well as its own proprietary products, Orion® and the Galaxy® fixed network AMR system. Proprietary products generally have higher margins than the other AMR products. Net sales and the corresponding net earnings are therefore also dependent on the mix of AMR products between proprietary and non-proprietary products. Orion® is currently being sold as a walk-by/drive-by system, but also has the ability to connect with a variety of other technologies, such as power line carrier, broadband over power line, municipal WI-FI and radio frequency systems to allow for remote reading of the data. The Galaxy® fixed network AMR system was introduced in late 2005 and has had limited sales to date.

There is a base level of annual business for utility products driven by replacement units and, to a much lesser extent, housing starts. Sales above the base level depend on conversions to AMR away from manual read meters. The Company believes that conversion from local read meters to AMR products can accelerate replacements of meters and result in growth, because it is estimated that only 20-25% of the water meter market has been converted to AMR. Badger Meter s strategy is to solve customers metering needs with its proprietary meter reading systems or other systems available through alliances within the marketplace.

The industrial products generally serve niche markets and have in the past utilized technology derived from utility products to serve industrial uses. As these markets evolve, these products are becoming more specialized to meet industrial flow measurement and communication protocol requirements. Serving these markets allows the Company to expand its technologies into other areas of flow measurement and control, as well as utilize existing capacity and spread fixed costs over a larger sales base.

Business Trends

During 2006, the Company carefully evaluated strategic alternatives for its subsidiaries in Nancy, France, including restructuring, sale or shutdown. In the third quarter of 2006, the Company began the process under French law to obtain the requisite governmental and regulatory approvals to close the operation. On October 16, 2006, the decision was finalized. The Company continues to believe that this decision will result in total after-tax charges ranging from $6.0 million to $8.0 million. In 2006, $5.4 million of charges, net of the income tax benefit, were recognized, with the remainder to be recognized in 2007 as assets are liquidated and liabilities are settled. All results associated with the Company s French operations have been removed from continuing operations and are presented as results of discontinued operations. See Note 3 in the accompanying consolidated financial statements for further discussion. All remaining comments in this section relate to continuing operations.

As noted above, the Company sells AMR products of other companies as well as its own proprietary product, Orion®. The Company currently has a distribution agreement under which it resells products produced by Itron, Inc. Prior to the Company s introduction of its own proprietary Orion® products, Itron® water utility-related products were a significant contributor to the Company s results. The Company s Orion® products directly compete with Itron® water AMR products and, in recent years, many of the Company s customers have selected Orion® products. As a result, the Company s 2005 annual sales of Itron® products decreased approximately 12%, while Orion® sales doubled compared to 2004. This trend continued in 2006 as sales of Itron® products decreased nearly 16% while Orion® sales increased 39% compared to 2005. The Company expects this trend to continue, although it also believes that Itron® products will remain a significant component of utility sales. Decreases in sales of Itron® products have been offset by increases in sales of Orion® products, which produce a higher gross margin than Itron® products. As a result, the Company does not expect this trend to have a material negative impact on the Company s financial position or results of operations.

Results of Operations

Net Sales

Badger Meter s net sales of $229.8 million increased $26.1 million, or 12.8%, for 2006 compared to 2005. The increase was the net result of sales increases in most of the Company s product lines driven primarily by increased volumes of product sold.

Residential and commercial water meter net sales represented 80.9% of total net sales in 2006 compared with 79.9% in 2005. These sales increased $23.2 million, or 14.3%, in 2006 to $185.9 million from $162.7 million in 2005. Unit volume increased in residential and commercial local (or manual) read water meters as well as meters utilizing AMR technologies. AMR technologies carry a higher price, which also contributed to the increase in net sales. In addition, net sales increased in part due to a significant increase over 2005 levels for the sales volumes of Orion®, the Company s proprietary AMR system, which has higher margins than other AMR products.

