ITRON INC /WA/
Form 10-Q
August 05, 2008

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

FORM 10-Q

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

For the quarterly period ended June 30, 2008

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

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

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

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

Large accelerated filer x Accelerated filer ¨
Non-accelerated filer ¨ (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 Act). Yes ¨ No x

As of July 31, 2008, there were outstanding 34,306,600 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Itron, Inc.

Table of Contents

	Page
PART I: FINANCIAL INFORMATION	
Item 1: Financial Statements (Unaudited)	
Condensed Consolidated Statements of Operations	1
Condensed Consolidated Balance Sheets	2
Consolidated Statements of Cash Flows	3
Notes to Condensed Consolidated Financial Statements	4
Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 3: Quantitative and Qualitative Disclosures About Market Risk	49
Item 4: Controls and Procedures	51
PART II: OTHER INFORMATION	
Item 1: Legal Proceedings	52
Item 1A: Risk Factors	52
Item 4: Submission of Matters to a Vote of Security Holders	52
Item 5: Other Information	53
Item 6: Exhibits	53
SIGNATURES	54

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in thousands, except per share data)			
Revenues	$ 513,931	$ 401,559	$ 992,407	$ 549,470
Cost of revenues	337,721	276,845	653,638	363,431
Gross profit	176,210	124,714	338,769	186,039
Operating expenses				
Sales and marketing	44,205	34,393	86,171	49,313
Product development	31,471	25,521	60,502	41,342
General and administrative	32,889	27,387	65,912	41,631
Amortization of intangible assets	31,467	25,223	62,719	32,263
In-process research and development	-	35,551	-	35,551
Total operating expenses	140,032	148,075	275,304	200,100
Operating income (loss)	36,178	(23,361)	63,465	(14,061)
Other income (expense)				
Interest income	1,460	2,216	2,884	8,305
Interest expense	(22,457)	(22,927)	(47,723)	(28,424)
Other income (expense), net	(1,845)	5,433	(1,657)	6,941
Total other income (expense)	(22,842)	(15,278)	(46,496)	(13,178)
Income (loss) before income taxes	13,336	(38,639)	16,969	(27,239)
Income tax (provision) benefit	(211)	14,759	(891)	10,539
Net income (loss)	$ 13,125	$ (23,880)	$ 16,078	$ (16,700)
Earnings (loss) per share				
Basic	$ 0.40	$ (0.79)	$ 0.51	$ (0.58)
Diluted	$ 0.37	$ (0.79)	$ 0.47	$ (0.58)
Weighted average number of shares outstanding				
Basic	32,796	30,068	31,746	28,641
Diluted	35,325	30,068	34,041	28,641

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

1

Table of Contents

ITRON, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 152,179	$ 91,988
Accounts receivable, net	356,328	339,018
Inventories	201,282	169,238
Deferred income taxes, net	5,642	10,733
Other	51,482	42,459
Total current assets	766,913	653,436
Property, plant and equipment, net	335,322	323,003
Prepaid debt fees	15,868	21,616
Deferred income taxes, net	133,614	75,243
Other	20,053	15,235
Intangible assets, net	595,147	695,900
Goodwill	1,416,305	1,266,133
Total assets	$ 3,283,222	$ 3,050,566
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Trade payables	$ 243,612	$ 198,997
Accrued expenses	65,620	57,275
Wages and benefits payable	83,109	70,486
Taxes payable	18,251	17,493
Current portion of long-term debt	356,341	11,980
Current portion of warranty	23,693	21,277
Deferred income taxes, net	1,716	5,437
Unearned revenue	30,374	20,912
Total current liabilities	822,716	403,857
Long-term debt	915,180	1,578,561
Warranty	18,491	11,564
Pension plan benefits	66,325	60,623
Deferred income taxes, net	185,689	173,500
Other obligations	49,417	63,659
Total liabilities	2,057,818	2,291,764
Commitments and contingencies		
Shareholders' equity		
Preferred stock	-	-
Common stock	935,464	609,902

Accumulated other comprehensive income, net	251,630	126,668
Retained earnings	38,310	22,232
Total shareholders' equity	1,225,404	758,802
Total liabilities and shareholders' equity	$ 3,283,222	$ 3,050,566