Industrial sales are affected by economic conditions, domestically and internationally, in each of the markets served by the various product lines. Industrial product net sales increased 7.1% in 2006 over 2005 levels. In total, the industrial products represented 19.1% of total net sales in 2006 compared to 20.1% in 2005. Industrial product net sales increased $2.9 million, or 7.1% to $43.9 million in 2006 compared with $41.0 million in 2005 driven primarily by higher sales of automotive fluid and electromagnetic meters.

International sales are comprised primarily of sales of small valves, electromagnetic meters and automotive fluid meters in Europe, sales of electromagnetic meters and water meters and related technologies in Latin America, and sales of valves and other metering products throughout the world. In Europe, sales are made primarily in euros and other currencies. Other international sales are made in U.S. dollars or local currencies. International sales increased 14.0% to $21.2 million in 2006 from $18.6 million in 2005 due principally to higher sales of industrial products in Europe.

Residential and commercial water meter net sales represented 79.9% of total net sales in 2005 compared with 79.6% in 2004. These sales increased $12.6 million, or 8.3% in 2005 to $162.7 million from $150.1 million in 2004. Unit volume increased in meters utilizing AMR technologies as well as local (or manual) read meters. AMR technologies carry a higher price, which also contributed to the increase in net sales. In addition, net sales increased in part due to a significant increase over 2004 levels for the sales volumes of Orion®, the Company s proprietary AMR system which has higher margins than other AMR products.

In total, the industrial products represented 20.1% of total net sales in 2005 compared with 20.4% in 2004. Industrial product sales increased $2.4 million to $41.0 million in 2005 compared with $38.6 million in 2004. All of the product lines showed growth over the 2004 levels, partially due to the effects of the strengthening euro.

International sales increased 4.5% to $18.6 million in 2005 from $17.8 million in 2004 due principally to the effects of the strengthening euro. Without the effects from foreign exchange, international sales were the same as 2004.

Gross Margins

Gross margins were 33.4%, 36.1% and 34.5% for 2006, 2005 and 2004, respectively. Gross margins decreased between 2006 and 2005 due to higher cost of materials, particularly copper, the main component of the brass housings used to make meters. This was mitigated somewhat by the higher mix of AMR versus local read meters, a higher percentage of Orion® AMR technology versus other non-proprietary AMR products, and price increases initiated in mid-2006. Gross margins increased between 2005 and 2004 as a result of a higher mix of AMR sales versus local read meters as well as a higher percentage of Orion® AMR technology versus non-proprietary AMR products, offset somewhat by higher metal costs.

Operating Expenses

Selling, engineering and administration costs increased 3.4% in 2006 over 2005 levels due to normal inflationary increases and increased costs associated with higher sales. Selling, engineering and administration costs increased 6.4% in 2005 over 2004 levels due to higher research and development costs, increased costs associated with higher sales, one-time expenses associated with the Company s 100th anniversary celebration and normal inflationary pressures.

Interest Expense

Interest expense was approximately $0.2 million less in 2006 than in 2005 due primarily to lower overall debt balances. Interest expense was approximately $0.2 million higher in 2005 than in 2004. This was the net impact of lower debt levels, offset by increasing interest rates and a new long-term loan replacing short-term debt.

Income Taxes

Income taxes as a percentage of earnings from continuing operations before income taxes were 39.7%, 37.0% and 40.7% for 2006, 2005 and 2004, respectively. The increase in the provision for income taxes between 2006 and 2005 was due to the inability to claim the estimated effects of the Section 199: Production Activities Deduction as permitted under the American Jobs Creation Act of 2004 due to the tax positions to be taken on the Company s 2006 tax return related to its French operations and the settlement of certain state tax audits. The decrease in 2005 from 2004 was due to slightly lower state taxes and the estimated effects of the Section 199: Production Activities Deduction.

Earnings and Earnings Per Share from Continuing Operations

As a result of the above-mentioned items, earnings from continuing operations were $16.6 million, $16.2 million and $12.1 million in 2006, 2005 and 2004, respectively. On a diluted basis, earnings per share from continuing operations were $1.15, $1.15 and $0.89, respectively, for the same periods.

Liquidity and Capital Resources

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations in 2006 was $16.8 million versus $18.4 million in 2005. The decline between years was due principally to lower earnings. Cash provided by operations in 2005 was $18.4 million, an increase of $12.1 million compared to 2004. The increase was the net result of increased net earnings, reduced inventory levels and the timing of payments of certain current liabilities, offset by increased receivables.

Receivables increased 8.2% between December 31, 2005 and 2006 due primarily to higher fourth quarter sales. Inventories increased 21.7% due to longer lead times for electronic components, higher levels of parts due to increased sales and higher costs of the materials.

Prepaid expenses and other current assets increased between December 31, 2005 and 2006 primarily because the December 31, 2006 amounts include $0.7 million of remaining book value related to the Rio Rico, Arizona facility that is classified as held for sale.

Capital expenditures totaled $11.1 million in 2006, $9.1 million in 2005 and $5.6 million in 2004. These amounts vary due to the timing of capital expenditures. Included in capital expenditures for 2006 is approximately $6.2 million related to the construction of new facilities in Mexico and Germany. The Company expects to spend approximately $8.5 million on the construction of another facility in Mexico in 2007 in addition to its normal level of capital expenditures. The Company believes capacity exists to increase production levels with minimal additional capital expenditures after the completion of these facilities.

In anticipation of the adoption of Financial Accounting Standards Board (FASB) Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158), the Company made no contributions to its pension plan in 2006. Because of this, the Company was required to recognize an additional minimum pension liability at its September 30, 2006 measurement date pursuant to the provisions of FASB Statement No. 87, Employers Accounting for Pensions (SFAS 87), which was combined with the related existing prepaid pension asset, resulting in a net accrued pension liability. See Note 7, Employee Benefit Plans , in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K for further discussion. Assumptions for determining pension and other postretirement benefits, expected return on assets and annual expense are reviewed and, if appropriate, adjusted annually. The impacts of hypothetical changes in certain assumptions are difficult to determine as economic factors can often impact multiple assumptions and inputs at the same time. The Company believes its current assumptions are reasonable. At December 31, 2006, the market value of the assets in the Company s pension plan was $46.1 million compared to $46.5 million at December 31, 2005.

The amount of net goodwill recorded at December 31, 2006 and 2005 was $7.0 million and $6.6 million, respectively. The net increase of $0.4 million was due to the strengthening of the U.S. dollar versus the euro.

Short-term debt increased $9.2 million in 2006 while total outstanding long-term debt (both the current and long-term portions) decreased $14.9 million. This net reduction of debt was due to cash generated from operations. None of the Company s debt carries financial covenants or is secured.

The $0.8 million increase in payables between years is primarily the result of the timing of purchases. Accrued compensation and employee benefits increased $0.2 million due to increased incentive costs associated with increased sales and earnings levels. Income and other taxes decreased $1.0 million as a result of the timing of tax payments.

Common Stock and capital in excess of par value both increased during 2006 due primarily to stock issued, and cash received, in connection with the exercise of stock options, grants of restricted stock and the tax benefit on stock options. Employee benefit stock decreased in 2006 due to the adoption of FASB Statement No. 123(R), Share-Based Payments , which required the reclassification of amounts from employee benefit stock to capital in excess of par and a $171,000 payment on the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) loan. Treasury stock decreased due to shares issued in connection the Company s dividend reinvestment program.

Accumulated other comprehensive income (loss) decreased by $12.0 million primarily due to the Company recognizing an additional minimum pension liability at its September 30 measurement date and the impact of the adoption of SFAS 158, offset by a $1.2 million increase in foreign currency translation adjustments due primarily to the strengthening of the euro versus the U.S. dollar.

Badger Meter s financial condition remains strong. The Company believes that its operating cash flows, available borrowing capacity including $28.4 million of unused credit lines, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and development of new products. The Company continues to take advantage of its local commercial paper market and from time to time may convert short-term debt into long-term debt.