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

2

Table of Contents

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

	Six Months Ended June 30,	
	2008	2007
	(in thousands)	
Operating activities		
Net income (loss)	$ 16,078	$ (16,700)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	89,466	47,156
In-process research and development	-	35,551
Employee stock plans income tax benefit	-	5,773
Excess tax benefits from stock-based compensation	-	(5,029)
Stock-based compensation	8,026	5,849
Amortization of prepaid debt fees	5,885	2,813
Deferred income taxes, net	(14,421)	(30,133)
Other, net	432	394
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(15,186)	(12,604)
Inventories	(32,158)	17,983
Trade payables, accrued expenses and taxes payable	39,562	25,811
Wages and benefits payable	12,481	(7,299)
Unearned revenue	9,975	(4,348)
Warranty	3,035	391
Effect of foreign exchange rate changes	2,986	-
Other, net	(5,712)	(2,689)
Net cash provided by operating activities	120,449	62,919
Investing activities		
Proceeds from the maturities of investments, held to maturity	-	35,000
Acquisitions of property, plant and equipment	(28,966)	(18,306)
Business acquisitions, net of cash and cash equivalents acquired	(95)	(1,715,626)
Other, net	1,379	5,897
Net cash used in investing activities	(27,682)	(1,693,035)
Financing activities		
Proceeds from borrowings	-	1,159,027
Payments on debt	(350,749)	(2,890)
Issuance of common stock	317,536	236,220
Excess tax benefits from stock-based compensation	-	5,029
Prepaid debt fees	(207)	(23,058)
Other, net	140	-
Net cash (used in) provided by financing activities	(33,280)	1,374,328
Effect of foreign exchange rate changes on cash and cash equivalents	704	256
Increase (decrease) in cash and cash equivalents	60,191	(255,532)
Cash and cash equivalents at beginning of period	91,988	361,405
Cash and cash equivalents at end of period	$ 152,179	$ 105,873

Non-cash transactions:				
Fixed assets purchased but not yet paid	$	4,390	$	3,506
Pre-acquisition costs incurred but not yet paid		-		1,006
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes	$	13,556	$	7,425
Interest, net of amounts capitalized		42,247		31,272

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

3

Table of Contents

ITRON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(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 Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007, Condensed Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007 and Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature. Intercompany transactions and balances are eliminated upon consolidation.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2007 audited financial statements and notes included in our Annual Report on Form 10-K, as filed with the SEC on February 26, 2008. The results of operations for the three and six months ended June 30, 2008 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. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. At June 30, 2008, we had no investments in variable interest entities.

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

Cash and Cash Equivalents
We consider all highly liquid instruments with remaining maturities of three months or less at the date of acquisition to be cash equivalents. Cash equivalents are recorded at cost, which approximates fair value.

Table of Contents

Derivative Instruments

We account for derivative instruments and hedging activities in accordance with Statement of Financial Accounting Standards (SFAS) 133, Accounting for Derivative Instruments and Hedging Activities, as amended. All derivative instruments, whether designated in hedging relationships or not, are recorded on the Condensed 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 SFAS 157, Fair Value Measurements. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income and are recognized in earnings when the hedged item affects earnings. If the derivative is a net investment hedge, the effective portion of any unrealized gain or loss is reported in accumulated other comprehensive income as a net unrealized gain or loss on derivative instruments. Ineffective portions of fair value changes or derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Condensed Consolidated Statement of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows. Derivatives are not used for trading or speculative purposes. Counterparties to our currency exchange and interest rate derivatives consist of major international financial institutions. We monitor our positions and the credit ratings of our counterparties when valuing our derivatives.

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally thirty years for buildings and three to five years for equipment, computers and furniture. Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Costs related to internally developed software and software purchased for internal uses are capitalized in accordance with Statement of Position 98-1, Accounting for Costs of Computer Software Developed or Obtained for Internal Use, 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 may not be recoverable. If there was an indication of impairment, management would prepare an estimate of future undiscounted cash flows expected to result from the use of the asset over its remaining economic life and its eventual disposition. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. There were no significant impairments of long-lived assets in the three and six months ended June 30, 2008 and 2007. Assets held for sale are classified within other current assets in the Condensed Consolidated Balance Sheets and are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Prepaid Debt Fees

Prepaid debt fees represent the capitalized direct costs incurred related to the issuance of debt and are recorded as noncurrent assets. These costs are amortized to interest expense over the lives of the respective borrowings using the effective interest method. When debt is repaid early, or first becomes convertible as in the case of our convertible senior subordinated notes (convertible notes), the related portion of unamortized prepaid debt fees is written-off and included in interest expense in the Condensed Consolidated Statements of Operations.