Off-Balance Sheet Arrangements

The Company guarantees the debt of the Badger Meter Officers Voting Trust (BMOVT), from which the BMOVT obtained loans from a bank on behalf of the officers of the Company in order to purchase shares of the Company s Common Stock. The officers loan amounts are secured by the Company s shares that were purchased with the loan proceeds. There have been no loans made to officers by the BMOVT since July 2002. The Company has guaranteed $0.5 million and $1.1 million of the BMOVT s debt at December 31, 2006 and December 31, 2005, respectively. The current loan matures in April 2007, at which time it is expected to be renewed. The fair market value of this guarantee at December 31, 2006 continues to be insignificant because the collateral value of the shares exceeds the loan amount. It is the Company s intention to eliminate the BMOVT by December 31, 2010, because it no longer fulfills its original purpose of providing officers with loans to purchase Common Stock. The Company has no other off-balance sheet arrangements.

Contractual Obligations

The Company guarantees the outstanding debt of the ESSOP that is recorded in long-term debt, offset by a similar amount of unearned compensation that has been recorded as a reduction of shareholders equity. The loan amount is secured by shares of the Company s Common Stock. Payments of $171,000 and $150,000 in 2006 and 2005, respectively, reduced the loan to $744,000 at December 31, 2006. The terms of the loan allow variable payments of principal with the final principal and interest payment due on April 30, 2008.

The following table includes the Company s significant contractual obligations as of December 31, 2006. There are no undisclosed guarantees.

	Payments due by period		
	Total	Less than 1 year	1-3 years
	(In thousands)		
Current portion and long-term debt	$ 12,631	$ 7,446	$ 5,185
Interest on current portion and long-term debt	731	354	377
Construction of facilities	541	541	
ESSOP	744		744
Royalty commitments	150	150	
Operating leases	949	836	113
Total contractual obligations	$ 15,746	$ 9,327	$ 6,419

Other than items included in the preceding table, as of December 31, 2006, the Company had no additional material purchase obligations other than those created in the ordinary course of business related to inventory and property, plant and equipment, which generally have terms of less than 90 days. The Company also has long-term obligations related to its pension and postretirement plans which are discussed in detail in Note 7 Employee Benefit Plans in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K. As of the most recent actuarial measurement date, no pension plan contributions are anticipated in 2007 and postretirement medical claims are paid as they are submitted. Postretirement medical claims are anticipated to be $777,000 in 2007 based on actuarial estimates; however, these amounts can vary significantly from year to year because the Company is self-insured.

Critical Accounting Policies and Use of Estimates

The Company s accounting policies are more fully described in Note 1 Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements in Part II, Item 8 of this 2006 Annual Report on Form 10-K. As discussed in Note 1, the preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company s more significant estimates relate primarily to several judgmental reserves: allowance for doubtful accounts, reserve for obsolete inventories, warranty and after-sale costs reserve, and the health care reserve for claims incurred, but not reported. Each of these judgmental reserves is evaluated quarterly and is reviewed with the Company s Disclosure Committee and the Audit and Compliance Committee of the Board of Directors. The basis for the reserve amounts is determined by analyzing the anticipated exposure for each account, and then selecting the most likely amount based upon historical experience and various other considerations that are believed to be reasonable under the circumstances. This method has been used for all years in the presented financials and has been used consistently throughout each year. Actual results may differ from these estimates under different assumptions or conditions.

The criteria used for calculating each of the reserve amounts varies by type of reserve. For the allowance for doubtful accounts reserve, significant past due balances are reviewed in conjunction with applying historical write-off ratios to the remaining balances. The calculation for the obsolete inventories reserve is determined by analyzing the relationship between the age and quantity of items on hand versus estimated usage to determine if excess quantities exist. The calculation for warranty and after-sale costs reserve uses criteria that includes known potential problems on past sales as well as historical claim ratios for current sales and current warranty trends. The health care reserve for claims incurred, but not reported is determined by using medical cost trend analyses, reviewing subsequent payments made and estimating unbilled amounts. The changes in the balances of these reserves at December 31, 2006 compared to the prior year were due to normal business conditions and are not deemed to be significant. While the Company continually tries to improve its estimates, no significant changes in the underlying processes are expected in 2007.