Table of Contents

Business Combinations

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

Goodwill and Intangible Assets

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

Warranty

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in thousands)			
Beginning balance	$ 41,803	$ 19,840	$ 32,841	$ 18,148
Actaris acquisition opening balance/adjustments	635	17,769	6,942	17,769
New product warranties	1,267	1,013	3,934	1,709
Other changes/adjustments to warranties	2,388	338	4,089	3,274
Claims activity	(3,936)	(2,655)	(7,516)	(4,597)
Effect of change in exchange rates	27	(115)	1,894	(113)
Ending balance	42,184	36,190	42,184	36,190
Less: current portion of warranty	23,693	18,861	23,693	18,861

Long-term warranty	$	18,491	$	17,329	$	18,491	$	17,329

Total warranty expense, which consists of new product warranties issued and other changes and adjustments to warranties, totaled approximately $3.7 and $1.4 million for the three months ended June 30, 2008 and 2007, and approximately $8.0 million and $5.0 million for the six months ended June 30, 2008 and 2007, respectively.

6

Table of Contents

Health Benefits

We are self insured for a substantial portion of the cost of U.S. employee group health insurance. We purchase insurance from a third party, which provides individual and aggregate stop loss protection for these costs. Each reporting period, we expense the costs of our health insurance plan including paid claims, the change in the estimate of incurred but not reported (IBNR) claims, taxes and administrative fees (collectively the plan costs). Plan costs were approximately $4.3 million and $4.1 million for the three months ended June 30, 2008 and 2007, and $9.4 million and $7.9 million for the six months ended June 30, 2008 and 2007, respectively. The IBNR accrual, which is included in wages and benefits payable, was $2.7 million and $2.1 million at June 30, 2008 and December 31, 2007, respectively. Our IBNR accrual and expenses can fluctuate due to the number of plan participants, claims activity and deductible limits. Our U.S. employees from the Actaris acquisition were transferred from a fully insured plan and added to our self-insured group health insurance at the beginning of 2008, resulting in higher 2008 self-insurance expenses compared with 2007. For our employees located outside of the United States, health benefits are provided primarily through governmental social plans, which are funded through employee and employer tax withholdings.

Contingencies

An estimated loss for a contingency is recorded if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of the ultimate loss. Changes in these factors and related estimates could materially affect our financial position and results of operations.

Bonus and Profit Sharing

We have employee bonus and profit sharing plans in which many of our employees participate, which provide award amounts for the achievement of annual performance and financial targets. Actual award amounts are determined at the end of the year if the performance and financial targets are met. As the bonuses are being earned during the year, we estimate a compensation accrual each quarter based on the progress towards achieving the goals, the estimated financial forecast for the year and the probability of achieving results. An accrual is recorded if management determines it probable that a target will be achieved and the amount can be reasonably estimated. Although we monitor our annual forecast and the progress towards achievement of goals, the actual results at the end of the year may warrant a bonus award that is significantly greater or less than the estimates made in earlier quarters.

Defined Benefit Pension Plans

We sponsor both funded and unfunded non-U.S. defined benefit pension plans. SFAS 87, Employers' Accounting for Pensions, as amended by SFAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, requires the assets acquired and liabilities assumed in a business combination to include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. SFAS 158 also requires employers to recognize the funded status of their defined benefit pension plans on their consolidated balance sheet and recognize as a component of other comprehensive income, net of tax, the actuarial gains or losses, prior service costs or credits and transition assets or obligations, if any, that arise during the period but are not recognized as components of net periodic benefit cost.

Income Taxes

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

We evaluate whether our tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements in accordance with Financial Accounting Standards Board (FASB) Interpretation 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB 109 (FIN 48). Under FIN 48, we recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities based solely on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense.

Table of Contents

Foreign Exchange

Our condensed consolidated financial statements are reported in U.S. dollars. Assets and liabilities of international subsidiaries with a non-U.S. dollar functional currency 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 these subsidiaries are translated to U.S. dollars using an average rate for the relevant reporting period. Translation adjustments resulting from this process are included, net of tax, in accumulated other comprehensive income in shareholders' equity. Gains and losses that arise from exchange rate fluctuations for balances that are not denominated in the functional currency are included in the Condensed Consolidated Statements of Operations. Currency gains and losses of intercompany balances deemed to be long-term in nature or considered to be hedges of the net investment in international subsidiaries are included, net of tax, in accumulated other comprehensive income in shareholders' equity.