Other Matters

The Company believes it is in compliance with the various environmental statutes and regulations to which the Company s domestic and international operations are subject. Currently, the Company is in the process of resolving environmental issues related to two landfill sites. Provision has been made for estimated settlement costs, which are not material.

The Company is also a defendant in numerous multi-party asbestos lawsuits pending in various states. These lawsuits assert claims alleging that certain industrial products were manufactured by the defendants and were the cause of injury and harm. The Company is vigorously defending itself against these claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

Market Risks

In the ordinary course of business, the Company is exposed to various market risks. The Company operates in an environment where competition varies from moderate to intense. The Company believes it currently provides the leading technology in water meters and AMR systems for water utilities. A number of the Company s competitors in certain markets have greater financial resources. Competitors also include alliance partners that sell products that do or may compete with our products, particularly those that provide AMR connectivity solutions. In addition, the market s level of acceptance of the Company s newer products may have a significant effect on the Company s results of operations. As a result of significant research and development activities, the Company enjoys favorable patent positions for several of its products.

The Company s ability to generate operating income and to increase profitability depends somewhat on the general health of the United States and foreign economies, the overall industrial activity, and to a lesser extent, housing starts in the United States. In addition, changes in governmental laws and regulations, particularly laws dealing with the use of lead or rules affecting the use and/or licensing of radio frequencies necessary for AMR products may impact the results of operations. These factors are largely beyond the Company s control and depend on the economic condition and regulatory environment of the geographic region of the Company s operations.

The Company has evaluated its worldwide operations to determine if any risks and uncertainties exist that could severely impact its operations in the near term. The Company does not believe that there are any significant near-term risks. However, the Company does rely on single suppliers for certain castings and components in several of its product lines. Although alternate sources of supply exist for these items, loss of certain suppliers could temporarily disrupt operations in the short term. The Company attempts to mitigate these risks by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

Raw materials used in the manufacture of the Company s products include metal or alloys (such as bronze, which uses copper as its main component, aluminum, stainless steel, cast iron, brass and stellite), plastic resins, glass, microprocessors and other electronic subassemblies and components. The price and availability of raw materials is influenced by economic and industry conditions, including supply and demand factors that are difficult to anticipate and cannot be controlled by the Company. Commodity risk is managed by keeping abreast of economic conditions and locking in purchase prices for quantities that correspond to the Company s forecasted usage.

The Company s foreign currency risk relates to the sales of products to foreign customers. The Company uses lines of credit with U.S. and European banks to offset currency exposure related to European receivables and other monetary assets. As of December 31, 2006 and 2005, the Company s foreign currency net monetary assets were substantially offset by comparable debt resulting in no material exposure to the results of operations.

The Company typically does not hold or issue derivative instruments and has a policy specifically prohibiting the use of such instruments for trading purposes.

The Company s short-term debt on December 31, 2006 was floating rate debt with market values approximating carrying value. Fixed rate debt was principally a U.S. dollar term loan with a 5.59% interest rate and a euro dollar revolving term loan with a 5.28% interest rate. For the short-term floating rate debt, future annual interest costs will fluctuate based upon short-term interest rates. For the short-term debt on hand on December 31, 2006, the effect of a 1% change in interest rates is approximately $151,000.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES OF MARKET RISK

Information required by this Item is set forth in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the heading Market Risks in this 2006 Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

BADGER METER, INC.

Management s Annual Report on
Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) under the Securities Exchange Act of 1934. The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2006 using the criteria set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, the Company s management believes that, as of December 31, 2006, the Company s internal control over financial reporting was effective based on those criteria.