Revenue Recognition

Revenues consist primarily of hardware sales, software license fees, software implementation, project management services, installation, consulting and post-sale maintenance support. In determining appropriate revenue recognition, we primarily consider the provisions of the following accounting pronouncements: Staff Accounting Bulletin 104, Revenue Recognition in Financial Statements, FASB's Emerging Issues Task Force (EITF) 00-21, Revenue Arrangements with Multiple Deliverables, Statement of Position (SOP) 97-2, Software Revenue Recognition, SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts and EITF 03-5, Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software in determining the appropriate revenue recognition policy.

Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) have value to the customer on a standalone basis, there is objective and reliable evidence of fair value of both the delivered and undelivered item(s) and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria considered for each unit of accounting. For our standard contract arrangements that combine deliverables such as hardware, meter reading system software, installation and project management services, each deliverable is generally considered a single unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect without being contingent upon the delivery/performance of additional items.

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

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

Product and Software Development Costs

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

Table of Contents

Earnings Per Share

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

Stock-Based Compensation

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

Fair Value Measurements

SFAS 157, Fair Value Measurements, became effective on January 1, 2008 and establishes a framework for measuring fair value, expands disclosures about fair value measurements of our financial assets and liabilities and specifies a hierarchy of valuation techniques based on whether the inputs used are observable or unobservable. The 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. The disclosure requirements include the fair value measurement at the reporting date and the level within the fair value hierarchy in which the fair value measurements fall. For fair value measurements using Level 3 inputs, a reconciliation of the beginning and ending balances is disclosed.

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.

Reclassifications

As a result of our Actaris acquisition, certain prior year balances have been reclassified to conform to the current year presentation. Such reclassifications did not affect total revenues, operating income, net income, total current or long-term assets or liabilities or net cash provided by operating activities.

Table of Contents

New Accounting Pronouncements

In December 2007, the FASB issued SFAS 141(R), Business Combinations, which replaces SFAS 141. SFAS 141(R) retains the fundamental purchase method of accounting for acquisitions, but requires a number of changes, including the way assets and liabilities are recognized in purchase accounting. SFAS 141(R) requires the recognition of assets acquired and liabilities assumed arising from contingencies to be recorded at fair value on the acquisition date; that in-process research and development be capitalized as an intangible asset and amortized over its estimated useful life; and that acquisition-related costs are expensed as incurred. SFAS 141(R) also requires that restructuring costs generally be expensed in periods subsequent to the acquisition date and that changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recognized as a component of provision for taxes. SFAS 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply SFAS 141(R) to any acquisition after the date of adoption.

In February 2008, the FASB issued FASB Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years (see Note 1, Fair Value Measurements). We are currently assessing the impact of SFAS 157 for nonfinancial assets and nonfinancial liabilities on our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51, which changes the accounting and reporting for minority interests. Minority interests will be re-characterized as noncontrolling interests and will be reported as a component of equity, separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. SFAS 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by us in the first quarter of 2009. SFAS 160 is currently not expected to have a material effect on our condensed consolidated financial statements.

In March 2008, the FASB issued SFAS 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement 133, which requires enhanced disclosures about how and why derivative instruments are used, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 also requires the fair values of derivative instruments and their gains and losses to be disclosed in a tabular format. SFAS 161 does not change how we record and account for derivative instruments. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 and will be adopted by us in the first quarter of 2009.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion, addressing convertible instruments that may be settled in cash upon conversion. This FSP requires, among other things, the issuer to separately account for the liability and equity components of the convertible instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. This FSP is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and must be applied retrospectively to all periods presented at the time of adoption. We will adopt the FSP on January 1, 2009. We expect the impact of the FSP to be significant to our condensed consolidated financial statements and are currently evaluating the impact on specific accounts and disclosures.

10

Table of Contents

Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	$ 13,125	$ (23,880)	$ 16,078	$ (16,700)
Weighted average number of shares outstanding - Basic	32,796	30,068	31,746	28,641
Dilutive effect of stock-based awards and convertible notes	2,529	-	2,295	-
Weighted average number of shares outstanding - Diluted	35,325	30,068	34,041	28,641
Basic earnings (loss) per common share	$ 0.40	$ (0.79)	$ 0.51	$ (0.58)
Diluted earnings (loss) per common share	$ 0.37	$ (0.79)	$ 0.47	$ (0.58)

The dilutive effect of stock-based awards is calculated using the treasury stock method. Under this method, EPS is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award and the amount of excess tax benefits, if any. Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock-based awards. At June 30, 2008 and 2007, we had stock-based awards outstanding of approximately 1.6 million and 1.9 million at weighted average option exercise prices of $48.59 and $34.83, respectively. Approximately 188,000 and 816,000 stock-based awards were excluded from the calculation of diluted EPS for the three months ended June 30, 2008 and 2007, and approximately 113,000 and 798,000 stock-based awards were excluded from the calculation of diluted EPS for the six months ended June 30, 2008 and 2007 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

In August 2006, we issued $345 million of convertible notes that, when convertible, have a potentially dilutive effect on our EPS. We are required, pursuant to the indenture for the convertible notes, to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares or a combination. The effect on diluted EPS is calculated under the net share settlement method in accordance with EITF 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share. Under the net share settlement method, we include the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are converted. The average closing price of our common stock for each of the periods presented is used as the basis for determining the dilutive effect on EPS. The average price of our common stock for the three and six months ended June 30, 2008 exceeded the conversion price of $65.16 and therefore, approximately 1.7 million shares and 1.5 million shares, respectively, have been included as dilutive shares in the calculation of diluted EPS for the three and six months ended June 30, 2008. For the three and six months ended June 30, 2007, if we had net income and included the dilutive shares in the calculation of diluted earnings per share for those periods, approximately 364,000 and 182,000 shares would have been dilutive because the average price of our common stock exceeded the conversion price of $65.16.

On May 6, 2008, we issued 3.4 million shares of common stock, no par value, at a public offering price of $91.52 per share, resulting in net proceeds of $310.9 million. The proceeds were primarily used to repay a portion of our non-convertible debt (see Note 6).

We have authorized 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, rates and subject to such adjustments set by the Board of Directors. There was no preferred stock issued or outstanding at June 30, 2008 and 2007.

Table of Contents

Note 3: Certain Balance Sheet Components

Accounts receivable, net		At June 30, 2008		At December 31, 2007
		(in thousands)		
Trade receivables (net of allowance of $6,408 and $6,391)	$	340,456	$	324,425
Unbilled revenue		15,872		14,593
Total accounts receivable, net	$	356,328	$	339,018

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

	Three Months Ended June 30,				Six Months Ended June 30,			
		2008		2007		2008		2007
	(in thousands)							
Beginning balance	$	6,236	$	615	$	6,391	$	589
Actaris acquisition opening balance/adjustments		(471)		4,891		(471)		4,891
Provision for doubtful accounts		576		300		743		386
Accounts charged off		(74)		(127)		(556)		(187)
Effect of change in exchange rates		141		-		301		-
Ending balance, June 30	$	6,408	$	5,679	$	6,408	$	5,679

Inventories

A summary of the inventory balances is as follows:

		At June 30, 2008		At December 31, 2007
		(in thousands)		
Materials	$	94,213	$	81,636
Work in process		17,863		16,859
Finished goods		89,206		70,743
Total inventories	$	201,282	$	169,238

Our inventory levels may vary period to period as a result of our factory scheduling and timing of contract fulfillments.

Property, plant and equipment, net		At June 30, 2008		At December 31, 2007
		(in thousands)		
Machinery and equipment	$	216,683	$	192,562
Computers and purchased software		68,018		66,412
Buildings, furniture and improvements		148,425		140,386
Land		43,042		41,750
Total cost		476,168		441,110
Accumulated depreciation		(140,846)		(118,107)
Property, plant and equipment, net	$	335,322	$	323,003

Depreciation expense was $13.6 million and $10.5 million for the three months ended June 30, 2008 and 2007, and $26.7 million and $14.9 million for the six months ended June 30, 2008 and 2007, respectively.

Table of Contents

Note 4: Intangible Assets

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

	At June 30, 2008			At December 31, 2007		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$ 421,279	$ (162,825)	$ 258,454	$ 403,665	$ (126,488)	$ 277,177
Customer contracts and relationships	335,033	(44,643)	290,390	312,709	(25,151)	287,558
Trademarks and trade names	82,492	(38,599)	43,893	154,760	(26,877)	127,883
Other	25,245	(22,835)	2,410	24,845	(21,563)	3,282
Total intangible assets	$ 864,049	$ (268,902)	$ 595,147	$ 895,979	$ (200,079)	$ 695,900

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

Three Months Ended June 30,		Six Months Ended June 30,
2008	2007	2008