The Company s independent registered public accounting firm, Ernst & Young LLP, have issued an attestation report on management s assessment of the Company s internal control over financial reporting. That attestation report is set forth immediately following this report.

BADGER METER, INC.

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Shareholders of Badger Meter, Inc.

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting, that Badger Meter, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Badger Meter, Inc. management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Badger Meter, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Badger Meter, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Badger Meter, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders equity and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 21, 2007, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin
February 21, 2007

BADGER METER, INC.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Badger Meter, Inc.

We have audited the accompanying consolidated balance sheets of Badger Meter, Inc. (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Badger Meter, Inc. at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the Consolidated Financial Statements, on January 1, 2006, the Company changed its method of accounting for share-based awards and on December 31, 2006, the Company changed its method of accounting for defined benefit pension and postretirement healthcare plans.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Badger Meter, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 21, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin
February 21, 2007

BADGER METER, INC.

Consolidated Balance Sheets

	December 31, 2006	December 31, 2005
	(Dollars in thousands except share and per share amounts)	
Assets		
Current assets:		
Cash	$ 3,002	$ 3,215
Receivables	29,276	27,060
Inventories:		
Finished goods	9,122	7,254
Work in process	10,302	9,048
Raw materials	13,866	11,047
Total inventories	33,290	27,349
Prepaid expenses and other current assets	3,179	2,182
Deferred income taxes	3,737	3,432
Assets of discontinued operations (Note 3)	6,875	9,326
Total current assets	79,359	72,564
Property, plant and equipment, at cost:		
Land and improvements	6,337	6,922
Buildings and improvements	27,695	24,115
Machinery and equipment	79,217	73,807
	113,249	104,844
Less accumulated depreciation	(68,540)	(64,507)
Net property, plant and equipment	44,709	40,337
Intangible assets, at cost less accumulated amortization	636	659
Prepaid pension		17,726
Other assets	4,211	3,998
Deferred tax asset	3,510	
Assets of discontinued operations (Note 3)		4,003
Goodwill	6,958	6,580
Total assets	$ 139,383	$ 145,867
Liabilities and shareholders equity		
Current liabilities:		
Short-term debt	$ 15,093	$ 5,897
Current portion of long-term debt	1,944	7,431

Payables	10,597	9,833
Accrued compensation and employee benefits	6,181	5,962
Warranty and after-sale costs	2,954	3,047
Income and other taxes	621	1,651
Liabilities of discontinued operations (Note 3)	8,321	5,820
Total current liabilities	45,711	39,641
Other long-term liabilities	557	634
Deferred income taxes	199	6,584
Accrued non-pension postretirement benefits	6,903	3,955
Other accrued employee benefits	8,266	6,277
Long-term debt	5,928	15,360
Commitments and contingencies (Note 6)		
Shareholders equity:		
Common Stock, $1 par; authorized 40,000,000 shares; issued 20,553,468 shares in 2006 and 20,111,344 shares in 2005	20,553	20,112
Capital in excess of par value	19,428	13,320
Reinvested earnings	77,479	74,258
Accumulated other comprehensive income (loss)	(12,041)	1
Less: Employee benefit and restricted stock	(744)	(1,357)
Treasury stock, at cost; 6,399,360 shares in 2006 and 6,415,046 shares in 2005	(32,856)	(32,918)
Total shareholders equity	71,819	73,416
Total liabilities and shareholders equity	$ 139,383	$ 145,867

See accompanying notes.

BADGER METER, INC.

Consolidated Statements of Operations

	Years ended December 31, 2006	2005	2004
	(In thousands except per share amounts)		
Net sales	$ 229,754	$ 203,637	$ 188,663
Cost of sales	153,126	130,218	123,591
Gross margin	76,628	73,419	65,072
Selling, engineering and administration	47,840	46,263	43,471
Operating earnings	28,788	27,156	21,601
Interest expense	1,299	1,492	1,276
Earnings from continuing operations before income taxes	27,489	25,664	20,325
Provision for income taxes (Note 8)	10,921	9,500	8,269
Earnings from continuing operations	16,568	16,164	12,056
Loss from discontinued operations (Note 3)	(9,020)	(2,911)	(2,423)
Net earnings	$ 7,548	$ 13,253	$ 9,633
Earnings per share:			
Basic:			
from continuing operations	$ 1.19	$ 1.20	$ 0.91
from discontinued operations	$ (0.65)	$ (0.22)	$ (0.18)
Total basic	$ 0.54	$ 0.98	$ 0.73
Diluted:			
from continuing operations	$ 1.15	$ 1.15	$ 0.89
from discontinued operations	$ (0.63)	$ (0.20)	$ (0.18)
Total diluted	$ 0.52	$ 0.95	$ 0.71
Shares used in computation of earnings per share:			
Basic	13,868	13,489	13,194
Impact of stock-based compensation	521	533	420
Diluted	14,389	14,022	13,614

See accompanying notes.

BADGER METER, INC.

Consolidated Statements of Cash Flows

	Years ended December 31,		
	2006	**2005**	**2004**
	(Dollars in thousands)		
Operating activities:			
Net earnings	$ 7,548	$ 13,253	$ 9,633
Adjustments to reconcile net earnings to net cash provided by operations:			
Depreciation	6,589	6,164	7,070
Amortization	418	195	148
Tax benefit on stock options		1,370	877
Deferred income taxes	(2,081)	(318)	1,518
Long-lived asset impairment	1,369		
Noncurrent employee benefits	4,147	3,025	2,182
Contributions to pension plan		(2,000)	(2,000)
Changes in:			
Receivables	1,373	(4,335)	(170)
Inventories	(1,531)	2,691	(5,345)
Prepaid expenses and other current assets	302	(343)	(788)
Current liabilities other than debt	(1,384)	(1,341)	(6,828)
Total adjustments	9,202	5,108	(3,336)
Net cash provided by operations	16,750	18,361	6,297
Investing activities:			
Property, plant and equipment	(11,060)	(9,088)	(5,582)
Other net	(516)	(271)	(733)
Net cash used for investing activities	(11,576)	(9,359)	(6,315)
Financing activities:			
Net increase (decrease) in short-term debt	8,971	(8,230)	13,566
Issuance of long-term debt		10,000	
Repayments of long-term debt	(14,919)	(7,376)	(9,679)
Dividends paid	(4,327)	(3,923)	(3,633)
Proceeds from exercise of stock options	3,057	2,434	1,949
Tax benefit on stock options	2,935		
Treasury stock purchases		(3,323)	(1,711)
Issuance of treasury stock	579	1,286	816
Net cash provided by (used for) financing activities	(3,704)	(9,132)	1,308
Effect of foreign exchange rates on cash	(825)	1,699	(545)

Increase in cash	645	1,569	745
Cash beginning of year	4,403	2,834	2,089
Cash end of year *	$ 5,048	$ 4,403	$ 2,834
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Income taxes	$ 10,846	$ 6,919	$ 7,767
Interest (including $232 of interest capitalized during facility construction in 2006)	$ 1,609	$ 2,269	$ 1,629

* Includes $2,046, $1,188 and $1,397 of cash included in the assets of discontinued operations.

See accompanying notes.

BADGER METER, INC.

Consolidated Statements of Shareholders Equity

	Years ended December 31,						
	Common stock	Capital in excess of par value	Reinvested earnings	Other compre-hensive income (loss)	Employee benefit and restricted stock	Treasury stock	Total
	(In thousands except per share amounts)						
Balance, December 31, 2003	$ 19,384	$ 5,541	$ 58,928	$ 1,280	$ (1,285)	$ (28,677)	$ 55,171
Comprehensive income:							
Net earnings			9,633				9,633
Other comprehensive income:							
Minimum employee benefit liability (net of $6 tax effect)				27			27
Foreign currency translation				717			717
Comprehensive income							10,377
Cash dividends of $0.28 per share			(3,633				